Inquiry: Design of a Sustainable Financial System

Building a sustainable financial system to serve India's development needs

Executive Briefing

November 2014

Disclaimer

The designations employed and the presentation of the material in this publication do not imply the expression of any opinion whatsoever on the part of the United Nations Environment Programme (UNEP) or Federation of Indian Chambers of Commerce and Industry (FICCI) concerning the legal status of any country, territory, city or area or of its authorities, or concerning delimitation of its frontiers or boundaries. Moreover, the views expressed do not necessarily represent the decision or the stated policy of the United Nations Environment Programme (UNEP) or Federation of Indian Chambers of Commerce and Industry (FICCI), nor does citing of trade names or commercial processes constitute endorsement.

Building a sustainable financial system to serve India's development needs

Nick Robins (UNEP) & Rita Roy Choudhury (FICCI)

The global context

Global investment needs for sustainable development in developing countries-for power, transport, telecoms, water and sanitation, food security and agriculture, climate change, eco-systems, education and health - have been estimated by UNCTAD at USD3.5 trillion per year through to 2030[i]. However, current investment levels leave an annual gap of USD2.5 trillion, even though, the assets of the global financial system exceed USD275 trillion. Ample capital is available, but the strategic policy and regulatory framework, to mobilize private investment into sustainable development is lacking.

Internationally, efforts are being made to stimulate investment, particularly in infrastructure, such as new Global Infrastructure Initiative launched at the 2015 G-20 Summit in Brisbane. But the practical links with critical sustainable development issues have yet to be made- a challenge that will command the spotlight in 2015 with the finalization of the United Nations post-2015 sustainable development goals. As the UN's Intergovernmental Panel of Experts on Sustainable Development Financing concluded recently 'current financing and investment patterns will not deliver sustainable development'.[ii]

The UNEP Inquiry has been launched to focus on how the 'rules of the game' that govern the financial system - in banking, insurance, investment and capital markets - can be better aligned with long-term sustainable development. Naina Lal Kidwai, country head of HSBC India, serves on the Inquiry's International Advisory Council and chairs the India Advisory Council. The Inquiry is partnering with FICCI to develop an Indian agenda for harnessing the financial system for the country's critical sustainability priorities such as clean energy and clean water.

India's imperatives

In India, reviving investment is essential for growth of both jobs and income. For infrastructure alone, the total investment required during the Twelfth Five Year Plan (2012-17) is estimated at USD1 trillion, half of which is expected to come from the private sector. The Twelfth Five Year Plan has laid special emphasis on

[i] UNCTAD, World Investment Report, 2015, Geneva

[ii] http://sustainabledevelopment.un.org/content/documents/4588FINAL%20REPORT%20ICESDF.pdf

infrastructure development as quality infrastructure is important not only for achieving high growth but also for ensuring the growth is inclusive and sustainable.

Access to clean and affordable energy remains a key priority. While the proportion of households with electricity has increased from 56% in 2001 to 67% in 2011, almost 45% of rural households have no electricity connection, and many who have connections do not have assured access. Further emphasizing the need for sustainability, the President of India and the Prime Minister recently launched a "Swachh Bharat Mission" for ensuring hygiene, waste management and sanitation across the nation.

The question is how to finance these imperatives, balancing the short- and the long-term, blending economic and environmental objectives? Public funding, domestic and international, is clearly essential to provide public goods and also help to 'crowd in' private capital. Ultimately, the key is to ensure that the risk: reward ratio for investments in sustainable development are attractive. This includes taking account of the new generation of environmental risks to economic growth and financial stability, such as climate change, which are set to exacerbate water stress and the impacts of natural disasters, particularly in vulnerable regions such as South Asia.

Financing low-carbon, climate resilient development

Against the backdrop of low per capita carbon emissions and vulnerability to climate impacts, India has voluntarily committed to reduce the emissions' intensity of its GDP by 20-25%, in comparison with 2005 levels, by 2020. A lower emissions pathway entails deployment of energy-efficient technologies, increased use of renewable alternatives for power production, sustainable waste management, and conservation of forests. To assess the economic and financial implications, an Expert Group on Low Carbon Strategies for Inclusive Growth was set up by the Planning Commission and submitted its final report this year [iii]. According to the group, the cumulative costs of low-carbon strategies between 2010 and 2030 were estimated at US$834 billion at 2011 prices; this shift in investment could also reduce the domestic growth rate by 0.15%. This makes the delivery of international finance - both public and private - critical to realizing India's climate priorities.

