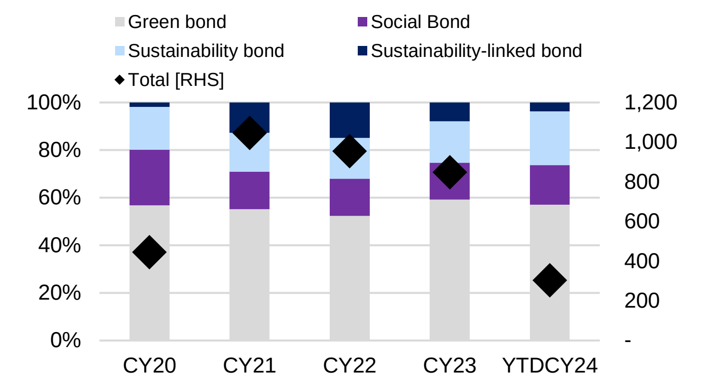
Volume XVI, April 2024

The Green Pill

Labelled bond issuances (USD bn)



Source: Bloomberg, SBICAPS; Data accessed on 08 Apr'24

Global sustainable funds in Q4CY23

Region	Flows (USD bn)	Assets (USD bn)	Funds (#)
Europe	3.3	2,492	5,433
US	-5.1	324	647
Asia ex.Japan	0.1	62	595
Australia/NZ	0.6	33	263
Japan	-1.2	25	235
Canada	-0.2	31	212
Total	**-2.5**	**2,967**	**7,485**

Source: Morningstar, SBICAPS; Includes funds, both debt and equity, defined as sustainable by Morningstar

Excess annualised returns of ESG indices vs. benchmark

Region	1Y	3Y	5Y
World	1.0	0.2	0.5
Europe	0.5	-0.6	0.9
USA	2.9	1.5	0.8
India	-9.8	-4.7	-0.9

Source: MSCI, SBICAPS; #ESG indices chosen are respective MSCI ESG vs. broader indices, on a net return in USD basis

Glide path for RBI's regulated entities for Climate-real financial disclosures

Regulated Entity	Governance, Strategy, and Risk Management	Metrics and Targets
SCBs	FY26 onwards	FY28 onwards
AIFIs	FY26 onwards	FY28 onwards
Top, Upper Layer NBFCs	FY26 onwards	FY28 onwards
Tier IV UCBs	FY27 onwards	FY29 onwards

Source: RBI, SBICAPS

Foreword

"Progress is impossible without unity. Coming together is a beginning; keeping together is progress; working together is success."

- Henry Ford

The ESG world is getting sharply polarised, belying the very unity the concept demands of humanity. On one side are regulators, especially Central Banks, sounding clarion calls and tightening their screws on their regulated entities. With the ECB leading the charge, others, including the RBI, have followed suit. Securities regulators have mirrored these developments, in a coterminous effort for inter-operability.

On the other hand, are financial institutions, whose hands are tied from lending to so-called ESG-negative sectors. Tall commitments made by major institutional investors are now falling apart as push comes to shove, and investors stare into eye-watering returns being made by conventional energy firms, without them getting their share of the pie. This pressure, percolating from the bottom-up, has led to the US SEC putting on hold its climate disclosures after multiple pleas against them, besides withdrawal of major investors from climate alliances.

Who are the detractors causing the fissure?

Not every detractor is of the same shade. We classify the ethical matrix of participants on a red (social) – green (environmental) axis, and observe that the landscape contains four principal archetypes – traditionalists (those who are not favourably inclined to climate and social goals), eco-sceptics (those in favour of social justice but critical of closing down polluting industries), socio-sceptics (those who recognise the scientific imperative of climate change but not that of social change), and finally ESG champions (those who believe in both E and S causes). Further, not every ESG champion is a corporate ally, as they may not have faith in the ability or willingness of corporations to act on these goals.

