STUDENT

The Institute of Internal Auditors

Concept of Green Finance

and its Challenges

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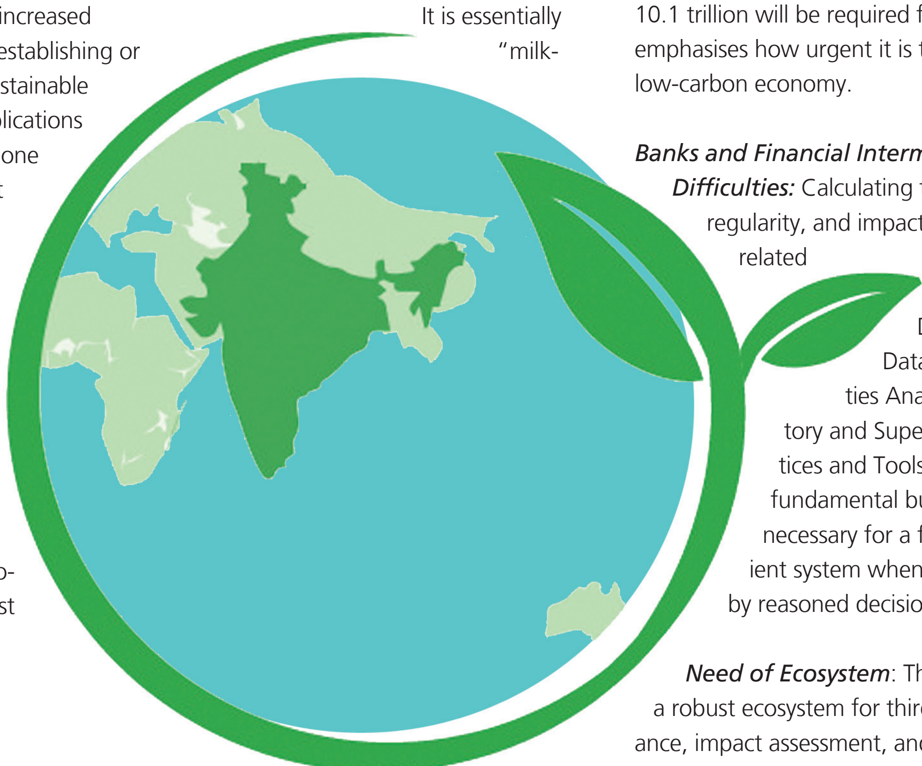
Today, India continues to move forward on climate issues with immense courage and determination. The country's initiative to contribute to the battle against climate change has grown gradually and reached a new level. Given the urgency and necessity to do more to combat climate change, Prime Minister Narendra Modi announced five nectar ingredients, or Panchamrit, as India's contribution to climate action during the COP 26 Summit in Glasgow.

Panchamrit aims at producing 500 GW of energy from non-fossil sources by 2030. It will help the country meet 50 per cent of its energy requirements from renewable energy by 2030, reduce the total projected carbon emissions by one billion metric tonnes by 2030, and reduce carbon intensity by more than 45%. Finally, by 2070, India will achieve the target of Net Zero. These Panchamrits will be an unprecedented contribution by India to climate action.

GREEN FINANCE

Since the announcement of five nectar ingredients, "Green Finance" has become a buzzword. "Green" today is a common phrase for a wide variety of topics, processes, goods, and services concerning sustainability and the environment. "Finance" means making investment decisions that consider financial returns. Combining these two together would mean making investment decisions that consider not only financial returns but also environmental aspects. It refers to financial arrangements designed to use environmentally sustainable projects or projects that incorporate elements of climate change. It stands for 'Financing the green economy' with the aim of increasing the level of financial flows toward green projects.

There are many available instruments of green finance, such as green bonds, sustainable bonds, green loans, sustainability-linked bonds, and blue bonds. All these instruments have the common goal of increasing financial flows from banking, microcredit, insurance, and investment to sustainable development initiatives from the public, private, and non-profit sectors. However, an appropriate incentive structure is required for increased allocation of funds towards establishing or adopting environmentally sustainable projects. While different publications provide varying estimations, one thing is clear: the investment required is enormous. The necessary investments will fund established technology and support research and development and capacity building, among other things. Some examples are the development of Carbon markets, value chain of renewable energy, carbon capture and storage technologies, EV ecosystem and robust disclosure mechanisms.



CHALLENGES:

While Green finance is central to the broader discussion of sustainable economic growth, one of the key constraints foreseen is the absence of supportive policies and regulatory frameworks required to mobilise green financing and close the present investment gap. To fulfil the gap, certain key developments are required:

Green Taxonomy Development: India currently lacks a green taxonomy. By offering a precise definition of green, taxonomy can assist in scaling up green financing by removing uncertainty in the industry. This can aid in increasing investor confidence and reducing greenwashing. From the beginning, “greenwashing,” or false claims of environmental compliance, has been the biggest challenge in the development of green finance. It refers to any false techniques used by businesses to promote themselves as more sustainable, such as creating a misleading image or providing inaccurate information regarding the sustainability of a product or service. The issue with “greenwashing” is that it serves more as a marketing gimmick than a commitment to environmental responsibility. It is essentially “milking,” as companies emphasise the financial benefits of appearing to be environmentally responsible without making the required changes to be eco-conscious. The best way to minimise or reduce the danger of greenwashing is to provide full and comprehensive disclosure about the green initiative and follow through on the promises made in such disclosure, even if they are not legally binding. Facts and figures may support financing that is green and sustainable.

Regulation and Policy Issues: As the regulatory environment for green finance changes regularly, it can be difficult for investors and businesses to keep up with the new standards. Additionally, there could be inconsistent laws and rules in various jurisdictions, which would be uncertain and discourage investment.

Lack of Urgency: To reach our net zero pledges by 2070, the Council on Energy, Environment and Water has already calculated that a total investment of US$ 10.1 trillion will be required for India. This emphasises how urgent it is to switch to a low-carbon economy.

Banks and Financial Intermediaries Face Difficulties: Calculating the occurrence, regularity, and impact of climate-related occurrences. Disclosures, Data, Vulnerabilities Analysis, Regulatory and Supervisory Practices and Tools are the four fundamental building blocks necessary for a financially resilient system when supplemented by reasoned decision-making.

Need of Ecosystem: The presence of a robust ecosystem for third-party assurance, impact assessment, and the green credentials of companies and projects is essential to scale up green finance. This would guarantee the free flow of capital and funding to the entities and resolve any potential worries about greenwashing.

To sum up, we face difficulty in thinking of methods to incorporate climate risk and ESG-related factors into commercial lending and investment decisions while juggling the demands of credit expansion, economic growth, and social development at a time when the global economy must expand quickly. Building on our early successes and tackling the difficulties of climate change would be significantly aided by collective engagement, and green financing can play a crucial role in accomplishing sustainable development.