[iii] Planning Commission, The Final Report of the Expert Group on Low Carbon Strategies for Inclusive Growth, 2014, Delhi

India's domestic plans on low-carbon and climate resilient development calls for significant financial outlays from government sources. To meet the targets laid down under the country's eight national missions, financing requirements of INR 2,56,836 crore (US$ 41.54 bn) alone are required in the Twelfth Plan period[iv]. But domestic public funds alone will be insufficient - and mechanisms are therefore urgently needed to raise and leverage private capital as well as international financial flows. As part of this, it is critical that the financial system's capacity and readiness to respond to climate change and other sustainable development priorities is enhanced, driving innovation across banking, insurance, investments and securities.

Deploying credit for clean energy

Financing for clean energy, climate change and sustainability requires the availability of low-cost, long-term finance and predominantly debt financing. In the Indian financial context, banking regulations and guidelines from the Reserve Bank of India direct credit to various sectors and influence interest rates, exposure limits, security and other conditions for lending by banks. For example, the system of priority lending requires 40% of bank credit to agriculture, micro and small enterprises, education, housing and export credit.

Clean energy financing in India therefore faces barriers not only in terms of the quantum of finance available but also from risks associated with political, regulatory, technological, and financial aspects that affect the bankability of new projects. In terms of financial regulation on the supply side, one measure proposed by FICCI that could assist would be the designation of renewable energy as a separate sector for measuring sectorial exposure limits by banks.[v] Off-grid solar is already included within the priority sector norms, but this could be expanded to the renewable sector as a whole. External commercial borrowing (ECB) norms could also be adjusted.

But India's energy deficit will not be closed without increasing finance for energy efficiency. A number of banks have already introduced energy efficiency financing products - starting with the State Bank of India in 2003 - and a range of policy mechanisms are in place. India is increasing its focus on both market and policy innovations that could scale up capital to conserve energy and save costs.[vi]

[iv] Government of India – Ministry of Finance, Economic Survey of India, 2013-14, Delhi

[v] FICCI, Financing Solar Energy, Delhi, 2013

[vi] IISD, 10 Big Ideas for Making Energy Efficiency Bankable in India, 2014, Manitoba

Mobilising credit for clean energy

India's equity and debt capital markets have grown strongly - but will need to play an even greater role to meet the nation's development needs. One useful innovation is the extension of the Real Estate Investment Trust (REIT), which provides stock market investment vehicles in property. To attract institutional investment in India's infrastructure, regulations for a new type of Infrastructure Investment Trusts (InvITs) were implemented in September 2014: a critical area to explore is how this new vehicle could be deployed for infrastructure investment focused on sustainability.

India's bond market could also provide a source of capital. At present, issuance of bonds for clean energy in India are largely limited to the Indian Renewable Energy Development Agency (IREDA). Globally, 'green bonds' - whose proceeds are ring-fenced for sustainable investments are growing fast: in 2013, US$11bn was raised; to date in 2014, issuance has reached US$34bn. Market standards, regulatory alignment and, potentially, tax incentives could help the market to grow in India

Developing sustainability policies for financial institutions

A range of voluntary and legislative actions in India have created the imperative for sustainability, resulting in a new momentum towards adoption of sustainable practices and initiatives. These will in turn create additional drivers for sustainable financing in the Indian context. The 2% CSR mandate under the Companies Act, 2013 formally introduced with effect from April 1, 2014 and the National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business (NVGs) released in July 2011 create additional imperatives for sustainable financing.

The Reserve Bank of India (RBI) also issued its first circular on banking and sustainable development in 2007, encouraging the adoption of best practice standards and greater transparency [vii] Since then, the Securities and Exchange Board of India (SEBI) has mandated the inclusion of Business Responsibility reports in the Annual Reports for the top 100 listed entities based on market capitalisation at BSE and NSE. Such important steps forward are crutial for integrating material environmental, social and governance factors into equity valuations and credit ratings.