This fascinating and complex landscape highlights the importance of consensus building in a multi-national, multi-ideological movement like ESG. Further, since the cause has time sensitivity, the emergence of effective and efficient leadership is the need of the hour.

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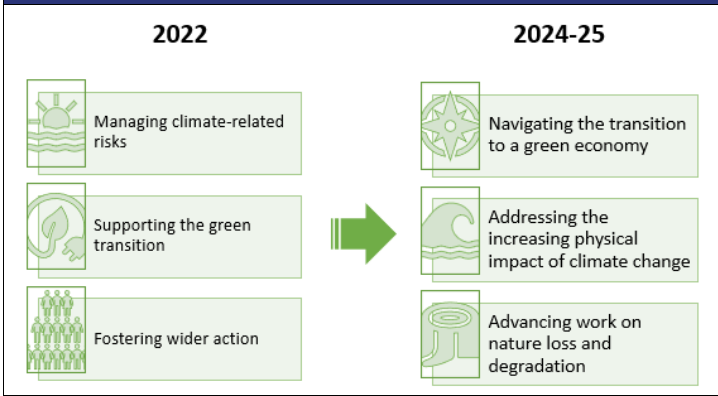
Central Banks plan for a green future…

The ECB recently released its Climate and Nature Plan 2024-25, in which it laid out strategic objectives, focus areas, and a roadmap to achieve its climate goals. This represents progress on its 2022 plan, which focused on improving the reporting and management of climate risks of the ECB and its regulated entities, developing frameworks for the same, and closing the data gap. In this regard, the ECB adjusted monetary policy actions and put together an all-encompassing climate scenario and stress test framework.

ECB Climate and Nature Plan



Source: ECB, SBICAPS

In some sense, 2022's plan was a primer for taking action. In 2024-25, the ECB has vowed to continue action on existing plans. Further, it has granularly articulated its focus areas. As far as the green transition is concerned, the ECB has moved from the stage of offering support to navigation – an incremental change. Specifically, it would analyse the interactions between transition funding and monetary policy.

The other two points represent a significant spotlight on specific issues – which was not articulated in 2022. The ECB has recognised adaptation challenges, reflecting the focus seen in COP28, and expressed the need for addressing the physical impact of climate change. This no doubt stems from several natural disasters seen worldwide during the previous stocktake period. Furthermore, exploration on nature loss, and subsequent impact on land use and biodiversity, forms the third focus area.

The RBI is hot on its heels

The RBI recently released the Draft Disclosure framework on Climate-related Financial Risks, 2024, aiming to enable proper disclosure and recognition of climate-related financial risks and opportunities by its regulated entities. The guidelines apply to many of RBI's regulated entities, including SCBs, all-India financial institutions, and top and upper layer NBFCs. The disclosure norms are expected to kick-in from FY26 onwards for the first three thematic pillars (governance, strategy, and risk management), while metrics and targets pillar will start with a lag of 2 fiscals.

Each pillar of disclosure is divided into baseline disclosure and enhanced disclosure. SCBs, AIFIs, and NBFCs are required to report both baseline and enhanced disclosures, while UCBs need to report only baseline disclosures (enhanced disclosures for them are voluntary).

Establishing sovereign as benchmark for green

The Union plans to issue Rs. 120 bn of SrGB in H1FY25. To participate wider non-resident participation in SrGB, eligible foreign investors in the IFSC are now permitted to invest in such bonds. This was announced in the latest MPC.

Central Banks around the world are taking a lead in not only directing their regulated entities, but also imbibing green principles to facilitate finance.

