

Sanjay Malhotra: Climate change risks and finance

Keynote address by Mr Sanjay Malhotra, Governor of the Reserve Bank of India, at the Policy Seminar on "Climate change risks and finance", organised by Reserve Bank of India, New Delhi, 13 March 2025.

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I am delighted to be present here and be part of this important event on climate change which continues to draw attention in the national and international discourse. I would not dwell in detail about the perils of climate change since this audience is already well aware about its impact not only on the real economy, but also the financial system, as well as our day-to-day lives. Climate related changes are perceptible, clear, and visible. They are intensifying and threatening ecosystems, livelihoods, and economies. It is our individual and collective responsibility, to work together effectively and contribute to the global efforts to mitigate the risks associated with climate change and ensure that the Indian financial system remains resilient.

Dimensions of Climate Change Risks

There are two dimensions to climate change related risks that we as regulators, policymakers and practitioners have to be aware of – the first is facilitative involving capacity building, development of the ecosystem and financing of green and sustainable transition; and the second is the prudential aspect, which is related to risk management.

While the role of the Central Banks in managing risks posed by climate change to the financial system is increasingly being recognised, their role in facilitating the financing of green and sustainable transition has been a matter of debate and has varying dimensions to it. Central Banks in Advanced Economies have traditionally followed an asset neutral approach. Central Banks in Emerging Markets and Developing Economies (EMDEs), on the other hand, have adopted directed lending policies to channelise credit to certain sectors of their economies given their individual country circumstances and developmental objectives. In the Indian context, as you are all aware, the priority sector lending guidelines facilitate credit to be channelled to specific sectors including renewable energy.

On the prudential aspect, there are several channels through which climate change risks impact the financial system. All the major types of financial risks - be it credit, market, or operational risk - are influenced by climate change. These risks include losses from credit portfolio due to extreme climate events or natural disasters (physical risks) and loss in value of collaterals due to stranded assets (transition risks); losses from investments; and operational losses. Although climate change impacts almost all economic sectors, the extent and nature of these risks vary by sector, industry, geography, and institution. The mitigation of climate change risks, therefore, rests – firstly, on realistic and comprehensive assessment of the frequency and severity of climate risks and secondly, estimating their financial impact, which is no easy task.

As a Central Bank, the Reserve Bank is mindful of its role in addressing and mitigating risks to the financial system from climate change. In this context, our endeavour has been to play the role of a facilitator – including supporting capacity building and fostering a conducive regulatory framework for promoting green and sustainable finance. One important aspect of green financing/lending for sustainable finance is the higher credit risk due to borrowers' use of new and emerging green technologies, which have relatively limited track record in terms of reliability, efficiency, and effectiveness. Regulated Entities, therefore, need to develop suitable capacity and technical know-how to better appraise risks in financing projects which use such green technologies.

Evolution of climate change risks and mitigation for the Indian Financial System.

The Reserve Bank's approach with respect to climate related financial risks is oriented not just for the short-term but also the medium-term, taking into consideration the evolving national and global circumstances. Over the short-term, our goal is to be able to make a realistic estimation of the impact of climate related risks not just on individual institutions but also on the financial system as a whole. This would involve scenario analysis and stress testing exercises, using both bottom-up and top-down approaches.

The risk management framework in Regulated Entities for climate related financial risks is still evolving. There is a need for concerted efforts in developing the risk management framework; building technical expertise and competencies for comprehensive assessment and mitigation of climate related financial risks as also on the extent of losses due to such risks. I would now like to highlight some of the initiatives of the Reserve Bank has taken in this regard.

Climate related financial risk modelling is very important and data intensive. There is limited data available for measuring financial impact of climate change. Moreover, there is lack of benchmark sectoral transition pathways and country-specific carbon emission database. These constraints limit our ability to make a comprehensive assessment of climate change risks. These limitations also constrain comparison of financial impact, as each Regulated Entity may use its own assumptions and models to process climate related data. To address such constraints, we had in October last year announced the creation of a repository called the Reserve Bank – Climate Risk Information System (RB-CRIS). The repository is intended to bridge data gaps by providing standardised datasets. These datasets include hazard data, vulnerability data and exposure data related to physical risk assessment, sectoral transition pathways and carbon emission intensity database related to transition risk assessment. Work on this repository is underway and we expect to launch it later this year.