[vii] RBI, Corporate Social Responsibility, Sustainable Development and Non-Financial Reporting – Role of Banks, 2007, Mumbai

Another critical issue is the incorporation of ESG risk factors into mainstream lending and financing decisions. In India, a number of institutions such as IDFC, SIDBI and YES Bank have been among the leaders in sustainable financing principles and practice. However, at present, there is no 'level playing field' in terms of common standards applied by Indian banks and financial institutions to ESG risks.

Stimulating leadership, drawing on international practice

India's needs for long-term sustainable finance are immense - as is the potential for policy and market innovation by leaders within the country. A two-fold process of change is needed: first, de-risking financial transactions by creating the necessary systems for managing social and environmental factors; and second, reallocating capital towards sustainable development priorities.

Here India can draw on experience, notably among other BRICS, which are integrating environmental and social factors into their financial system. Examples include China's 'green credit guidelines', the recent resolution by Brazil's central bank on environmental and social risk and South Africa's inclusion of ESG factors into pension fund policy.

The challenge lies in seizing the opportunity to build a sustainable financial system to serve India's development needs. The FICCI partnership with the UNEP Inquiry seeks to develop practical options to meet this challenge, drawing on the inputs of its Indian advisory group as well as other government, business and civil society leaders. A final report will be produced in 2015.

UNEP Inquiry on the Design of a Sustainable Financial System

The UNEP Inquiry into the Design of a Sustainable Financial System aims to advance policy options that would deliver a step change in the financial system's effectiveness in mobilizing capital towards a green and inclusive economy –in other words, sustainable development.

The inquiry addresses three core questions

- Why and under what circumstances should the rules governing the financial system be deployed in pursuit of sustainable development outcomes ?
- What rules governing the financial system have been, or could be, deployed for achieving sustainable development ?
- How can rules be most effectively deployed for sustainable development, given the complexities and competitiveness concerns of financial actors ?

The Inquiry's approach is to crystallize relevant experience and proposals into a coherent framework to support and encourage action by those responsible for setting the rules governing the financial system. This includes central banks, financial regulators, finance ministries and financial market standard setters, such asaccounting standards, credit rating and indexes and voluntary initiatives.

The Inquiry is running over two years, and has operationalized its approach over its initial eight months through country-level and international engagement and research.

The Inquiry's countries engagement would involve the following countries: Brazil, South Africa, China, Bangladesh, UK, EU, India, USA, Indonesia, Colombia, Kenya, Morocco, Netherlands, Switzerland, Uganda

Overall, the Inquiry's work has helped to catalyse and knit together a growing informal, international network of institutions working on design aspects of a sustainable financial system.

The Inquiry's Advisory Council oversees its activities and champions many aspects of its work. The Advisory Council comprises leading financial system experts, policy makers and regulators, and practitioners from around the world. Several country engagements are being championed by specific members, notably in Bangladesh, Brazil, India, South Africa, Uganda and the UK.

Members of India Advisory Council

Chairperson

Ms Naina Lal Kidwai
Country Head, HSBC India & Director,
HSBC Asia Pacific, Member of UNEP Inquiry
International Advisory Council

Members

- **Mr A K Kapur**
  Chief General Manager, Small Industries Development Bank of India (SIDBI)
- **Mr Alok Dayal**
  Senior Director-Credit & Environment Risk, IDFC Limited
- **Mr Ardeshir Contractor**
  Managing Director, Kiran Energy
- **Mr Ashok Khosla**
  Chairman, Development Alternatives
- **Mr Chandra Bhushan**
  Deputy Director General, Centre for Science and Environment (CSE)
- **Ms Divya Datt**
  Fellow, The Energy and Resources Institute (TERI)
- **Mr Krishan Dhawan**
  Chief Executive Officer, Shakti Sustainable Energy Foundation
- **Mr M V Tanksale**
  Chief Executive, Indian Banks' Association (IBA)

