

ESG BEST PRACTICES -FINANCE SECTOR

2023



Introduction

Banks and Finance companies perform a crucial role in the economy by intermediating funds from savers and depositors to activities that support enterprise and help drive economic growth. Banks' safety and soundness are key to financial stability, and the way they conduct the business, therefore, is central to economic health. In the year 2007, RBI issued a notification mentioning the urgency of the banks to take sustainable development initiatives considering the crucial role they play in financing the economic and development activities of the world. In the said notification RBI advised the banks to take note of the ESG issues raised and consider using the same to put in place a suitable and appropriate plan of action towards helping the cause of sustainable development, with the approval of the Boards.

Due to the nature of business the finance industry does not have a direct impact on the Environment and Social as most of those impacts are due to the activities of other businesses that rely on banks/finance companies – the businesses in a loan or investment portfolio. However, despite the relatively indirect nature of the environmental and social impacts, banks and finance companies need to examine the ESG effects of the lending and investment decision.

ESG Best Practices Metrics for Finance Sector

The following indicative metrics are developed by using the recommendations and observations of various reports and surveys issued by RBI and Fair Finance India, Sustainability Reports of the Indian banks and Finance companies, and interactions with the Banks.

Environment

1) Board-level engagement and responsibility:

- Responsibility assigned for overseeing initiatives related to climate risk and sustainability.
- Inclusion of climate risk/sustainability / environmental, social and governance (ESG) related Key Performance Indicators (KPIs) in the performance evaluation of the top management.
- Mechanism at either the Board or top management level for overseeing and scaling up initiatives relating to climate risk and sustainability.

2) Strategy

- Separate business unit or vertical for sustainability and ESG-related initiatives.
- Strategy for embedding ESG principles in the business, scaling up the sustainable finance portfolio and incorporating climate change risks into the existing risk management framework.

3) Risk Management

- Consideration of climate-related physical, transition and liability risks to be a material threat to the business.
- Focus on the social and governance aspects while evaluating credit proposals above a certain amount.
- Quantification of the amount of loan and investment portfolio that is susceptible to ESG risks.
- Strategy for managing climate risk and integrating it into risk management framework.

4) Transition to low-carbon exposure:

- Reduce exposure to high-carbon emitting/polluting businesses
- Mobilized new capital to scale up green lending and investment
- Target for incremental lending and investment for sustainable finance
- New Loan products to tap the opportunities from climate change
- Green deposits to scale up lending to environment-friendly businesses
- Inclusion of climate-related litigation as a potential risk in the risk assessment of the large corporate exposures.

ESG Best Practices Metrics for Finance Sector

5) Climate-related financial disclosures:

- Aligned the climate-related financial disclosures with any internationally accepted framework e.g. TCFD
- Separate webpage on 'Sustainability or ESG or Climate Risk' on its website for single-point dissemination of all its climate-related financial disclosures, ESG and sustainable finance-related initiatives

6) Moving towards a low-carbon environment in financing operations:

- Measures or have plans to decrease the absolute carbon emissions arising from the own operations
- Increase the proportion of renewable energy in the total sourced electricity
- Announced time-bound plans to come up with a roadmap over the next 12 months to become carbon-neutral.
- Measurement of portfolio emissions or initiated discussions with its large corporate borrowers about the plans to reduce the carbon emissions and offered to support them in this process

7) Capacity building and data gaps

- In-house awareness programs on climate risk ESG and Sustainable finance
- Dedicated resources to successfully tap the opportunities arising from climate change, sustainable finance and the growing focus on ESG

Social Welfare

1) Labour Rights

- A policy commitment to International labor rights standards or national laws and guidelines for the welfare of workers.
- Support the employees to freely associate and form unions
- A Policy commitment to discouraging discrimination, child labor and forced labor

2) Human Rights

- Policy commitment to national and international human rights standards
- Grievance mechanisms to address human rights violations
- Commitment to integrating human rights criteria in assessing risks in project finance

