cl!ent alert

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ahead of the curve

Draft Disclosure Framework on Climate - related Financial Risks, 2024
The Reserve Bank of India

Background

According to the World Economic Forum's Global Risks Report 2024[1], the top 4 risks in the long-term (10-year time horizon) and one of the top two risks in the short-term (2-year time horizon) are all climate change related. Climate change related risks occupied top spots in the previous reports as well. All sectors and businesses are impacted by these climate risks, whether the risks emanate from climate events or the response to climate change (transition to low carbon economy). These risks, therefore, tend to accumulate at banks and other financial institutions. The occurrence of certain climate change scenarios could lead to climate related financial risks impacting the stability of banks and financial institutions and the stability of the financial system itself.

The Financial Stability Board[2] (**FSB**), recognizing the impact of climate related financial risks on global financial systems, created the Task Force on Climate Related Financial Disclosures (**TCFD**) in 2015 to develop recommendations on the types of information that companies should disclose to support investors, lenders, and insurance underwriters in appropriately assessing and pricing climate-related risks. In 2017, TCFD released its climate risk disclosure guidance titled *Recommendations of the Task Force on Climate-related Financial Disclosures*[3]. The TCFD recommendations are structured around four thematic areas that represent core elements of how organizations operate—governance, strategy, risk management, and metrics and targets. These recommendations are further supported by recommended disclosures-key climate-related financial disclosures aligned to the four thematic areas.

Many jurisdictions across continents have mandated TCFD-aligned financial disclosures in various formats. These include UK, Switzerland, Japan, New Zealand, Thailand, Malaysia, Philippines, Brazil, Columbia, Egypt, Kenya, Canada, and the US.

In 2021, the Indian market regulator, SEBI, amended regulation 34 (2) (f) of (Listing Obligation and Disclosure

1 Global Risks Report 2024 | World Economic Forum | World Economic Forum (weforum.org)Global Risks Report 2024 | World Economic Forum | World Economic Forum (weforum.org)

2 FSB was initially established as Financial Stability Forum under the G7 in 1999 to promote international financial stability. In 2009, it became FSB under G20. On 28 January 2013, the FSB established itself as a not-for-profit association under Swiss law with its seat in Basel, Switzerland

3 FINAL-2017-TCFD-Report.pdf (bbhub.io)

Requirements) Regulation, 2015 ("LODR Regulations"), mandating ESG disclosures (Business Responsibility and Sustainability Report (**BRSR**)) starting from FY2023 as part of the annual report by the top 1000 listed companies by market capitalization. BRSR covers mandatory disclosure of Scope 1 and Scope 2 emissions and optional disclosure of Scope 3 emissions. In 2023, SEBI further amended the LODR Regulations and mandated disclosure of, inter alia, value chain emissions covering at least 75% of upstream and downstream value chain business starting from FY2025 by the top 250 listed companies by market capitalization. SEBI actions have already set the obligated entities, including banks, on a climate disclosure trajectory. However, the SEBI mandates do not require climate risk assessment or risk disclosure.

The Reserve Bank of India (**RBI**), on 28 February 2024, released a draft regulation titled Draft *Disclosure Framework on Climate-related Financial Risks*, 2024[4]. The Draft is a follow on to the *Discussion Paper on Climate Risk and Sustainable Finance*[5] that RBI issued on 27 July 2022. Both the Discussion Paper and the Draft Disclosure Framework are built around the TCFD[6] recommendations.

Purpose

The regulated entities (**REs**) under the RBI will be impacted by climate change. Left unaddressed, climate-related risks can impact the financial stability of the country. Therefore, the Draft is meant to foster (i) assessment and management of climate-related financial risks (ii) disclosure climate-related financial risks and opportunities to help better decision-making, and (iii) bring consistency and comparability to climate-related financial disclosures by REs.

Applicability

The disclosure framework applies to:

a. All Scheduled Commercial Banks (excluding Local Area Banks, Payments Banks and
b. Regional Rural Banks)
c. All Tier-IV Primary (**Urban**) Co-operative Banks (**UCBs**)
d. All All-India Financial Institutions (viz. EXIM Bank, NABARD, NaBFID, NHB and SIDBI)
e. All Top and Upper Layer Non-Banking Financial Companies (**NBFCs**)
f. Foreign banks for their operation within India
g. Voluntary for regulated entities not covered by (a) to (d).

Effective date

RE	Governance, Strategy, and Risk Management	Metrics and Targets
SCBs, AIFIs, Top and Upper layer NBFCs	FY 2025-26 onwards	FY 2027-28 onwards
Tier IV UCBs	FY 2026-27 onwards	FY 2028-29 onwards
Disclosure requirements for the other REs shall be announced in due course		

How to disclose

The REs shall disclose the information detailed in these guidelines as follows:

a. On a standalone basis and NOT consolidated basis
b. To be included as a part of the RE's financial results/ statements on its website
c. The disclosures should be subject to appropriate internal control assessments and the Board of Directors, or a Committee of the Board should review them
d. Disclose third-party assurance, if taken (not mandatory)

4 Climate risk management and Disclosures (rbi.org.in)
5 CLIMATERISK46CEE62999A4424BB731066765009961.PDF (rbi.org.in)
6 TCFD has been disbanded since October 2023 and FSB has asked the IFRS Foundation to take over the program).

