

SUSTAINABILITY IN FINANCE

I. INTRODUCTION

Financial sector holds enormous potential in bridging the gap in the corporate sector through funding and other decisions bring awareness about sustainability. Investing in businesses and projects with suitable ESG (Environment, Society, and Governance) perspectives is steadily increasing, as the demand for finance professionals with ESG expertise is also on the rise, it is imperative to understand the essentials of sustainable finance.

1. **Definition:** Sustainable finance is defined as investment decisions that take into account the environmental, social, and governance (ESG) factors of an economic activity or project.

Sustainable business approaches in a descriptive surge being experienced by business. Initially, sustainability concept was presumed to be significant as a marketing technique, but eventually business leaders opine that ecological and social perspectives definitely act as driving forces in delivering consumer value and build Goodwill of the organisation.

- Environmental concerns can be issues ranging from climate change to preservation of ecology upto reducing carbon footprint.
- Social concerns include inclusiveness, human relations, investing in human capital, people skills etc.,
- Government issues include management structures, remunerations, leadership, compliance etc.,

2. **Meaning:** Sustainable finance can be understood as finance decisions to support economic growth while reducing negative impact on environment, promote social development and maintaining transparency in governance.

ESG thinking demands a radical shift in the analytical abilities of finance professionals, as the concept of sustainable finance has emerged as a response to a world that is finally seeking to bridge social, environmental and other gaps. Sustainable finance facilitates directing capital towards sustainable activities and projects. Sustainable finance is a broader concept that not only includes environment and concerns but also includes human as well as community concerns alongside importance to self-regulation and compliance.

II. GREEN FINANCE

As this juncture it is also necessary to differentiate sustainable finance from green finance. Green finance is a part of sustainable finance that considers the environment all objectives such as prevention of pollution conservation of natural resources and the like in boosting the circular economy. It's primary focus on the planet earth and making it a better place for future generations

Green finance encompasses only one of the three key focus areas of sustainable finance. Whereas, sustainable finance is all about using the power of investment funding to choose only companies that comply with ESG standards. On the other hand sustainable finance includes a wide range of activities from investing capital assets into greener projects to putting money into companies that value social values and/or good governance. Hence, its purview is broader and more comprehensive.

III. DIFFERENCES BETWEEN GREEN FINANCE & SUSTAINABLE FINANCE

Aspect	Green Finance	Sustainable Finance
Meaning	They refer to financial products & Services designed to fund Environmental friendly projects	Investment decisions are made taken considering the ESG factor
Focus	Focusses on addressing environmental Challenges and reducing carbon footprint of investment	It aims in promoting sustainable & responsible investment Practices
Goals	Reduces Green home gas Emissions and mitigate climate Change	Mitigate climate change, meet investors demand, and enhance corporate social responsibility.

IV. WHY IS SUSTAINABLE FINANCE IMPORTANT?

Integrating sustainability into financial decisions has gained importance as never before. It is important for several reasons but primary for two major things as follows: Sustainability approach to decisions in finance brings in all the stakeholders to be heard equally and all forms of capital will be valued equally. Typically businesses or profit centric and always target towards profit maximization or utmost wealth maximization while pushing the cost of achieving it on the society.

Customer/investor value preposition has radically changed. They tend to more critically evaluating managements and corporate entities on ESG metrics, rather than profitability metrics alone. The pertinent question that is surfacing is - why should an investor, invest the limited resources to support your business and it's profit motives unless the answer is for ESG purposes. Sustainability in finance decisions has a critical role to play in delivering on commitment towards climate resilience, resource efficiencies and fair economies as a compliment to the public money.

Sustainable finance is key in promoting the transition to the carbon neutral and sustainable country. We All are the custodians of the natural world and responsible citizens of our society and this brings our concern for making the world a better place to be on our priority test. Of course, from the moral perspective sustainability aspects / considerations should form the underlying factors for all over decisions on a daily basis. However from a purely business perspective also there is a hard - headed logic for sustainability.

As more and more human beings are seeking ways to promote ESG compliance and are willing to explore various techniques and mechanisms to support the idea , businesses need to incline driving their decision towards the ESG concerns and more so their financial decisions.

Non-Compliance: Investors and others take holders or essentially looking for ESG complaint companies, weather it be for products, services or investments. They want to see the target companies to have ESG on cards in all there strategic decisions. This has knock-out effects on finance leaders. As the non- complaint companies can experience severe damage to their reputation. Eventually, the government might also introduce reporting and compliance regulation leading to non- complaint businesses experiencing a major set-back.

V. HOW IS SUSTAINABILITY IN FINANCE CHANGING THE WORLD?

Apart from helping the planet, making society a better place, sustainable finance to a great extent is offering higher returns for investors. Study conducted by fidelity between 1970 and 2014 on ESG investments worldwide, revealed that more than half of such investments over performed the markets.

