



# **Practitioners' Guide**

## **Mitigating Potential Risks in Financing Agro-Commodities in India**

### **The Case of Palm Oil**

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Centre for Responsible Business (CRB) and Roundtable on Sustainable Palm Oil (RSPO)



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The guide has been informed by discussions in workshops with select representatives of financial institutions and sector experts on the subject and linkage between sustainable palm oil and climate change, biodiversity conservation as well as additional research/analysis.

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# ABBREVIATIONS

<b>CDP:</b>	Carbon Disclosure Project
<b>CSPO:</b>	Certified and sustainable palm oil
<b>E&amp;S:</b>	Environmental and Social
<b>ERM:</b>	Enterprise Risk Management
<b>ESAP:</b>	Environmental and social Action Plan
<b>ESG:</b>	Environmental, Social and Governance
<b>FCI:</b>	Food Corporation of India
<b>FGD:</b>	Focus Group Discussion
<b>FPIC:</b>	Free, Prior and Informed Consent
<b>FSC:</b>	Forest Stewardship Council
<b>GDP:</b>	Gross Domestic Product
<b>HCS:</b>	High Carbon Stock
<b>HCV:</b>	High Conservation Value
<b>IFC:</b>	International Finance Corporation
<b>IPCC:</b>	Inter-governmental Panel on Climate Change
<b>ISPO:</b>	Indonesia Sustainable Palm Oil scheme
<b>KPI:</b>	Key Performance Indicators
<b>M&amp;E:</b>	Monitoring and Evaluation
<b>MSPO:</b>	Malaysia Sustainable Palm Oil
<b>NDC:</b>	Nationally Determined Contribution
<b>NDPE:</b>	No Deforestation, No Development of Peatlands, and No Exploitation
<b>ODI:</b>	Overseas Development Institute
<b>OECD:</b>	Organisation for Economic Co-operation and Development
<b>PSL:</b>	Priority Sector Lending
<b>RBI:</b>	Reserve Bank of India
<b>RSPO:</b>	Roundtable on Sustainable Palm Oil
<b>SBTi:</b>	Science-based Targets Initiative
<b>SME:</b>	Small and Medium Enterprise
<b>TCFD:</b>	Taskforce on Climate-related Disclosures
<b>TNFD:</b>	Taskforce on Nature-related Financial Disclosures

# EXECUTIVE SUMMARY

Risks from climate change, deforestation and land-use degradation are growing. The agriculture commodities sector is particularly prone to these risks. India is a dominant refiner, processor and consumer of palm oil mostly imported from Southeast Asia. This makes its businesses and financial stakeholders vulnerable to potential climate and nature related risks in the palm oil value chain.

This document is aimed to act as a guidance for Indian financial sector stakeholders, to enable better understanding of climate risks, why is it an urgent and pressing danger, how it transmits through business and economic impacts into climate-related financial risks, and ultimately impacts the conventional risks of the financial institutions.

Further, it offers a set of action-points on how to manage these emerging risks in their lending/investing decisions. These action-points are categorised into governance, strategy, risk management and metrics in line with the Taskforce on Climate-related Disclosures (TCFD) recommendations. Following these steps would enable financial institutions plan better in the face of these risks, mitigate them, and channelise financing towards sustainable palm oil, and sustainable agro-commodities in general. The guide aims to mobilise more sustainable finance in the agro-commodities sector.

The following box depicts the information and action points that Indian financial institutions should consider about a potential investee or counterparty, to gauge how well they are managing risks related to climate change, deforestation and degradation. Most Indian banks adhere to an Environment and Social Framework (E&S) framework as a checklist, mostly designed for infrastructure projects to assess issues like floods, pollution, rehabilitation, etc. Even the IFC Performance Standards and Equator Principles, that many banks are signatories to, are often used for project financing. Hence, there is a need to re-look at the approach of financing decisions around agro-commodities, like palm oil, in order to better manage potential risks.

**Governance** covers action-points like; putting in place a Board to oversight mechanisms and structures, to see whether technical climate experts are being inculcated at the Board-level, improving the institution's climate competency, and institutionalization of the oversight process

**Strategy** looks at whether climate change and deforestation risks are being included in the 4 P's of financial institutions (i.e., products, portfolio, policies and progress) along with the need to develop alternate financial products and incentive structures to boost financing towards sustainable commodities, conducting of active engagement with companies for awareness and adherence, complying with specified use-of-proceeds while raising green capital and avoiding incidents of greenwashing

**Risk Management** looks at how a financial institution should approach risk at the pre, during and post-investment stages, in order to reduce the incidences of transmission of these risks to conventional risks of the financial institution. It also looks at issues around data, traceability and monitoring, for both new investments and existing portfolios. It mentions the need to conduct a baseline assessment of risks

**Metrics/Disclosure** covers metrics specific to palm oil-related sustainability risks that may be used by financial institutions towards disclosures, the need to apply these metrics in the core business, not just as an additionality and meeting the changing expectations of stakeholders from disclosures

# I. INTRODUCTION

## 1. TARGET AUDIENCE OF THE REPORT

This report is targeted at the risk management, finance, credit and investment officers, at mid- and senior levels in Indian financial institutions to enable them to take better credit and risk decisions. It is also targeted at financial sector regulators, training institutes, and industry associations, as it would help create knowledge and awareness of these risks.

## 2. METHODOLOGY AND STRUCTURE OF THE REPORT

The report is compiled based on internal analysis, secondary research of good practices and developments and inputs from financial sector stakeholders from FGD stakeholder engagement calls curated towards this project. This approach has helped in making the report more contextual for the target audience.

As mentioned in the Executive Summary, this report is built along the lines of the four recommendations of the TCFD standard. TCFD is a comprehensive standard to assess climate-related risks and impacts to an organisation. Its four recommendations, i.e., governance, strategy, risk management and metrics/disclosures, have been used to guide the framework for this report. With the awareness of TCFD picking up in financial circles, including in India, this structure may make it easier for Indian financial institutions to contextualize and approach these risks in practice.

## 3. CONTEXT

### Climate change: A growing concern for the economy and financial institutions

IPCC, the Intergovernmental Panel on Climate Change that analyses the science of climate change, defines climate change as changes in the state of climate, in terms of shifts in its variability or mean, that are observed over an extended period. As per the IPCC's 6th Assessment Report, 'The Physical Science Basis,' the planet's temperature was already ~1.1°C<sup>1</sup> higher in 2011-2020 vs. pre-industrial levels (with a higher ~1.6°C increase observed over land surfaces). The number seems small, but each degree shift holds significant ramifications for the economy, which concerns business and financial stakeholders. For instance, Swiss RE estimates global GDP could shrink by ~11%<sup>2</sup> by 2050 in a ~2°C scenario, with declines of ~17% expected in Asian developing countries.

**~1.6°C**  
rise in land  
surface  
temperature  
during 2011-  
2020, from  
pre-industrial  
levels

To explain climate-related financial risks, they refer to potential negative impacts of climate change on an organization. This also includes risks that arise from efforts to reduce the effects of climate change. These negative changes are termed climate related financial risks and they directly or indirectly, impact the financial stability of an organization and hence, its lenders and investors. A 2020 report by Intelicap and Shakti Foundation estimates climate change could cost businesses and investors globally over ~USD1.2tn<sup>3</sup> over the next 15 years. Even the Basel Committee on Banking Supervision, a forum that sets standards for prudential regulations of banks mentioned in a 2021 report that economic/financial impacts associated with climate change are expected to cause considerable future losses<sup>4</sup> for banks, as they may transmit and impact banks' conventional risks like credit risk, market risk, operational risk, IT risk, compliance risk and reputation risk.

<sup>1</sup> [https://www.ipcc.ch/report/ar6/wg1/downloads/report/IPCC\\_AR6\\_WGL\\_SPM\\_final.pdf](https://www.ipcc.ch/report/ar6/wg1/downloads/report/IPCC_AR6_WGL_SPM_final.pdf)

<sup>2</sup> <https://www.weforum.org/agenda/2021/06/impact-climate-change-global-gdp/>

<sup>3</sup> [https://shaktifoundation.in/wp-content/uploads/2020/09/CLIMATE\\_RISK\\_MAINSTREAMING\\_APPROACHES\\_FOR\\_INDIAN\\_FINANCIAL\\_INSTITUTIONS.pdf](https://shaktifoundation.in/wp-content/uploads/2020/09/CLIMATE_RISK_MAINSTREAMING_APPROACHES_FOR_INDIAN_FINANCIAL_INSTITUTIONS.pdf)

<sup>4</sup> <https://www.fsb.org/work-of-the-fsb/financial-innovation-and-structural-change/climate-related-risks/>