ESG Best Practices Metrics for Finance Sector

3) Gender Equality

- Policies on dealing with sexual harassment.
- Systems in place to manage to pay equity between the genders
- Systems in place to prevent and mitigate gender-based discrimination among the customers
- Recognised self-help groups (SHGs) as a mechanism of empowerment of its female customers
- Guaranteeing equal participation and access to women to senior level positions.
- Providing targeted professional development such as training for employees for promoting equal Access for women to senior level positions
- Policy commitments to gender with respect to the companies that it invests in

4) Financial Inclusion

- Policies, services, or products that specifically target poor and marginalised groups
- Set up branches in rural areas and also provided branchless, cashless and mobile banking services
- Taking clear steps to communicate risks (including risks of indebtedness) associated with financial products or services to low-literate clients and MSMEs
- Policy commitments to providing terms and conditions in the national or local languages
- Improving financial literacy among low-income, marginal groups and MSMEs
- Clearly communication on whether they charged clients for opening a basic bank account
- Offered details about domestic remittance processes
- Provided information about the low-income housing finance that they offered

5) ARMS and Ammunition

- An exclusion list that includes sectors engaged in production or trade in biological and chemical weapons
- Policies related to lending to companies in the arms sector

ESG Best Practices Metrics for Finance Sector

Governance

1) Transparency and Accountability

- Complied with the disclosures norms as per SEBI's BRSR obligations
- Reported the credit exposure to sectors and industries as per Basel III requirements
- Reported a detailed industry-type distribution of the lending portfolios
- Disclosed the names of investee companies
- Policy on grievance mechanisms for non-customer and non-employee stakeholders

2) Corruption

- Policy disclosures on ethics and codes of conduct that facilitate employees to report fraudulent practices
- Clear policy disclosures on bribery or any other indicators of corruption
- Policies to combat terror financing activities including procedures for monitoring transactions
- Disclose lobbying activities or having any linkages with any lobbying bodies

3) TAX

- Invest in or lend to corporations that pay the taxes in a fair and transparent manner
- Publicly disclosing any policies on tax transparency for the internal operations and for the investee companies

About Lodha & Company :

We are one of the oldest and largest Audit firms in India, present across India's major cities.

MUMBAI

40, Karim Chambers, A. Doshi
Marg, Fort, Mumbai-400001.
mumbai@lodhaco.com,
esg@lodhaco.com

KOLKATA

Esplanade Mansion,
14 Government Place East,
Kolkata-700 069
cal@lodhaco.com

NEW DELHI

C-1 Upasana Building,
1 Hailey Road,
New Delhi-110 001
delhi@lodhaco.com

CHENNAI

20/7 Lalithapuram Street,
Guru Kirpa Niwas Royapettah,
Chennai-600 014
chennai@lodhaco.com

JAIPUR

Khetan Bhawan
Mirza Ismail Road,
Jaipur-302 001
jaipur@lodhaco.com

HYDERABAD

Plot No. 84 BHEL Enclave,
Akbar Road,
Secunderabad-500 009
hyderabad@lodhaco.com

About Lodha & Company :

Mr. Pradeep Malu
Partner
pradeepmalu@lodhaco.com

Simony Rathod
ESG Consultant
simony@lodhaco.com

To learn more about our Research Work please visit our website -
www.lodhaco-esgplus.com

Our expert speaks - Our Webinar-series -
<https://www.youtube.com/@esgbriefings>

Disclaimer

This document, prepared by Lodha&Co (the company), is solely for information purpose and do not constitute any offer for services or a document for advertising or marketing the services, and does not formwork of solicitation of professional work, whatsoever. This information in this document is provided in confidence at the request of the receiving party and the receiving party may not disclose or forward it to any third party or use it for any other purpose without the express written permission of the company. Logos used in the documents are the property of the respective companies except for the logo of Lodha&Co. Due credit has been given to the respective organization/companies/research team wherever 3rd party content is used as reference material in this documents and hence, there is no infringement of any kind of copyright in any manner.