Companies with higher ESG ratings have been generating higher share price and paying higher dividends to the shareholders. This is an safe indication for institutional investors as well institutional investors like pension funds have a fiduciary duty to generate returns and the fact the returns are increasing on sustainable assets means a lot to trustees as the no longer have to compromise profit for sustainability.

VI. RETURNS ON SUSTAINABLE ASSETS EXPLAINED

Apart from the inclusive benefit to the environment and society, there is incremental evidence that sustainable investments provide higher returns to investors. One of the vital factors is the changing investor attitudes. Study reveals that close to 60% of the individuals prefer to transact with companies that share there values. Consumers or extremely likely to purchase from businesses that endorse the corporate purpose, which is evident from the challenging situations encountered by carbon intensive industries, finding harder and harder to rice capital from the market. In this context sustainable companies are more likely to win contracts, save budgets while utilising fear resources, have less regulations.

"Global companies took in a record \$859 billion in sustainable investments in 2021, including \$481.8 billion in green bonds that raised money for environmental projects". "And total level of sustainable final is only to grow in future exceeding \$53 trillion by 2025, working out to be one third of world investments."- Bloomberg

VII. HOW IS SUSTAINABLE FINANCE CHANGING THE WORLD?

Sustainable finance has longer and implications and also has rippling effect in the economy world over. It not influences the investors to invest in socially responsible corporate entities but also provides them with a deep sense of satisfaction for making valuable decision. Variable financial unknown financial implications or as follows:-

- 1. Creating Capital Assets:** Sustainable business practices can definitely pave way to capital formation for firms. Several investors, both retail and institutions are including ESG into their decision making criteria. Corporates of all sizes have initiated measures to align their corporate strategies to sustainable finance principles. This might be in an attempt to attract landers and investors or just to create a better image of the business. In all ways, they can access a larger pool of resources.

2. **Risk Analysis and Management:** This conservative approach in finance enables or rather pushes businesses to identify, explore and manage risk in much effective manner. Businesses that are well prepaid to manage such risks and implement backup plans to manage them are better perceived and position for persistent and resilient results in the long term.
3. **Investor Expectations:** In the recent decade there has been a metamorphosis in the stakeholder value prepositions. Consumer for very much concerned about the ecology and social framework and its will be in along with being thoughtful about products and services and their likely impact on our lives. Individuals also want to work for an employer with strong commitment towards ESG. Regulators have been keen on enforcement of regulations in order to minimise risks associated with ESG aspects. All the firms that are ready to adopt sustainable finance postulates can certainly gain through goodwill garnered and worth the relationships built.
4. **Disclosures and Reporting:** Invest hours now check for disclosures about ESG and include them in their evaluation criteria. Hence, sustainable investments and their reporting have been increasingly important. This not only enables firms to project their long term commitment towards ESG goals, but also helps investors make informed decisions. Hence, robust reporting mechanisms becomes inevitable requirement for businesses.

VIII. ESSENTIALS OF SUSTAINABLE FINANCE

The Paris agreement on climate goals for 2021 has made every business to be more sustainable. No wonder, the financial sector is also gearing up to get more sustainable. Owing to this large size and lucrative nature, it ought to thrive for sustainability. Sustainable finance is the set of financial rules, guidelines, products, framework that progress towards protecting the environment, society while practicing governance. It provides a systematic framework to financial activities, ensuring investments synchronise with development objectives.

Sustainable finance includes the following principles:

- Positive contribution to sustainable development
- Transparency and disclosure
- Stakeholder expectations assurance
- Responsible investment decisions
- Social responsibility

1. **Illustration#1:** Let us consider an automobile manufacturer is looking to rise capital for its electric vehicle manufacturing unit. In this scenario, the company issues green bonds rather than seeking convention funding to the project. These bonds or intended exclusively fund for the EV manufacturing unit. Hence, the company needs to report the project's environmental impact and reduction in carbon footprint. This example illustrates how the company would benefit from lower financing costs of green bonds, simultaneously building on its Goodwill, while achieving sustainability goals.
2. **Illustration#2:** With the increased impetus on new reporting and regulatory work for sustainable goals achievement. Companies focusing on the sustainable finance strategies,

implementation, reporting would definitely over their peers. According to PWC reports," at the current growth rate ESG assets or to contribute 21.5% to global assets under management in less than 5 years from now".