**Climate-related financial risks can broadly be categorized into three types, as shown below:**

Physical risks	Transition risks	Liability risks
<ul style="list-style-type: none"> <li>• Arise due to climate change related weather events</li> <li>• Acute events include floods, storms, cyclones, heatwaves, etc.</li> <li>• Chronic events include gradual rise in temperature, precipitation, sea-level, etc.</li> <li>• Apart from direct impact on infrastructure, it includes indirect supply chain risks</li> <li>• Banks &amp; FIs are affected due to the impact on borrowers' continued ability to repay</li> <li>• Agriculture, energy utilities, real estate, infrastructure sectors most impacted</li> </ul>	<ul style="list-style-type: none"> <li>• Arise from efforts to address climate change effects</li> <li>• Such efforts may lead to shifts in regulations or policy, technology innovations or market dynamics (consumer demand preferences)</li> <li>• Banks &amp; FIs are affected due to risks of stranded assets, fines, compliance costs, etc.</li> <li>• Carbon-intensive sectors like energy, mobility, as well as food and real estate most impacted</li> </ul>	<ul style="list-style-type: none"> <li>• Arises when compensation for losses suffered from physical or transition risk events is sought</li> <li>• Mostly impacts insurance players within BFSI space</li> <li>• Impacts availability of insurance, and quantum of premium, going ahead</li> </ul>

In India specifically, a ODI report, 'Costs of climate change in India', estimates the country is already experiencing damages at ~1°C<sup>5</sup> of global warming. Apart from extreme weather, climate variability is also visible. For example, after a drought in 2018, both 2019 and 2020 saw above average monsoons in India, with a dry spell in June-July followed by extreme deluge in August-September. Such types of climate variability have repercussions for a number of economic sectors across the country.

Further, a 2021 CDP report, which analysed 39 large Indian companies and banks for risk from climate change to their businesses, found as much as ~85% of the estimated ~USD 100bn<sup>6</sup> at risk pertained to three financial institutions alone, with most of this risk attributable to agriculture and high-carbon assets.

**~85%**  
of estimated  
business at risk  
attributed to  
three Indian FIs

**Climate risks and Agro-commodities**

What adds to this situation is most of the climate action by the financial sector globally, has largely focused on the energy and industrial sectors, owing to the discourse around fossil fuels. This has been the general feedback of most Indian financial institutions as well. However, agriculture, forestry and land use were the 2<sup>nd</sup> largest source of emissions<sup>7</sup> in 2016, as per a study by ClimateWatch and WRI. UNEP's report, 'Becoming Generation Restoration', highlighted ~50%<sup>8</sup> of global GDP is connected to natural assets which are being degraded by emerging risks of climate change, deforestation and land use degradation. The last decade saw ~13mn<sup>9</sup> hectares of tropical forests deforested each year. That is equivalent to the total area of Bangladesh eliminated each year, only for agriculture commodities. IPCC's Special Report on Climate Change and Land estimated ~23%<sup>10</sup> of global emissions were from land use, of which ~11% pertained to deforestation while ~12% related to agriculture, of this ~11%, ~7% were attributable to tropical deforestation, of which ~5% were from agricultural commodities. Further, Climate Trace's data adds that of the 11.3<sup>11</sup> GtCO<sub>2</sub>e emissions globally from forestry and land-use in 2020, 58% were from fires and 31% were from forest clearing. Both these activities are driven partly by agricultural commodities' plantations.

**2<sup>nd</sup>**  
highest  
contribution to  
GHG emissions,  
from agriculture,  
forestry & land  
use

<sup>5</sup> <https://odi.org/en/publications/the-costs-of-climate-change-in-india-a-review-of-the-climate-related-risks-facing-india-and-their-economic-and-social-costs/>

<sup>6</sup> <https://www.fortuneindia.com/enterprise/india-inc-faces-713-lakh-crore-climate-change-risk/105819>

<sup>7</sup> <https://ourworldindata.org/ghg-emissions-by-sector>

<sup>8</sup> <https://wedocs.unep.org/bitstream/handle/20.500.11822/36251/ERPNC.pdf>

<sup>9</sup> <https://rainforests.mongabay.com/deforestation/>

<sup>10</sup> [https://www.ipcc.ch/site/assets/uploads/sites/4/2020/02/SPM\\_Updated-Jan20.pdf](https://www.ipcc.ch/site/assets/uploads/sites/4/2020/02/SPM_Updated-Jan20.pdf)

<sup>11</sup> <https://www.climate TRACE.org/inventory?sector=forests&time=2020&country=all-countries>



CDP's report, *Neglected Risk*, added corporate revenues of close to ~USD 1tn<sup>12</sup> globally depend on soft agro-commodities (derived from forests, plantations and agriculture) that place natural ecosystems at risk, driving climate change-induced risks to financiers and investors through their counterparties (borrower company or project) and investees. Financial institutions need to assess their impact and dependencies on nature, and their double-materiality with climate risks, they should deploy capital towards interventions that do not harm, but rather restore, natural ecosystems. As per CERES's 'Investor Guide to Deforestation', two-thirds<sup>13</sup> of tropical deforestation-related emissions is caused due to expansion of agro-commodities, like palm oil, soy, rubber, cocoa and coffee.

In India, an ICAR report said, 201 out of 573<sup>14</sup> rural districts are 'high-risk' in terms of vulnerability of agriculture to climate change. Further, a Down to Earth report indicated the country lost ~5mn<sup>15</sup> hectares of crops in 2021 due to extreme weather conditions. The impacts of climate change are worsened by the fact that most of these losses are uninsured;<sup>16,17</sup> for instance, in India itself, an Earth Security Group report says ~80%<sup>18</sup> of the ~USD 9-10bn economic losses the country faces annually from extreme weather events are uninsured.

**~\$1tn**  
in global  
corporate revenue  
depends on  
forest-risk soft  
commodities

The risks to agriculture ecosystems, owing to climate and deforestation issues:

<b>Output</b>	Changes in climate patterns owing to deforestation-induced climate risks, lead to weather changes, water shortages, pest incidents, etc., which imply production losses, more so in monoculture models.
<b>Pricing</b>	Volatility in output quantity, supply chain disruptions and input pricing may impact price of output, and thus the farmers' income.
<b>Market Access</b>	Damage to transport routes and infrastructure can impede the ability to transfer the harvest to market and vendors in time, a challenge for perishable commodities. This also includes damage to warehouses and storage facilities.
<b>Farm Families</b>	There is a social risk for farm families, impacted by dwindling yields and output, which often accelerates economic distress-led migration from rural to urban clusters.

Overall, this situation makes it imperative for financial institutions to consider risks from climate change, deforestation and land use degradation, in their financial decision-making.

### Focusing on palm oil

- Palm oil is considered a high-risk agro-commodity, both in terms of social risks related to land-grabs<sup>19</sup> and child labour, as well as environmental risks related to emissions, deforestation, peatland conversion and biodiversity loss<sup>20</sup>. As per UNDP's Palm Oil Scoping Paper, cultivation of palm oil globally expanded by ~0.3mn<sup>21</sup> hectares each year during the early 2000s. In the financial year 2018-2019, palm oil production globally was estimated at ~71mmt<sup>22,23</sup>, and this is only expected to increase owing to the crop's competitiveness as compared to other edible oils.
- A substantial share of palm oil globally is produced and consumed in large-population Asian developing countries. This is because over ~85%<sup>24</sup> is produced in Indonesia and Malaysia, with ~40%<sup>25</sup> of land under production globally cultivated by smallholders. Similarly, 60%<sup>26</sup> of consumption since last two decades has been driven by China, India, Indonesia, Pakistan, Thailand, Bangladesh, Philippines, Malaysia and Vietnam, where socio-economic conditions to create jobs and a general lack of awareness about regulations on sustainability and climate risks makes it tough to push towards a transition to sustainable alternatives like CSPO.

<sup>12</sup> [https://cdn.cdp.net/cdp-production/cms/reports/documents/000/004/574/original/CDP\\_China\\_soy\\_finance\\_research\\_report.pdf?1559310918](https://cdn.cdp.net/cdp-production/cms/reports/documents/000/004/574/original/CDP_China_soy_finance_research_report.pdf?1559310918)

<sup>13</sup> <https://engagethechain.org/investor-guide-deforestation-and-climate-change>

<sup>14</sup> <http://www.nicra-icar.in/nicrarevised/images/publications/Risk%20&%20vulnerability%20assessment%20of%20Indian%20agriculture%20to%20climate%20change.pdf>

<sup>15</sup> <https://www.downtoearth.org.in/news/climate-change/climate-crisis-has-cost-india-5-million-hectares-of-crop-in-2021-80809>

<sup>16</sup> <https://www.munichre.com/en/risks/natural-disasters-losses-are-trending-upwards.html>

<sup>17</sup> <https://phys.org/news/2022-07-extreme-weather-billion-losses.html>

<sup>18</sup> <https://earthsecuritygroup.com/wp-content/uploads/2016/06/ESG.IndiaInsurance.pdf>

<sup>19</sup> <https://www.maplecroft.com/insights/analysis/palm-oil-cobalt-highest-risk-for-commodity-linked-land-grabs/>

<sup>20</sup> <https://engagethechain.org/palm-oil>

<sup>21</sup> <https://www.undp.org/content/dam/undp/library/Environment%20and%20Energy/Green%20Commodities%20Facility/Palm.oil.scoping.paper.pdf>