References: ECB, RBI

RBI's Thematic Pillars for Disclosure

Source: RBI, SBICAPS

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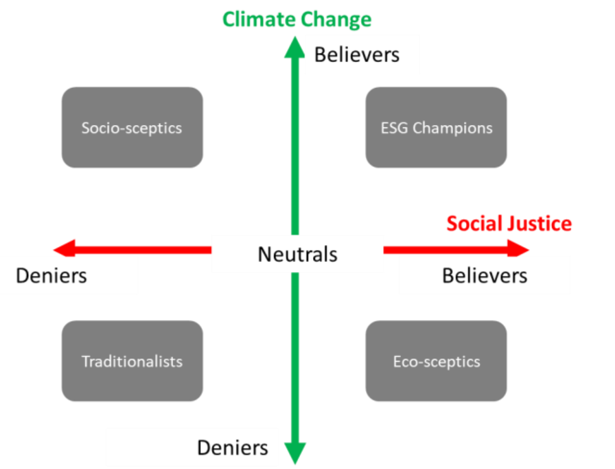
… But the rest of the world is having second thoughts

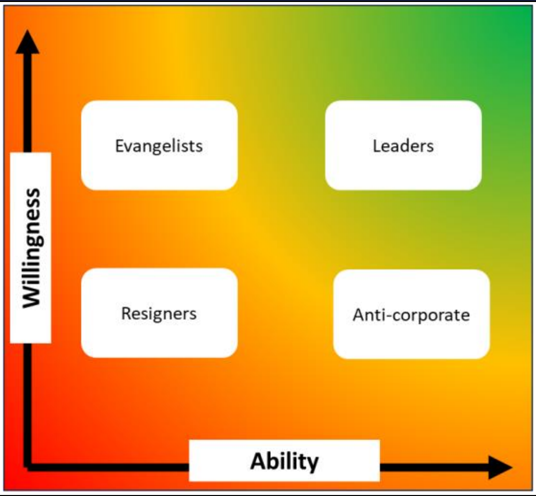
While Central Banks remain gung-ho about climate change, the rest of the world is reconsidering. Early strains could be seen in some of the foremost practitioners of ESG eat their words during the gas shortage which brought forth concerns over the energy trilemma in recent years. This has been amplified by what is perceived by some as sub-optimal investing by financial institutions, betraying their fiduciary responsibility towards their investors.

Anti-ESG comes in as many shades as ESG

Just like ESG, the anti-ESG movement comes in various shades as well. Firstly, there are those who deny climate change and do not believe in movements towards social justice – their belief systems are in line with traditional conservatives. Some modern conservatives have adjusted their belief system considering scientific evidence on climate change but remain socio-economic critics of “woke” culture – they are the socio-sceptics. The opposite is the traditional left who support redistributive socio-economic justice but may not be warm up to winding down fossil-fuel intensive industry. Finally, are those who believe in both causes, the so-called ESG champions.
But being an ESG champion in itself does not mean much for a corporate. Only a person/entity who champions these causes and believes corporates are willing and able to act on them would be a leader for change. This is only a heuristic to understand distinct types of attitudes towards ESG, and the realities will always exist in the continuum, and there are those who may lie outside this – for instance, ESG champions who believe corporates are able and willing to act but are not mandated/obliged to.

Ethical Matrix: Red-Green Identity	Belief Matrix: Impact Quotient





Source: SBICAPS

Withdrawing money (and regulations) where the mouth is

All said and done, this motley group of critics have started showing their impact. Three of the world’s largest asset managers backed off from the Climate Action 100+, a move thought to remove USD 14 trn of assets from climate change efforts. This comes in the wake of phase two requirements of the initiative which called for signatories to engage with policymakers and for some to publish details on their talks with companies towards the goal of getting them to lower emissions to zero on a net basis by 2050. Truth be told, the increasing political pressure could also be telling. And why not, since despite platitudes, even latest studies suggest two-thirds of consumers are unwilling to spend more time and money to be sustainable.
The biggest victory of the anti-ESG clan may be the US SEC’s decision to pause the implementation of recently released climate disclosure rules for regulated entities. With multiple states suing the SEC, and politicians feeling the heat, the future of ESG is in precarious hands!

References: US SEC, EY, HBR

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