

Proposed Discussion Paper on Climate Risk

Expectations from RBI

The Governor's statement in the Monetary Policy Committee meeting dated 8th April 2022 announced that "To facilitate better understanding and assessment of the potential impact of climate-related financial risks by Regulated Entities, a Discussion Paper on Climate Risk and Sustainable Finance will be published shortly for feedback." We present the areas which need to be addressed by the RBI in its proposed Discussion Paper.



Expectations from RBI Discussion Paper

Central Banks across the world have started their journey to incorporate climate risk in their regulations. The Network for Greening Financial Systems (NGFS) started in 2017 is one step in that direction which brings central bankers together to share

their expertise and work towards a common goal of fighting climate change. However, RBI has been slow in its action in comparison with its peers and became the 90th member of NGFS in May 2021 after four years of its formation. RBI's ranking in "The Green Central Banking Scorecard" has been lagging in comparison with its fellow central banks in G20. ECB has been at the forefront in issuing guidelines on climate risk. Other regulators like APRA, MAS and HKMA have also issued guidelines on climate risk. In view of these developments, RBI's announcement to issue a Discussion Paper on climate risk is although late but a welcome step in the right direction.

At the onset, Climate risk has to be addressed as a systemic risk threatening the stability of the financial system and the macroeconomy. In line with its peer Central Banks, RBI can prescribe guidance on Governance, Climate Risk Strategy and Opportunities and Climate Risk Management. Scenario Analysis is one area that needs to be addressed by RBI and its approach can be different from peer Central Banks. The lessons learned from the Advanced Measurement Approach (AMA) on scenario analysis can be incorporated into Physical Risk scenarios. The Transition Risk scenarios need to be integrated with credit risk stress testing. Considering India's unique geographical position where climate change has diverse impacts ranging from drought to floods and hot summers to cold winters and India's dependence on

Monsoons, RBI needs to specify guidelines on climate risk scenarios to capture the local details.

In terms of BCBS guidelines on Principles for the effective management and supervision of climate-related financial risks released in June 2022, RBI needs to ensure that Principles laid down for the Banks as well as Supervisors are incorporated.

For disclosures, RBI needs to specify applicable standards. These can be TCFD or GRI or the newly formed ISSB or something unique that RBI develops for Banks in India that brings best of all standards with a blend of local. However, RBI should not be dependent on BRSR by SEBI for Banks as BRSR is not suitable for Banks in India.

Industry classification is one area in which the understanding of the Banks in India has not been uniform. The starting point for the Banks in India would be exposure mapping to various industries. There are different practices available for industry mapping which includes SICS by SASB, industry classification by MOEF and UN PRB industry classification.

Priority Sector lending norms are unique to India which helps in providing credit to the targeted segment. In the present context when managing climate risk is urgent, the priority sector norms need complete revamp to target credit flow towards mitigating physical and transition risk. Similarly, for agriculture loans, a complete revamp of loans classification is

required to incentivize practices contributing positively to the environment.

The development of sustainability taxonomy for banking in India would be a welcome step by RBI. The banking industry would also immensely benefit if principles related to green finance and sustainability linked loans were developed. Risk weight as a tool to target credit flow has been used by RBI in the past. For promoting green finance and sustainability linked loans, RBI can tweak the risk weights.

These are some of the areas in which a Discussion Paper by RBI can guide the Banks. We are sure that RBI would bring the global best practices which will also suit the unique position of India in terms of its geographical, economical and societal position.