<sup>22</sup> <https://www.unilever.com/planet-and-society/protect-and-regenerate-nature/sustainable-palm-oil/>

<sup>23</sup> <https://ourworldindata.org/palm-oil>

<sup>24</sup> <https://www.iucn.org/resources/issues-briefs/palm-oil-and-biodiversity>

<sup>25</sup> <https://chainreactionresearch.com/report/future-smallholder-deforestation-possible-palm-oil-risk/>

<sup>26</sup> [http://goodgrowthpartnership.com/wp-content/uploads/GGP-Workshop\\_Developing-Opportunities-and-Solutions-in-Sustainable-Agricultural-Finance.pdf](http://goodgrowthpartnership.com/wp-content/uploads/GGP-Workshop_Developing-Opportunities-and-Solutions-in-Sustainable-Agricultural-Finance.pdf)

- India, one of the largest consumers of palm oil imports the bulk of the palm oil used in domestic refining and processing industries. In 2020, it imported ~8.4 mmt<sup>27</sup> of palm oil. This was a marginal reduction from the numbers seen in earlier years<sup>28</sup> largely owing to Covid impact and an import duty hike following geopolitical issues with Malaysia. The decadal growth in imports was 4% CAGR from 2010 to 2020.
- Moving to CSPO specifically, it makes up ~20%<sup>29</sup> of global output. However, in India, CSPO holds a far less share of only ~3%<sup>30</sup>. Since palm oil's demand in large-population Asian developing countries is expected to remain strong owing to its favourable economics, driving engagement with countries like India is inevitable to channel more financing towards CSPO.
- Europe, another leading consumer of palm oil owing to biofuel blending, has seen regulatory initiatives which aim to channelize more funding towards products that are sustainable in nature. This is impacting its demand for conventional palm oil. In India, similar roll-outs by the RBI, such as the Sustainable Finance Taxonomy and push towards climate stress testing of bank portfolios, or industry's need to estimate extended carbon footprint, could provide a tailwind to drive the BFSI-sector's conversations around CSPO.

### Connecting palm oil with climate-related financial risks

- The main environmental concerns<sup>31</sup> in palm oil plantations are deforestation and emissions. The latter was estimated to be the cause of ~11% of global emissions in 2019. Large forest patches are cleared by burning, and converted into plantations for palm oil. The cost of regenerating the soil in existing plantations is often higher than cutting new forests, resulting in large-scale degradation of land. This is more so when regulations are still developing. There are also several social risks associated with palm oil cultivation, apart from the threat to biodiversity. Thus, climate change, deforestation and land-use degradation are most apt to pose risks to companies engaged in the palm oil value-chain, and lenders and investors to those companies.
- Southeast Asian nations, being upstream players engaged in production, face primary risks related to the conversion of cropland and forest cover for producing agriculture soft commodities. India, which falls majorly on the consumption side, is a downstream player in the palm oil value chain consuming for refining or processing of palm oil. It is impacted by secondary risks related to deforestation and land use, which might be transmitted across the supply chain in case regulations and policies come up to counter these risks. Downstream companies are more exposed to market and reputation risks, for example, water runoff from processing mills contains chemical sludge which could pollute local water bodies. With millennial consumers generally opting for more sustainable products by choice, there is a market-driven need to switch tracks to sustainable agro-commodities, even in palm oil. Thus, even for India, there is an imminent need for importing companies to source CSPO from their supply chains
- Indian financial sector is yet to see a meaningful interest from domestic companies about sourcing certified and sustainable palm oil because there is a cost associated with sustainable products and there is a general lack of incentive amongst companies and financiers to do so. Most Indian financial institutions also do not yet have a process to check whether the investee/counterparty company sources from RSPO-certified supply chain or not, as part of their credit assessment
- For Indian banks, the financing of palm oil trade occurs mostly through trade finance (for imports) and wholesale finance (for refining, processing and related activities). Trade finance includes both fund and non-fund-based exposures, while wholesale finance comprises fund-based exposures through term loans and working capital lines. It is assumed fund-based exposure to palm oil would largely fall under the edible oils segment

As per RBI's credit data of banks for fund-based exposures, food processing segment comprised ~2% of credit, while edible oils (a part of food processing) comprised ~0.2-0.4% of credit in recent years.

27 <https://www.indexmundi.com/agriculture/?country=in&commodity=palm-oil&graph=imports>,

28 <https://www.businesstoday.in/current/economy-politics/india-palm-oil-import-at-9-month-low-after-27-fall-in-feb/story/433696.html>,

29 <https://www.eco-business.com/news/what-is-sustainable-palm-oil/>

30 <https://chinadialogue.net/en/business/pioneering-sustainable-palm-oil-in-india/>

31 <https://engagethechain.org/palm-oil>

- However, while these numbers seem low relatively, these must be read in conjunction with the basic nature of refined palm oil product. Given its favourable economics and wide applicability, it is used across several industries, from food and beverages, cosmetics and personal care, chemicals, etc. It is the most-used cooking oil amongst Indian commercial food establishments, as well as many households; making risks associated with unsustainable palm oil a risk to India’s food security. Any initiative to tackle climate, deforestation, or land degradation risks to palm oil would impact the value-chain and output of several industries it is supplied to. Banks would have credit exposure to those sectors as well, which magnifies the overall Value-at-Risk
- Moreover, the context of engaging with Indian financial sector players and policymakers on the topic of including climate and sustainability considerations in financial decision-making must be seen beyond the scope of palm oil. It is understood that it is tough for banks to look at steps for financing of sustainable palm oil, when it has materially higher exposure to other sectors. Thus, looking at climate, deforestation and land-use degradation risks with a wider lens of agriculture soft commodities, rather than palm oil, may be a more pragmatic approach with Indian financiers. After all, these risks would impact most commodities, and lenders may have higher exposure to those commodities as compared to palm oil

### Risks to financial institutions, given issues with climate, deforestation and land use degradation

The impact of climate risks on the economy and the financial system can occur via asset destruction, income and work disruption, stranded assets and declining wealth/profitability. This would hold true for both palm oil (and agro-commodities) as well as other industries in the economy, barring any sector-specific nuances.

<b>Credit risks or Investment risks</b>	Climate risks impacts farm output, its continuity in specific regions, and disrupts supply chain and transport routes, thus hindering the borrowers’ ability to earn. It impacts the productivity and mortality of farm workers, again impacting output. It may impact the value of real assets, like warehouses, kept as collateral. All these impacts to the borrower/investee, may lead to credit risks or investment risks for the financial institutions. The borrowers’ lack of adaptability or agility to tap the changes in the regulatory landscape in this space, may also accelerate these risks.
<b>Market risks</b>	Volatility in output quantity and pricing, or increase in prices of inputs, may lead to market risks and losing out on contracts. Since most agriculture soft commodities are imported or exported in the value-chain, restrictions to their foreign trade may also imply market risks.
<b>Compliance and Reputation risks</b>	There is a risk of compliance and legal action, in case of penalties levied for violating environmental standards, causing harm to local communities or owing to impact of regulations like carbon pricing on the palm oil business, not to mention ensuing reputation risks. The need for transparent product disclosures is also picking up.
<b>Liquidity risks</b>	Dwindling financial standing of the corporate borrowers in the agribusiness sector may impact their credit rating, and hinder their ability to raise funds, or access growing pools of green capital abroad, leading to liquidity risks.
<b>Physical and Transition risks</b>	Apart from acute or chronic weather-related physical risks of climate change, transition risks of climate change may impact soft commodity sectors in case policy or market dynamics change. The inability of suppliers to deliver the required quantum as per new criteria may be a risk, as would be changing demand preferences of consumers.

Of course, a lot depends on the availability of granular data; and there is often a need to use intuitive or proxy data in the absence of actual data. Data availability and asymmetry is anyway a critical challenge in the Indian agriculture ecosystem.

It must be noted here that the Indian central bank, RBI, is a signatory to the NGFS (Network for Greening the Financial System), and a key component of NGFS is a higher capital charge for non-sustainable funding, or lower risk weights for sustainable financing. As and when the NGFS recommendations are rolled out for Indian banks, banks that enable funding of sustainable commodities like palm oil would benefit from a lower capital charge.



## The other side of risk is opportunity

At the same time, climate risks also pose opportunities related to climate action. World Economic Forum's report, Role of Financial Sector in Deforestation-Free Supply Chains, says deforestation-free agricultural practices offers an investment opportunity of ~USD 200bn<sup>32</sup>.

With India promoting palm oil cultivation as part Atmanirbhar Bharat<sup>33</sup>, to reduce the import bill and promote food security. In August 2021, the union government launched a new Mission on Oil palm to be known as the National Mission on Edible Oils – Oil Palm (NMEO-OP) as a new Centrally Sponsored Scheme. A financial outlay of Rs.11,040 crore has been made for the scheme, out of which Rs.8,844 crore is the Government of India share and Rs.2,196 crore is State share and this includes the viability gap funding also.