IX. SUSTAINABLE FINANCE PRODUCTS

1. Corporate Sustainable Finance Products

- **Green Bonds** - A type of debt instrument that is used to raise capital for projects with environmental benefits
- **Sustainable Investment Funds** - An investment vehicle designed to generate positive financial returns while also considering the environmental and social impacts of investments.
- **Project Finance** - Specialised service divisions are dedicated to long term financing of clean energy projects.
- **Portfolio Financing Technique** - combines the financing of a portfolio of renewable energy projects considering and managing the risk associated.
- **Partial Credit Guarantees** - Financial institutions facilitate a bond issued by a quasi-government body to finance environmental project.
- **Securitization** - This is a risk sharing agreement. Financial institution acts as a guarantor at the superficial level of risk and allows the client to transfer risk to the bank. This includes eco- securitization schemes green mortgage backed securities.
- **Forest & Cat Bonds** -Forest bonds or designed to fund large scale reforestation and cat bonds provides ancillary capital for risks from natural calamities.
- **Private Equity**- Includes private equity investments focused on renewable energy generation and distribution and forest conservation along with preserving the biodiversity.
- **Carbon Finance & Trading** - Banks provide equity loans to aquarium carbon credits from CDM and JI projects. Allowance trading products can include but are not limited to discrete placement of physical orders fixed or floating swaps and indexed sales and purchases, options and price heading based on cross commodities.

2. Retail Sustainable Finance Products

- **Green Loans** - green commercial building loans for the generation of cost savings during the life- time of energy efficient equipment and material.
- **Auto and Fleet Loans** - With below market interest rates green auto loans to be extended to encourage the automobiles demonstrating no GHG intensity and/or high fuel efficiency.
- **Green Credit Cards** - Green credit cards are offered by most large credit card companies, typically to offer in jio donations equal to approximately 0.5 percentage point on every purchase, balance transfer or cash advance made by the card owner.
- **Green-Sale and Travel Money Products:** These products include environmental donations tied to traditional sale transactions, environmental awareness and partnerships tied to travel products.
- **Technology Leasing / Environmental Leasing:** Environment friendly technology's or provided at referential rates to commercial customers. It has also referred as green

leasing. Rabo bank is a global leader in green technology leasing funding €103 million towards green lease arrangements.

- **Microfinance** -Banks or considering to provide micro loans to individuals and SME's in order to finance small environmental projects such as small solar installations. For example, credit Suisse, Societe Generale' have recently entered this area by refinancing local lenders.

3. Regulatory Framework for Sustainable Finance: An essential aspect of sustainable finance, it requires regulatory work which makes its more accountable and effective. This regulatory framework needs to bind in the banking entities and also the financial service providers.

4. Objectives of the Regulations

- Contributing to the sustainability goals with high degree of transparency and accountability.
- Integrating investors ESG preferences and possible ESG risks in investment advice and portfolio management.
- Creating transparency for clients on ESG in investment advice and portfolio management.
- Finally strengthening the finance eco- system nationally and internationally for sustainability.

5. Purpose of Regulation: These guidelines define a uniform minimum standard within the finance industry for the consideration of ESG preferences and risks in investments. They prevent green- washing when providing investment advice to investors.

6. Scope: This regulations would explicitly define - ESG, ESG criteria, ESG preferences, ESG approaches, ESG investments, ESG characteristics, ESG returns and ESG risks. Along side formulating the regulatory scope it would also chart out the implementation of these regulations. The regulations would necessarily include client segmentation information disclosure requirements.

7. Main parts of regulatory framework: Essentially the following aspects of framework or to be clearly defined and implemented

- **Documentation**
 - Financial service providers need to document
 - ESG preferences or ESG Neutral
 - ESG characteristics
 - Mismatch and handling.
- **Training and Professional Development**
 - Relevant training for the professionals should include the following basics of ESG and risks in ESG
 - International principles and regulations.
 - Specific knowledge of how the ESG investments solutions work and satisfy ESG preferences.

- Knowledge of how the existing system can be transitioned to ESG investment solutions.
 - Basic knowledge of green washing and how to avoid it
- **Audit:** this is the verification of compliance with the self regulations including necessarily in the audit catalogue of financial service providers.

X. SUSTAINABILITY IN FINANCE - INDIAN SCENARIO

In Indian context sustainability finance has gained prominence recently owing to the augmented awareness of the need for sustainable development and growth. RBI has been on the forefronts to promote sustainable finance with its maiden initiative of guidelines to banking sector to report its sustainable practices in 2015. Following this in 2018 a broad framework has designed and implemented for green bonds. This framework provides guidelines for issuance of such bonds and also incentivizing the banks for financing sustainable projects.

The SEBI has also been instrumental to promote sustainable finance, with the release of its new framework for mutual funds to encourage ESG investing. Under this framework the mutual fund companies are required to disclose ESG investments and report their sustainable practices. Eating clothes ESG investment selection guidelines and motivates fund managers to make sustainability fostering investment decisions.

Other Regulatory Initiative of SEBI: Regarding access to capital for sustainable projects, identify, access and manage ESG risks ,drive innovation and create new market opportunity. It also includes emphasizing on transparency, accountability and reporting on ESG projects.

In India, sustainable finance by private equity and venture capital firms is expected to grow \$125 billion by 2026 with a 5 year CAGR of 46%. This exponential growth in sustainable investments is one of the critical factors defining the economic and social prospects of our country.