- **Mr Mahesh Babu**
  Managing Director, IL&FS Environmental Infrastructure & Services Ltd.
- **Ms Namita Vikas**
  Senior President & Country Head-Responsible Banking, YES Bank Ltd
- **Mr Navroz Dubash**
  Senior Fellow, Centre for Policy Research
- **Mr Nitin Desai**
  Former UN Under Secretary General and Distinguished Fellow, TERI
- **Mr Pashupathy Gopalan**
  President-Asia Pacific, SunEdison
- **Mr Paul Abraham**
  Chief Operating Officer, IndusInd Bank
- **Dr Prasad Modak**
  Executive President and Founder, EMC
- **Mr Rakesh K Singh**
  Group Head-Investment Banking, HDFC Bank
- **Dr Rathin Roy**
  Director, National Institute of Public Finance and Policy (NIPFP)
- **Mr Ravi Singh**
  Secretary General and CEO, WWF-India
- **Ms Rita Roy Choudhury**
  Senior Director & Head -Environment, Climate Change, Renewable Energy, FICCI
- **Mr Samir Saran**
  Senior Fellow & Vice President, Observer Research Foundation (ORF)
- **Mr Shalabh Tandon**
  Head-Climate Change, South Asia Region, International Finance Corporation (IFC India)
- **Mr Stephen O' Leary**
  Chief Risk Officer, HSBC India
- **Ms Sucharita Mukherjee**
  Vice Chairperson, Institute of Financial Management and Research (IFMR)

Federation of Indian Chambers of Commerce and Industry (FICCI)

FICCI, the apex industry organisation in India, is the leader in policy thinking and change and is in the vanguard of nation building. Established in 1927 and with a nationwide membership of over 1500 corporates and over 500 chambers of commerce and business associations, FICCI espouses the shared vision of Indian businesses and speaks directly and indirectly for over 2,50,000 business units. FICCI facilitates business-to-business linkages, promotes trade and investment linkages, creates awareness on key issues for the economy, provides inputs for policymaking, acts as a conduit for government-industry exchange and promotes bilateral ties.

FICCI's Committees and Task Forces on Environment, Climate Change and Renewable Energy serve as platforms for policy deliberations and interface with the government on key policy and regulatory developments. Corporate Sustainability assumes an important dimension to focus on as FICCI realises the growing interest of Indian companies in building a sustainability paradigm. Conducive policy frameworks are extremely important to facilitate positive action and innovation by industry. FICCI therefore is deeply engaged in mainstreaming Indian Industry's views in environmental policy areas such as waste management (municipal, electronic and hazardous waste management), environmental and forest clearances, biodiversity issues, etc. FICCI's annual flagship platforms like the India International Cleantech Summit, India Sustainability Conclave and India Climate Policy and Business Conclave bring together stakeholders in all these spaces to exchange ideas and best practices so that collective actions can be explored to create a positive impact on environment and society.

Inquiry: Design of a Sustainable Financial System

UNEP

United Nations Environment Programme (UNEP)

UNEP, established in 1972, is the voice for the environment within the United Nations system. UNEP acts as a catalyst, advocate, educator and facilitator to promote the wise use and sustainable development of the global environment. To accomplish this, UNEP works with a wide range of partners, including United Nations entities, international organizations, national governments, non-governmental organizations, the private sector and civil society.

UNEP work encompasses:

- Assessing global, regional and national environmental conditions and trends
- Developing international and national environmental instruments
- Strengthening institutions for the wise management of the environment

Mission

"To provide leadership and encourage partnership in caring for the environment by inspiring, informing, and enabling nations and peoples to improve their quality of life without compromising that of future generations."

Mandate

"to be the leading global environmental authority that sets the global environmental agenda, that promotes the coherent implementation of the environmental dimensions of sustainable development within the United Nations system and that serves as an authoritative advocate for the global environment"

For India Inquiry and the India Advisory Council
Please Contact

Ms Rita Roy Choudhury
Senior Director & Head - Environment, Climate Change & Renewable Energy
Tel: +91-11- 23325110 (D), 23738760-70 Extn 354 I Fax: +91- 11- 23721504, 23320714
Email: rita.roychoudhury@ficci.com

Federation of Indian Chambers of Commerce and Industry (FICCI)
Federation House, Tansen Marg, New Delhi 110001, INDIA

For the UNEP International Inquiry
Please Contact

Mr Nick Robins
Co-Director
nick.robins@unep.com
www.unep.org/inquiry