**Domestic**  
palm oil plans can help pilot sustainable palm oil financing right from the outset

Under this scheme, it is proposed to cover an additional area of 6.5 lakh hectare (ha.) for oil palm till the year 2025-26 and thereby reaching the target of 10 lakh hectares ultimately. The production of Crude Palm Oil (CPO) is expected to go up to 11.20 lakh tonnes by 2025-26 and upto 28 lakh tonnes by 2029-30. The scheme will immensely benefit the oil palm farmers, increase capital investment, create employment generation, shall reduce the import dependence and also increase the income of the farmers. There is a significant opportunity to drive financing towards sustainable palm oil right from the outset, because climate, deforestation- and land use-induced risks may now impact Indian companies and financiers as primary risks itself.

However, for domestic palm oil production to scale up, price competitiveness is crucial. A key reason for Indonesia and Malaysia contributing over ~85%<sup>34</sup> of global palm oil is owing to their ability to produce palm oil at the most competitive price. This is further evidenced by the fact that major consumers of palm oil sourced from Southeast Asia, are highly price-sensitive Asian markets. While Indian regions may have similar climatic conditions like Southeast Asia, price competitiveness depends on myriad of factors. Till then, uptake from corporate buyers of palm oil may be limited. This is crucial because Indian financial sector stakeholders feel sustainable agro-products, in general, are priced higher than conventional agro-products which impacts demand pull from the larger middle class consumer base. Market availability is a key criteria for financing decisions into sustainable products. Moreover, they opine improving productivity is a factor of many things including water-use efficiency, fertilizer efficiency, reduction of intermediaries, creation of value-chain linkages, etc., and not just cultivating sustainable palm oil. However, once price competitiveness is achieved, this domestic plan may be an ideal springboard to create a case-study on financing of sustainable palm oil, since it is easier to introduce new practices before a market reaches maturity.



Photo Source: Mike Norton

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33 <https://www.financialexpress.com/economy/rmodis-atmanirbhar-bharat-how-palm-oil-cultivation-can-make-india-self-reliant-in-edible-oil/2037185/>

34 <https://www.worldwildlife.org/stories/endangered-species-threatened-by-unsustainable-palm-oil-production>



## II. APPLICATION

The following section provides actionable measures for the financial institutions in India to consider for preventing/and or mitigating climate related risks in the palm oil sector.

*This section on governance covers governance-related aspects of the potential investee/counterparty that a financial institution must consider, as part of its risk management and credit appraisal decision in order to gauge how well they are managing risks related to climate change, including deforestation and degradation. This also includes criteria like Board oversight mechanisms and structure, inclusion of climate technical experts at the Board-level, institutionalization of the overall oversight process and improving the organisation's climate competency matrix*

### 1. Put in place Board and Management oversight mechanisms and reporting structures

Financial institutions hold public money and have a fiduciary duty towards their debtors. Their Boards and management hold responsibility to oversee potential risk factors impacting the portfolio, including how emerging risks from climate change and deforestation will impact the conventional risks in its ERM frameworks (like credit risk, market risk, compliance risk, etc.). Putting in place oversight mechanisms would mean setting up Board-level committees, identifying processes to assign responsibility, highlighting chain of command to follow, identifying who needs to respond, putting in place a response mechanism to be used, putting in place KPIs and track their progress and lastly, frequently to report to the Board and management on that progress. There is a need to separate the responsibility of risk oversight vs. day-to-day risk management, thus delineating the two roles.

#### How are sample banks developing Board oversight structures

Several financial institutions, especially in Europe in order to oversee climate risks are putting in place a climate change risk committee at the Board-level. In most cases, this is chaired by the Chief Risk Officer and/or a senior business officer, who are backed by an internal climate management group comprising of members from across functions. This committee assigns roles and responsibilities, designs response mechanisms, reporting structures along with KPIs and monitoring progress. Large banks, like ING<sup>35</sup> of Netherlands as per its 2021 Climate Report, have put such Climate Change Committee structures in place. However, in most Indian financial institution, ESG risks are still under the purview of the CSR Committee. A quick scan of annual reports of select large banks shows only one bank, i.e., Axis Bank, explicitly mentioning a dedicated ESG Committee that has been recently institutionalised to oversee ESG risks.

Only **1**  
Indian bank, out  
of select large  
banks, has a  
dedicated ESG  
Committee for  
climate risk  
oversight

Closer home in Asia, DBS of Singapore has been a regional leader in terms of bringing in ESG and climate risk practices into its oversight mechanisms, in a manner that is investor-focused and is in line with the guidance provided by NGFS and other regulatory initiatives. Its governance oversight structure involves a Sustainability Council, which is chaired by the Chief Sustainability Officer, but comprises of senior leaders from across business and support functions. This helps add a cross-functional perspective to its approach on business sustainability. This Council reports to the CEO, and a member of this Council also heads the Bank's Sustainable Finance team. To that extent, aligning the Council to the Board and delineating it from business operation functions may augur better from the governance oversight perspective.

### 2. Bring in technical experts and improve the financial institution's climate competency matrix

A barrier towards adoption of climate and ESG risk management practices by banks in emerging economies, has been the poor understanding by their managers of the appropriate internal policies that may be required around climate action. Thus, climate risk oversight also implies improving the overall climate competency matrix of the financial institutions' managers. This involves doing the following:

<sup>35</sup> <https://www.ing.com/MediaEditPage/2021-Climate-Report.htm>

Hiring technical climate experts in the Board to help the institution be better prepared	Ensure the technical experts are experienced in both physical and transition-related risks	Provision for awareness-building or training of the Board, on climate related financial risks	Training the management, who would be working on and reporting to the Climate Committee	Establishing the chain of command and responsibilities, across the organisation hierarchy
Reporting the details of the experts, progress, and the Committee's work, in annual reports	Monitoring, verification and grievance mechanisms, for climate risk progress, supplier compliance, negative news or client feedback	Ability to recognise and leverage the opportunities that climate change provides	Aligning key management compensation with climate KPIs, to bring in more accountability	Ability to respond to growing activism by shareholders and investors on climate issues

### 3. Institutionalise climate oversight processes in the financial institution, irrespective of the CEO's tenure

The other advantage of putting in place oversight mechanisms in the form of a climate-competent Board and Board-level climate committees, is to make climate action into an ongoing process. Often, it has been observed that climate action becomes CEO dependant. Motivated CEOs put in place strategies and mechanisms, but these cease once that CEO departs after their tenure. To overcome this issue, there is a need to put in place oversight mechanisms and improving the climate competency matrix would help institutionalise this as a process, with clear timelines, targets and hierarchies. Institutionalizing would involve putting in place that aligns as climate risks with the institution's risk appetite framework (or risk appetite statement) and credit and investment strategy, inclusion of these risks during risk assessments of counterparties or investees and driving climate as a strategic priority.

To summarise, the Governance Checklist would comprise of:

Governance	Put in place Board and Management oversight mechanisms and structures
	Bring in technical experts and improve the climate competency matrix of the institution
	Institutionalize the oversight processes

## ACTION POINTS ON STRATEGY

*This section looks at Strategy-level considerations that the financial institution must look at, in order to take more informed decisions while addressing climate risks. This also covers inclusion of climate and deforestation issues in the 4 Ps of financial institutions (i.e., products, portfolio, policies and progress), developing alternate financial products as well as incentive structures to boost financing towards sustainable commodities, conduct active engagement with companies to raise awareness and adherence, ensure compliance with specified use-of-proceeds while raising green capital and avoid deliberate and inadvertent incidents of greenwashing*

### 1. Include climate and deforestation within the 4 Ps for financial institutions: Portfolio, Policies, Products and Progress

Integrating climate change aspects within business strategy holds implications from risk and opportunity standpoint. The financial institution may aim for projects or companies, that reduce emissions and land degradation, sequester carbon at-scale, or improve resilience of the farm communities. At the same time, any targets, say in emissions, set out by the investee or counterparty, to which sustainable finance terms may be linked, must be against a baseline scenario.