Several jurisdictions have started work on the assessment and disclosure of climate related risks. International organisations such as International Sustainability Standards Board (ISSB) of the International Financial Reporting Standards (IFRS)¹ Foundation has released standards on climate related disclosures. The Basel Committee on Banking Supervision (BCBS) has also released a consultative document on disclosure of climate-related financial risks² with a view to integrate climate risk related disclosures under the Pillar III disclosure requirements of the Basel framework. The Reserve Bank,

as you are aware, had already issued draft guidelines on Disclosure Framework on Climate related Financial risks in February 2024, for public comments. We have received valuable feedback and are in the process of finalising the guidelines. A guidance note on Climate Scenario Analysis and Stress Testing is also being developed for the Regulated Entities.

As we all are aware, technology and finance have a critical role in the transition towards a low-carbon economy. There is a need to build innovative solutions and capabilities in these areas. The Reserve Bank has been encouraging and facilitating innovations through its Regulatory Sandbox and Hackathon initiatives in the Fintech space. We propose to set up a dedicated "on Tap" cohort on climate change risks and sustainable finance under RBI's Regulatory Sandbox initiative. We are also planning to conduct a special "Greenathon" on climate change and related aspects.

We had in April 2023, issued the Framework on acceptance of Green Deposits³ with the objective of enabling banks to augment the flow of credit to green activities and projects. This again shows our willingness to facilitate financing green/sustainable projects. The idea behind the Green Deposits is similar to that of sovereign green bonds. We all need to raise awareness about such products.

I would like to highlight an important initiative to promote green finance. We have included finance to small renewable energy projects – solar, biomass based, windmills, micro-hydel plants and non-conventional energy based public utilities viz. street lighting systems, and remote village electrification projects as part of priority sector lending.

One of the oft-cited constraints to adequate flow of climate related finance has been the lack of bankable projects. Capacity and expertise constraints limit the ability to appraise and thus finance climate change mitigation. It also enhances the risk of funding such projects. Thus, creation of a common pool of such bankable projects will have multi-fold benefits for the entire ecosystem. Regulated Entities with experience of such projects can contribute to the pool for the benefit of others, while also benefiting from such information shared by other Regulated Entities. This will help share knowledge for benefit of all. There is a need for collaboration in this emerging and evolving area. I urge the Regulated Entities to seriously consider setting up such a pool through an appropriate institutional arrangement.

Before I conclude, let me say what is perhaps obvious. The impact of climate change risks is not limited to the financial system alone but extends to the real economy. Be it the corporates or the MSMEs or the agricultural sector, climate change risks are ubiquitous. This calls for a cohesive co-ordination and harmonisation in approach, among not only the financial sector regulators and the Regulated Entities but also various government agencies. There is a need to adopt a holistic approach towards mitigation of climate change risks considering the country specific requirements and circumstances. We will collaborate and coordinate with the government and other regulators to ensure that there is harmonisation and consistency in rules, regulations and our approach towards mitigating the impacts of climate change.

I am happy to note that while we are deliberating on this important topic, the Annual Steering Committee meeting of the Network for Greening the Financial System (NGFS) is also taking place today at this venue. NGFS is doing some pioneering work in the

area of managing climate related financial risks. Be it the NGFS scenarios, the recent work on adaptation, or the work on data directory, they have been a source of technical guidance and capacity building across the globe. We look forward to continued engagement and coordination with the NGFS.

Conclusion

To conclude, let me reiterate that climate change risks are real and all stakeholders need to be prepared to address the risks and challenges from climate change. Even though we have made a decent start, there are still issues that need to be addressed. The Reserve Bank remains committed to continue adopting a constructive and consultative approach towards supporting the various initiatives being undertaken towards management and mitigation of financial risks related to climate change. We will continue to work steadfastly to realise our vision to build a financial system that can not only withstand future climate shocks, but also actively contribute to India's journey towards a sustainable and resilient future. I urge you all to contribute towards this cause. As Albert Einstein had said "The world will not be destroyed by those who do evil, but by those who watch them without doing anything."

Let me also take this opportunity to extend my best wishes to you and your families on the occasion of Holi - the festival of colours.

Thank you.

¹ <https://www.ifrs.org/issued-standards/ifrs-sustainability-standards-navigator/>

² <https://www.bis.org/bcbs/publ/d560.pdf>

³ <https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=12487&Mode=0>