What to disclose

REs must disclose the entire process of risk assessment, management, integration, and tracking through four thematic pillars: Governance, Strategy, Risk Management, and Metrics & Targets.

Disclosure Requirements

Governance

a. The Board's oversight of climate-related risks and opportunities, and

b. Senior Management's role in assessing and managing climate-related risks and opportunities.

Strategy

a. The identified climate-related risks and opportunities over short, medium, and long term,

b. The impact of climate-related risks and opportunities on the RE's businesses, strategy, and financial planning, and

c. The resilience of the RE's strategy taking into consideration the different climate scenarios

Risks & Opportunities

a. The processes and related policies to identify, assess, prioritize, and monitor climate-related financial risks,

b. The processes used for managing climate-related risks, and

c. The extent to which, and how, the processes for identifying, assessing, prioritizing, and monitoring climate-related financial risks and opportunities are integrated into and inform the overall risk management.

Metrics & Targets

a. The metrics used to assess the climate-related financial risks and opportunities in line with its strategy and risk management process,

b. Scope 1, 2 and 3 greenhouse gas (**GHG**) emissions and the related risks, and

c. The targets used to manage climate-related risks and opportunities and performance against targets.

The disclosure requirements are detailed in Annex 1 (of the Draft), where, under each pillar, a set of Baseline disclosure parameters and Enhanced disclosure parameters are defined. SCBs, AIFIs and NBFCs to whom these guidelines are applicable should report both Baseline and Enhanced disclosures. UCBs to whom these guidelines are applicable should report Baseline disclosures at the minimum, while the Enhanced disclosures are voluntary.

Governance actions

a. Set time horizons for Short-term, Medium-term, and Long-term for risk assessment purposes

b. Define financial materiality threshold for risk acceptance

c. Climate considerations in remunerations of whole-time directors, CEOs, and material risk-takers

d. Set controls and procedures for oversight

e. Competences and skills in the board and leadership (governance) and availability of resources – this requires an end-to-end education of RE's staff and represents a big challenge

Implementation – key actions and associated challenges

a. Financed emission reporting: Emission reporting must cover 100% of gross exposure, with explanations for any exclusions. REs must gather and report financed emission data for their investee companies. REs may include only that share of emissions attributable to them by way of their investment/loan. This will be a serious challenge to all REs. Some REs have already taken early steps in this direction, but all have a long way to go. The entire loan approval process and loan agreement must undergo a reset to make this happen. Emission data gathering at this scale will require appropriate technology and tools.

b. Risk assessment: REs are required to assess both Physical and transition risks. This is another big challenge REs must overcome to comply with this mandate. Understanding physical risks requires a methodology based on an overlay of geographical mapping and sectoral mapping. Physical risks can include loss of/harm to lives, loss of/damage to assets, and loss of business. Since physical risk will increase with worsening global warming, warming scenarios other than a 2-degree scenario may be relevant to consider. Assessing transition risks also will require sectoral and geographical mapping. Transition represents significant risk as well as big opportunities. Risk considerations for company vs group is another challenge.

c. Business strategy: Risks, including those identified through scenario analyses, are to be integrated into business strategy and are to be considered in the Internal Capital and Liquidity Adequacy Assessment Processes. While REs will have to develop appropriate approaches and methodologies for integrating climate related financial risks into business strategy and business model, complete and reliable inputs from steps (a) and (b) above will make this process easier.

d. Disclosure of impact of risk drivers: REs are required to disclose the impact various risk drivers on their credit risk, market risk, liquidity risk, and operational risk profiles. Reliable inputs from steps (a) and (b) will aid this process; however, a common approach may take time to evolve.

e. Develop a transition plan: A transition plan can in fact be a risk management plan – transitioning away from high-risk areas and moving into emerging opportunities. A transition plan will invariably include targets and relevant metrics.

Conclusion

The Draft Disclosure Framework is currently under public comment period. The regulated entities must utilize this opportunity and provide their comments and inputs (by e-mail[7]) before the deadline set by the RBI (by April 30, 2024) . At the same time, the regulated entities must view this as impending regulation and act now. Although the proposed compliance year is FY2025-26, a meaningful disclosure and compliance will require significant lead-time. Much time will be lost by delaying action while waiting for this Draft to become a regulation. The REs must undergo end-to-end change - from people to systems & processes to technology to governance.

How CAM can help

CAM has an integrated ESG practice consisting of lawyers and ESG experts. We advise clients on their regulatory transition, compliance with specific ESG regulations, due diligence, regulatory risks, and other related matters. We will be able to support REs in the following areas.

a. A preparedness review to identify current activities aligned to the requirements and further action required on a priority basis.
b. Governance, policies, and internal processes
c. Framework for risk-mapping, assessment, and management
d. Review of loan agreements to incorporate emission reporting provision
e. Mapping of Policy and legal risks under transition risks, a sector-wise review for all investees and counterparties

7 Reserve Bank of India - Press Releases (rbi.org.in)

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