**4 P's**  
to integrate these risks  
into business strategy  
of a FI

For a financial institution, the integration of these risks into business strategy may be looked from the perspective of 4 P's: Portfolio, Policies, Products and Progress:

Portfolio	Policies	Products	Progress
Reduce the exposure of business activities, and financial portfolios, to physical and transition climate risks	Adherence to NDPE, IFC P/S, EP or certifications, so that pledges are followed with action, within business and financial models	Alternate sources of finance, like green or sustainable bonds, blended finance or even sustainable letter of credit, that promote sustainable land use and deforestation-free supply chain as part of use-of-proceeds	Hasten low-carbon transition; and in case of palm oil, transition which is deforestation-free and less chance of land degradation
Reduce misalignment in capital allocation to carbon-intensive strategies, via targets to reduce exposure to risky sectors	This is more so in high-risk countries, where these risks need to be made part of materiality assessments	Financial products with incentives that promote deforestation-free practices and natural ecosystem restoration, like sustainability-linked bonds or loans	Promote land conservation amongst palm oil value chain, including HCV and HCS land areas
Increase policy advocacy to have a regulatory framework for export of sustainable agro-products, in order to enhance market availability	Policies to be put in place for timebound KPIs on emissions, escalation measures, disclosure of progress and communication of expectations to partners	Financial products promoting circular economy practices, by institutionalising the use of palm oil agro-residue, as input for other interventions	Better results for adaptation by mitigating emissions, because adaptation by itself cannot yield meaningful impact if mitigation remains a challenge

## 2. Conduct active engagement with investees/borrowers, within strategy integration

Integrating aspects related to borrowers' sustainability policies, progress and business value-chain into the strategy of the financial institution would require active engagement with those counterparties. Furthermore, in order to assess the portfolio's financed emissions and carbon footprint, understand their commodity sourcing patterns for identifying where the risk lies, track their progress to mitigate those risks, assess whether their targets are in line with Paris Goals or SBTi, follow-through on the pledges they had made, or nudge them by voting on shareholder resolutions. Moreover, the lending criteria for a transaction needs to look at the buyer-seller relationship along with the nature of the receivables by when they would be converted to cash, the ability of the seller to find alternate buyers in case of market disruption, and related aspects of the agribusiness value chain. All these should also form part of active engagement of the financial institution strategy.

In the Indian mutual fund industry, the ESG assessment models are mostly active engagement-related, including up to Tier 2 or 3 suppliers, and so this may be useful approach to build upon.

## 3. Develop alternate products and incentives, to shift financing from public to commercial investors

While the matrix in the 4 Ps section highlighted the need for financial products that incentivize deforestation-free practices, also needed to focus on this simply because conventional financial products in India are not really designed as per the risk-return-impact paradigm; rather they only focus on financial risk and return.

Thus, until alternate financial products that combine risk-return-impact scale up, it would be tough to turn the spotlight towards emerging issues like climate, deforestation and land use within conventional financial products. Such products may also involve longer tenors than normally seen in Indian banking space, while targeting use-of-proceeds that traditionally were not in the radar.

Within the green bond space, sustainable landscape bonds, ecosystem impact bonds, or forest resilience bonds are examples of alternate finance products. The use of green bonds still needs to pick up for sustainable land use which is estimated at only ~3%<sup>36</sup> of overall green bond issuances in 2020.

With palm oil predominantly being an import product in India's downstream value-chain, implying non-fund-based finance through trade finance facilities is often used, Trade finance products mirrored on IFC's sustainable letter of credit facility, where terms are linked to sustainable commodities and supply chain, may be useful alternate products to consider.

Other alternate mechanisms may involve risk-sharing models between private and public sector investors, where restoration costs are shared, or a guarantee or credit enhancement is provided, given the nuances of the natural capital sector. Alternate products not only help ecosystems, but also communities, while pushing the country closer to the NDCs. Another alternative is value-chain based financing. It evaluates palm oil growers, processors and traders in order to understand the nature of buyers and sellers, the strength of their relationships, and goes much beyond the financial indicators.

Such innovative financial products almost often include an incentive for issuers to look at those options. The incentive may be from the risk or opportunity standpoint. At the same time, incentives need not always be in the form of a discount in the interest rate if sustainability KPIs are met within a sustainability-linked bond, or payment of interest by an outcome payee in case pre-defined outcomes are met, as is the case in a outcome-based financing mechanism.

Role of **incentives** since conventional finance is unable to consider impact

Rather, incentives might also be created in the form of:

- Carbon credits for protecting HCV or HCS forest areas, which is more contextual to plantation crops like palm oil. For example, plantation farmers may be included within innovative financing mechanisms wherein the sale of carbon credits generate revenue.
- While research is still ongoing on whether sustainable agriculture indeed leads to improved land use and crop yields over time, such evidence would be useful to make the case for further cultivation of certified and sustainable palm oil.
- Tax holiday by the government of the exporting or importing country, given soft commodities like palm oil are traded across borders.
- Extension of tenors, because land- and forest-restorative production is often long gestation in nature, placing them outside the time horizon of conventional finance.
- Bulk off-taker arrangements to buy certified, sustainable palm oil at scale.
- Mechanisms like payment for ecosystem services, to enable land users to earn by conserving their natural ecosystems and biodiversity, thus disincentivizing deforestation.
- Credit enhancement mechanisms, like guarantees for sustainable land use projects, or innovations in trade finance products, like sustainable shipment letter of credit. In India, guarantees have worked well in microfinance.

**Carbon pricing** may help move the needle as an incentive towards CSPO

Higher allocation of public monies towards land use and forestry projects, which could be woven into blended finance structures, such that it gives comfort to private sector investors.

#### 4. Avoid risks of greenwashing

At the same time, the lack of a uniform definition of green (or ESG) in most markets, including India, creates a situation where green business strategies are often hauled up for inadvertent or deliberate greenwashing. This impacts the company's reputation and market risks.

<sup>36</sup> <https://www.globallandscapesforum.org/publication/how-can-green-bonds-catalyse-investments-in-biodiversity-and-sustainable-land-use-projects/>



A guidance, in the form of a Sustainable Finance Taxonomy, which India is currently working on<sup>37</sup>, would be useful in providing a uniform definition. Cases of greenwashing, moreover, only makes market players in India sceptical of the discourse around sustainability and climate action. In order to scale up interest in India towards these issues, especially from commercial financial institutions, roll-out of such regulations is the need of the hour.

**Adherence to  
good  
practices**  
of industry leaders,  
in absence of a  
uniform regulatory  
definition, may help  
add credibility

Till the time a uniform definition is in place, it is crucial to align policies around climate action and deforestation to a standard that represents industry good practice, as an alternate approach. These may be guidelines or policies followed by market leaders in the sustainable financing space, since that would still offer a degree of credibility to an institution’s approach. The other part of this is to bring in external technical experts on this subject to advise the financial institution while devising appropriate policies and guidelines.

### 5. Comply with use-of-proceeds norms, for green finance towards sustainable palm oil

In terms of end uses against which green financing is raised, as per the project’s Capital Utilization Plan document, a general alignment may be needed as per the below yardsticks:

<b>Alignment with global goals</b>	<ul style="list-style-type: none"> <li>• SDGs (like climate action, sustainable consumption, clean energy or reduced inequalities)</li> <li>• Science-based targets (SBTi)</li> <li>• Aligning the portfolio’s financed emissions with a 1.5oC scenario</li> </ul>
<b>Upstream palm oil activities</b>	<ul style="list-style-type: none"> <li>• Sustainable cultivation practices (in line with RSPO, NDPE or related standards), and sustainable practices at the crude palm oil mills (that align with the global goals). These interventions align with protecting and restoring natural ecosystems, avoiding their degradation, promoting their capacity for carbon sequestration and low-carbon or climate-resilient agriculture practices, afforestation, etc.</li> </ul>
<b>Downstream palm oil activities</b>	<ul style="list-style-type: none"> <li>• Sustainable sourcing practices, in relation to refining or palm oil/kernel, processing for industries like food, personal and household care products, cosmetics, etc., or trading of palm oil products</li> </ul>

*To summarise, the Strategy Checklist must look at:*

<b>Strategy</b>	Inclusion of climate & deforestation in the 4 P’s for financial institutions
	Developing alternate financial products, and incentive structures
	Conducting active engagement with companies
	Avoidance of greenwashing
	Adherence to specified use-of-proceeds while raising green capital



Photo Source: RSPO

<sup>37</sup> CRB is part of a Ministry of Finance working group on sustainable finance, which is working on developing the taxonomy for sustainable finance in India. A task force was established in 2021. CRB would highlight the link between deforestation free supply chains (through sustainable palm oil) as an important pathway to mitigate climate and biodiversity related risks.

## ACTION POINTS ON RISK MANAGEMENT

*This section on Risk Management covers how a financial institution should approach risk at the pre, during and post-investment stage, in order to reduce chances of transmission of these new risks to the conventional risks of the institution. It also looks at issues around data, traceability and monitoring along with mentioning the need to conduct a baseline assessment of risks*

### 1. Mitigate risk at the pre-investment, investment and post-investment steps

Given palm oil's interlinkages with croplands, forests and natural ecosystems, commitments to certification standards like RSPO or policies like No Deforestation, No Development of Peatlands, and No Exploitation or NDPE (especially in case of corporate loans) and to financial standards like the IFC Performance Standards or Equator Principles (especially in case of project-based financing) are possible pre-investment steps to mitigate risks related to agriculture soft commodities. Adherence to such production-related certification may help in reducing eventual production risk and adherence to financial standards may reduce conventional risks related to compliance, credit and reputation. Gauging the impact of risks related to climate, deforestation and land degradation on the continuity or sustenance of the business model may impact credit and investment risk.

With deposit inflows to Indian banks remaining volatile, and generally slow, owing to India's consumption boom, banks are increasingly looking at alternate sources to raise liabilities. One avenue is to raise funding from multilaterals and development financial institutions. However, such institutions often demand an Environment and Social Management Plan (ESMP) when working with commercial banks, as part of their regular mandate to check if the banks have integrated sustainability into their operations. For risk management, the ESMS would then act as an E&S risk categorisation system for each transaction they work on. At the same time, using ESMS effectively and efficiently presupposes the bank's talent is able to do so. It has been observed that generally in the industry that many financial institutions lack the understanding to assess and use the assessment tools with respect to criteria around climate change and deforestation. Thus, capacity building of relevant actors is important.

Most Indian financial institutions have an E&S framework in place, as part of credit risk assessment processes. This typically covers issues like land acquisition, flood risk, rehabilitation, trees to be cut, etc. However, most Indian financial institutions are yet to consider risks related to climate, deforestation and land use degradation in their credit risk assessment frameworks. Financing sustainable palm oil, specifically, may require financial institutions to ask the investee or counterparty to put in place an ESAP framework (also called E&S Risk Management), which would help address the gaps with established standards, say, IFC Performance Standards. The framework should not only look at the environmental or climate targets, but also look at the demonstrated ability or action-plan of the counterparty/investee to achieve those targets. The same would hold true for social targets as well.

**Adherence**  
to standards, ESAP  
& protection plans,  
& approvals, key to  
risk management in  
palm oil

Moreover, even if all Indian banks and financial institutions put in place such criteria. The industry would also need a common and harmonious set of evaluation criteria for palm oil-related financing that would bring in consistency in the industry in terms of viewing risks related to palm oil financing.

Given the interlinkages with ecosystems, investees must develop a long-term Landscape Protection Plan to cover the High Carbon Stock (HCS) and High Conservation Value (HCV) land areas around the project site. This may include creating buffer zones, which may help to retain the region's biodiversity, Zero Burning techniques, etc. On the social risk front, an FPIC from all the local communities around the project site, may help.

In the investment stage, in India, banks like Rabobank have put in place exclusion screening criteria and extended due diligence processes at transaction-level, that states it would only invest in projects where the palm oil, being sourced, is compliant with necessary standards and certification. Banks like HSBC has zero tolerance policies towards certain commodities, which are complicit in damaging natural ecosystems. For a financial institution, such criteria or policies may generally be at project-, commodity or company-level and it may even use the findings from such due diligence for loan limitations or to adjust the loan to value, something not really being done now in Indian-owned banks. By making this part of the due diligence during investment assessment, risks flowing along the supply chain may be minimised, thus safeguarding Indian financial institutions.

However, integration of certification and standardization tools would need a strong policy framework. The upside is it may benefit sustainable palm oil growers in terms of a meaningful price differential over conventional palm oil, incentivising further adoption and demand of sustainable palm oil. And once the growers and traders are incentivised to do so, even the financial institutions servicing them would move towards sustainable finance products and strategies.

De-risking in the investment stage may also be achieved by using blended finance structures, wherein part of the risk is shifted from the commercial finance provider to sources of public/philanthropic capital. This in turn will help catalyse higher multiples of risk capital from private capital sources. Blending of public sector and private sector capital has often been instrumental to move the ground in case of sectors, geographies or market participants that are viewed as less material for the domestic conventional financial institutions. For example, while it is known palm oil is one of the key agri-commodities contributing towards emissions and deforestation risk, it's tiny share in the portfolios of Indian banks makes it less material for the Indian financial sector stakeholders. Hence, a need to leverage alternate approaches.

During the investment stage, as part of due diligence, most banks would prepare a Credit Appraisal Memorandum for each loan application, completed by the transaction's Relationship Manager. An initial ESG assessment may be done using data from the CAM covering the counterparty's approach to mitigate ESG/climate risks, their commitments, and progress. This may include site visits, third-party reviews or mandatory adherence to certification or standards. The results of this assessment may be used to make climate-related adjustments to loan covenants, collateral requirement or loan pricing, thus factoring in environmental and climate externalities into financial decision-making. That may help move the industry towards sourcing and financing sustainable palm oil.

**Consideration**  
of exclusion, due diligence,  
CAM risk assessment,  
materiality mapping &  
extended carbon footprint/  
intensity scoring key for  
Indian FIs

In addition, given that most Indian banks are yet to include climate-related risks within the materiality matrix in their sustainability reports, materiality assessment with internal and external stakeholders is itself a useful first-step Indian financial institutions might look at, to identify crucial risks.

The other part of materiality is that once the crucial risks are established, to quantify the risk to an extent. The experience of many European financial institution shows that carbon intensity scoring or carbon footprint analysis of the portfolio, has often been an initial step towards quantifying the climate risk to the books. In case of palm oil, extended carbon footprint which considers the risks at the upstream end from where the palm oil is being sourced into India, may be an ideal step to manage the secondary risks related to climate, deforestation and land use, that may impact Indian financial institutions.

The post-investment stage would include tracking the existing portfolio on the carbon metrics, their progress along the KPIs set around these issues and tracking negative news and controversies about the companies on these issues. This may include voting in shareholder meetings to bring in positive changes within the company's practices, as well calling back subsequent tranches of a sanctioned loan facility in case of non-compliance with metrics and KPIs.

In agriculture, this may include using remote sensing and satellite techniques to get the right images and data points for farmers to help them make better decisions, while also reducing reliance on more expensive foreign satellite images. Technologies to measure data about soil, moisture content, what kind of chemicals are required to optimize inputs which, in turn, would reduce the impacts of climate change also form part of this. For sustainable agriculture practices to be successful, there should be an improvement in the farmers' income, and this holds true in the palm oil space as well.

## 2. Consider issues around data, traceability and monitoring

- Climate, deforestation and land use degradation risks, if identified as material to portfolios, must form part of all the three lines of defence of risk management, i.e., at the stage of client onboarding and credit review, at the stage of independent risk assessment, and at the stage of internal audit and controls.
- However, a challenge lies in the availability of data. Since the availability of granular data is a key limitation, there is a need to mix qualitative and proxy data, along with quantitative inputs. At the

end, most models for ESG integration, combine probability-based scoring of the risk factors along with a degree of judgement call. This is owing to the paucity of hard data. Nevertheless, assigning a probability to score the data, is still an indicator; although these models need to be kept dynamic and iterations need to be done as and when new data comes up. Another aspect on data availability is a challenge specific to the developing countries. Forecast data on weather events have been developed in the advanced markets, while these data might not yet be fully accurate for developing countries. In such cases, it is essential to combine data from local, scientific sources with global forecasts. For instance, a UNEP-FI report, charting a New Climate, mentions Standard Bank of South Africa, while assessing the risks of physical climate events to its loan portfolio, combined local scientific sources because global forecasts of weather events were not available for Africa.

- Next, traceability to the source may help gauge the emissions at origin, and the deforestation risk related to that supply chain. This is more pertinent when extended carbon footprint is more critical than the direct carbon footprint. The development of new technologies related to blockchain, remote sensing, IOT, satellite imagery, etc., would help assess traceability better, and financial institutions must leverage these. Furthermore, this implies a need to develop more tools. In the biodiversity segment, the UN-backed ENCORE biodiversity module launched by Natural Capital Finance Alliance provides financial institutions with an analysis of the potential impact of their portfolio on species extinction risk and ecological integrity.
- Lastly, risk management is not just about screening new loan or investment applications, but also in terms of monitoring the existing portfolio. This includes monitoring negative events at the project or counterparty level, as well as tracking news (or controversies), an integral part of ESG screening.

### 3. Conduct a baseline assessment for risks

Every analysis starts from a baseline, and risk management by financial institutions for palm oil is not different, especially where financing of sustainable palm oil is concerned. This may involve the following activities:

- Calculation of financed emissions of the institution's portfolio, say using PCAF method, as part of carbon intensity scoring of the portfolio. This may include using an extended footprint approach, to cover palm oil sourced from other markets.
- Proportion of financed emissions, as a result of exposure to agriculture soft commodities, either as part of agriculture loan, wholesale finance, or trade finance portfolios.
- Since India is in the downstream segment of the palm oil value chain, Scope 3 emissions becomes critical for Indian financial institutions while assessing investees or counterparties, since Scope 3 looks at risks related to the supply chain.
- Current knowledge of the staff about climate and deforestation risks, and practices to manage these risks within the institution's credit or investment processes.
- Engage with palm oil investees and counterparties, to quantify their risk exposure from these risks, the KPIs they have set, and the progress they have made against those KPIs.
- Potential areas for intervention to reduce exposure to these risks, and prioritise them to start with low-hanging fruits that are likely to show faster outcomes.

### 4. Benefits, including from the perspective of conventional risks

In terms of benefits, understanding and management of the nuanced risks specific to the palm oil value chain, would help gauge how these would impact the conventional risks for the financial institution.

The broad ways in which better management of risks related to climate, deforestation and land use degradation would translate to the conventional risks of the institution, include:

- Continued social licence to operate for the companies, leading to lower chances of defaulting or asset write-offs (**thus, minimizing credit and investment risks**)
- Improved access to markets despite the impact to market share owing to growing consumer awareness about sustainable product variants (**thus, minimizing market risks**)



- Access to cheaper sources of capital from dedicated green pools of capital (**thus, minimizing liquidity risk**)
- Better relations with stakeholders, media and civil society organisations (**thus, minimizing reputation risks**)
- Adherence to changing regulations and guidelines (**thus, minimizing compliance risks**)

*In summary, the Risk Management Checklist covers:*

Risk management	Approaching risk during pre-, during and post-investment stage
	Issues around data, traceability and monitoring
	Conducting a baseline assessment of risks

## ACTION POINTS ON METRICS AND DISCLOSURES

*This section highlights metrics that may be used by financial institutions to measure and disclose palm oil-related sustainability considerations, need to apply these metrics into the core business and meeting the changing expectations of stakeholders from disclosures*

### 1. Apply metrics to core business, and meet the changing demands from disclosures

Active engagement of investors and bankers with companies, traditionally, used to largely focus on demanding standard disclosures on ESG issues. However, it is now understood that mere disclosures are insufficient, because it was viewed as something additional, or ‘good-to-have,’ over and above the actual business. Therefore, it was often observed ESG indices or funds often had fossil fuel companies in their portfolios, because those companies may have done positive action on the S-of-ESG, which made their ESG disclosures look attractive and gave them a good ESG rating, despite their core business in fossil fuels.

Thus, using ESG disclosures as an additional screener over and above the core business yields limited outcome. It is now being understood that integrating ESG yardsticks into the core business model and processes is more critical to yield positive outcomes; and to this extent, active engagement of the financial community with the companies has witnessed a shift, from asking for mere disclosures, to demanding stronger action on integrating these into the business models or calculating the ESG/climate risks they are exposed to. Impact investing funds are at the forefront of using this approach, by asking prospective investees in areas like climate-smart agriculture as to how the underlying technology addresses climate risks. Impact funds face a huge opportunity by offering funding at more competitive rates without sacrificing spreads. They then assess how the business model would respond to varying climate aspects like weather changes, pest conditions, geographic variations and climate resilience. While this is challenging to do, it is this approach that impact funds opine would help them take more informed decisions.

**Demands**  
of financiers  
wrt disclosures  
changing,  
demanding  
integration into  
core business  
model/processes

Additionally, it is important to know when do financial institutions conduct sustainability checks vis-a-vis credit checks. Rabobank, a leader in the sustainable food and agriculture banking space, conducts its sustainability check prior to the credit checks, possibly implying a higher degree of integration of ESG parameters within the credit and investment decision-making.

To that extent, a caveat that may be added in such active engagement is to make adherence to transparent disclosures on such parameters a condition to avail new financing. In the case of palm oil, these parameters would include the risks, from climate, deforestation and land use degradation, along the supply chain that may impact the counterparty or investee, and hence the financial institution.

Financial institutions in SEBI’s top 1,000 list are expected to use the BRSR format for submitting their ESG disclosure in India. Financing transitions to sustainable palm oil could help these FIs with relevant data to highlight their contribution on various aspects of ESG, viz a viz the BRSR requirements.

## 2. Metrics specific to palm oil-related sustainability risks

As mentioned in the previous section on Risk Management, carbon intensity scoring of the portfolio and extended carbon footprint analysis, especially around Scope 3 emissions for downstream activities along the palm oil value chain, are critical. Equally critical is to disclose adherence to standards, certifications and criteria, for example, IFC Performance Standard, Green Taxonomy, etc. Such a taxonomy approach would go well beyond existing E&S risk frameworks, particularly when it comes to the depth of criteria and systematic use of thresholds and metrics.

However, it is crucial these metrics and disclosure focus on time-bound targets, which can be tracked and would help showcase actual outcomes the investee or counterparty, and its creditor or investor via their portfolio, are able to achieve. Metrics without time-bound targets do not help.

Metrics that enable financiers to track these parameters may form part of disclosures. Such metrics may include, but are not limited to:

<b>Emissions</b>	<ul style="list-style-type: none"> <li>Quantity of emissions and reduction targets, from deforestation and land use practices</li> <li>Quantity of emissions and reduction targets along the supply chain (Scope 3)</li> </ul>
<b>Land</b>	<ul style="list-style-type: none"> <li>Quantity of land deforested, included forest cover</li> <li>Quantity of afforestation, of both new land and deforested patches</li> <li>Quantity of plantation land degraded, or replanted</li> <li>Quantity of HCV or HCS land converted to plantations, or avoided</li> <li>Mapping of fragile soil areas</li> <li>Quantity of soil organic carbon</li> <li>Soil sampling process to check soil fertility and/or soil nutrient recycling strategy</li> <li>Use of Better Land Management Practices to re-use existing plantation patches and boost yields</li> </ul>
<b>Waste</b>	<ul style="list-style-type: none"> <li>Quantity of agro-residue stubble burnt at the plantation</li> <li>Use of zero burning techniques</li> <li>Discharge of chemical effluents from plantations/mills into natural ecosystems, and their treatment</li> </ul>
<b>Commodities</b>	<ul style="list-style-type: none"> <li>Quantity of commodities verified as per the ESAP (E&amp;S impacts)</li> <li>Quantity of commodities that are traceable to source/origin</li> </ul>
<b>Social</b>	<ul style="list-style-type: none"> <li>Quantity of suppliers compliant with standards and certifications</li> <li>Fair contracts with smallholder suppliers</li> <li>Complaints from workers, related to health, safety or labour rights</li> <li>Complaints from local communities, owing to pollution, loss of natural ecosystems, land grabbing, etc.</li> <li>Complaints from consumers, owing to harmful quality or inadequate product disclosure</li> <li>Number of staff of the financial institution, who underwent capacity building on these risks</li> <li>Number of capacity building programs on these risks</li> <li>Employment of local indigenous community members in the project / enterprise</li> <li>Fair pay between male and female workers</li> <li>Arrangements for ensuring security of women employees at the site / enterprise</li> </ul>

<b>Governance</b>	<ul style="list-style-type: none"> <li>• Quantity of companies, and their suppliers, held for governance lapses, fines or non-compliance</li> <li>• Number of companies that require further checks and balances, wrt due diligence and assessment</li> </ul>
<b>Others</b>	<ul style="list-style-type: none"> <li>• Use of carbon offsets</li> <li>• Impact on biodiversity and endangered species</li> <li>• Use of clean energy at plantations, mills or along the supply chain</li> <li>• Record of agrochemicals, like fertilizers and pesticides, applied</li> <li>• Water management plan, both at plantations and at mills</li> <li>• Water and soil pollution (air pollution covered under emissions)</li> </ul>

In terms of reporting, if ESG practices are being truly integrated into the core business model and processes, that implies reporting is not just restricted to the sustainability report referred to by ESG rating agencies, but also in other communication collaterals.

In terms of benefits, periodic disclosure via quantified metrics, on the risks specific to palm oil value chain, would help monitor the progress made against KPIs set to manage these risks, hold the companies accountable in case of non-adherence or lack of progress, and make strategic changes to reduce overall portfolio risk. Ideally, such disclosures or progress must be independently verified by third-party verifiers, not only to give comfort to the financier, but to enable the company to engage in fundraising from alternate sources of finance, as highlighted in the section on Strategy. The lack of data availability is a challenge to scale up sustainability interventions within financial decision-making. Disclosures would also help build datasets on these parameters.

*In summary, the Metrics/Disclosure Checklist looks at:*

Metric/ Disclosure	Application of metrics into the core business, not just as an additionality, and meeting the changing expectations of stakeholders from disclosures
	Metrics specific to palm oil-related sustainability risks



Photo Source: REUTERS/Rajendra Jadhav



## III. RECOMMENDATIONS

There is a case of a large multilateral bank not directly engaging in this sector due to legacy risk issues, which its Board was not comfortable with. In such a case, financing of sustainable palm oil, instead of the conventional variant may help tackle these legacy risks. Using India's domestic palm oil plans to pilot the financing of sustainable palm oil, may be an opportunity worth considering.

Another opportunity to plug in sustainable palm oil would occur during the planting cycle, a stage where Malaysia and Indonesia are at now, given most of their current palm trees were planted back in the 1980s-90s.

The opportunity angle is one way to motivate Indian financial institutions to consider risks related to climate, deforestation and land use degradation and financing of sustainable palm oil. One of these revolves around the innovative green financial products. India has already seen several issuances of innovative green products, from green or sustainability bonds, ESG- or sustainability-linked bonds, blended finance structures, etc. Globally, experiences of institutions like UNEP, Rabobank, BNP Paribas, amongst others, shows how innovative financial products can be scaled up in the agriculture, forestry and plantations space, with Tropical Landscape Financing Facility, &Green Fund, Agri3 Fund, Restoration Seed Capital Facility, are some examples. Sustainable financing products that incentivize natural ecosystems and landscape restoration as an outcome, would compel the issuer to consider these emerging risks as well. Such financial products would create a blueprint for further issues, including from commercial finance institutions to look at these sectors and also build credit ratings of the borrowers in such sectors, thus unlocking scope to raise further capital based on their ratings.

On the topic of sustainable finance products, palm oil is a majorly imported commodity in India. Thus, product innovations in the trade finance space like sustainable letter of credit where the terms of the non-fund-based financing is linked to specific sustainability criteria, may be crucial to move the Indian financial institutions and their counterparties towards sustainable palm oil.

A recommendation from the perspective of commercially driven financial institutions, is to find ways to neutralize the costs related to integrating climate and sustainability considerations into the business models. Most climate and sustainability solutions are expensive. An example for this is the new technologies that help assess risks better. Unlike multinational banks who can amortize such solutions across locations, Indian financial institutions face limitations to do so. Devising effective ways to neutralize this cost would help mainstream these amongst Indian financial institutions.

On the topic of regulation vs. market forces to accelerate the consideration of these risks by Indian financial institutions, initial stakeholder engagements to get discussants for focus group discussions highlighted the need for regulations as a precursor for financial institutions to mainstream these risks into their policies. Multinational financial institutions operating in India are integrating these risks, largely owing to the developments in their countries of origin. At the same time, there are very few players amongst the Indian-born and bred financial institutions who are also considering these risks to varying degree. This makes it more critical to push regulations regarding these emerging risks so that more and more Indian public- and private-sector banks, who comprise a major share of assets in the Indian financial spectrum, also start considering these risks actively.

The topic of regulations as a precursor is all the more critical for two reasons. One, stakeholder inputs suggest unless a system-wide uptake of sustainable palm oil financing and risk integration occurs, it will be tough to show meaningful impact to the sector at large. Even if some banks and financial institutions were to proactively put stringent guidelines in place as part of their strategy, there would always be financial players in the market to whom palm oil-related borrowers can turn to since the latter would demand lesser compliance to these risks. With Indian public- and private-sector banks comprising ~80% of Indian banking sector advances, as per RBI handbook data, most of whom are commercial in nature rather than developmental, system-wide uptake is key; and such system-wide uptake can be facilitated by regulations.

Secondly, palm oil comprises a very small share of an average Indian bank's portfolio. Thus, it is tough for banks to justify steps for the financing of sustainable palm oil, which reduces the incentive of market forces and puts more onus on regulatory action.



As far as the average commercial bank in India perceives, it has higher exposure to other sectors in its portfolio, and it sees more merit to respond as per market forces on those sectors instead. To that extent, approaching this issue with a wider lens of agriculture soft commodities may yield better results in India.

However, market forces can be instrumental in creating change at scale. Conventional palm oil is not being supplied to Europe owing to stringencies about sourcing non-sustainable commodities into Europe. Thus, market forces in the form of demand changes from a large buyer-market shifted the supply towards CSPO in that market with the conventional palm oil continuing to flow to Asian markets where such stringent measures are not in place. In case Indian regulators make the sourcing of sustainable palm oil into domestic processing industries more stringent, the market forces will automatically push the case for financing sustainable palm oil.

A lot depends on active engagement with the borrower companies, especially given that awareness itself in the Indian market on these topics is largely inadequate. At the end, the financial institution will fund what their borrower demands, especially commercial finance players who hold the major share of the Indian financial ecosystem's assets. Many Indian companies in the downstream value-chain are SMEs where awareness levels on business sustainability are typically lower than large companies. Hence, it is key to engage with companies to build their awareness and acceptability of sustainable palm oil, and the emerging risks related to climate, deforestation and land use degradation, such that a shift in their financing demand would automatically make the financial institution step in line.

Engagement with policymakers and regulators on including climate and sustainability considerations in the PSL (priority sector lending) norms of the Indian banking sector, would also help mainstream these emerging risks amongst Indian financial institutions.

Apart from impact investors taking a lead within the investor community to finance sustainable palm oil, Indian banks like State Bank of India, ICICI, etc. that have offices in Southeast Asia must take the lead within the banking community to channel funding towards the sustainable palm oil value chain.

Awareness-building with policymakers and industry must include new developments like carbon cross-border tax, to assess how it might impact an Indian firm engaged in processing palm oil into a product, and hence, its creditors. Engagement with policymakers may also cover on how to leverage the proposed sovereign green bond, or the new development finance institution, as announced in recent budgets, towards financing sustainable land use and forestry projects in India, including its domestic palm oil cultivation plans.

At the end, while there is increased commitment by banks and financial institutions in emerging economies like India to become carbon neutral, their awareness on how to do it needs to be refined. This Practitioner's Guidebook aims to facilitate that in the palm oil and agro-commodities space, a sector contributing extensively to deforestation-induced emissions and climate change.

## Recommendations - In Brief

- Using India's domestic palm oil plans to pilot the financing of sustainable palm oil
- Scaling of innovative financial products in the agriculture, forestry and plantation space
- Sustainable financing products to incentivize natural ecosystems and landscape restoration
- Product innovations in the trade finance space
- Identify methods to neutralize the costs related to integrating climate and sustainability into business models
- Push regulations regarding the emerging risks in the agro-commodity sector
- Making sourcing of sustainable palm oil into domestic processing industries more stringent, pushing the case for financing sustainable palm oil
- Engage with companies to build their awareness and acceptability of sustainable palm oil and the emerging risks related to climate, deforestation and land use degradation

# IV. ANNEXURE

## 1, Some Good Practices

Sustainability reports of large banks from Malaysia and Indonesia, production centers of palm oil, suggests they have started to look at materiality aspects specific to the palm oil value chain. India, as one of the largest consumers, might take note of this too.

How are select, large banks in Malaysia and Indonesia looking at this<sup>38</sup>

Factor	Indonesian banks			Malaysian banks	
	Mandiri	BNI	Bank BRI	CIMB	Maybank
<b>Certification</b>	ISPO	RSPO or ISPO	RSPO or ISPO	RSPO, MSPO or FSC	RSPO or MSPO
<b>Ecosystems</b>	<ul style="list-style-type: none"> <li>Review of EIA &amp; environmental management &amp; M&amp;E efforts</li> <li>No financing for peatlands</li> <li>No financing to ecologically sensitive zones, wetlands, mangrove, or biodiversity areas</li> </ul>	<ul style="list-style-type: none"> <li>Focus on deforestation, with impact on HCA land</li> <li>Support to debtors refraining from biodiversity loss, forest logging, etc.</li> </ul>	<ul style="list-style-type: none"> <li>Review of EIA, environmental management, M&amp;E &amp; mitigation efforts</li> <li>Protection of HCV &amp; primary forests</li> <li>Land is not HCS</li> <li>Demonstrate efforts to increase carbon sequestration, remove oil palm from peatlands or eliminate burning</li> </ul>	<ul style="list-style-type: none"> <li>Supports NDPE** commitments and protection of local forest ecosystems</li> </ul>	<ul style="list-style-type: none"> <li>Supports NDPE commitments</li> <li>Conduct HCV and HCS land area assessments</li> <li>Support protection of wetlands and conservation efforts</li> </ul>
<b>Stakeholders</b>	<ul style="list-style-type: none"> <li>Working with pilot debtors on CSPO</li> </ul>	<ul style="list-style-type: none"> <li>n/a</li> </ul>	<ul style="list-style-type: none"> <li>Efforts to increase use of clean energy in mills</li> </ul>	<ul style="list-style-type: none"> <li>Engagement with logging, forestry and shipping clients for awareness building</li> </ul>	<ul style="list-style-type: none"> <li>Adherence to Vendor Code of Conduct for suppliers</li> </ul>
<b>Local Communities</b>	<ul style="list-style-type: none"> <li>No financing to projects negatively impacting ethnic communities or labour abuse</li> </ul>	<ul style="list-style-type: none"> <li>No support to debtors engaging in human rights abuse</li> </ul>	<ul style="list-style-type: none"> <li>Demonstrate efforts to respect rights of local communities and labour</li> </ul>	<ul style="list-style-type: none"> <li>No Exploitation campaign for fair treatment for communities</li> </ul>	<ul style="list-style-type: none"> <li>Community engagement on FPIC principles</li> </ul>

<sup>38</sup> Recent sustainability reports of the five banks

## Rabobank, Netherlands

To address risks related to deforestation and land use, Rabobank’s screening processes covers the following:

Ecosystems	Land	Adherence	Reporting
<ul style="list-style-type: none"> <li>• Works with clients who show awareness of risks and opportunities, related to natural ecosystems. This includes issues like deforestation and land conversion</li> <li>• Works on projects that avoids adverse impact from land use &amp; conversion</li> <li>• Promotes net zero deforestation by encouraging clients to preserve biodiversity and ecosystems</li> <li>• Part of TNFD Informal Working Group, to develop metrics for FIs wrt nature</li> </ul>	<ul style="list-style-type: none"> <li>• Encourages clients to convert only degraded land for plantations, reducing deforestation risk</li> <li>• Promotes sustainable land and agriculture practices by designing loan products that incentivise such migration (like planet impact loan or organic transition loan)</li> <li>• Promotes geospatial solutions for land mapping and monitoring, for commodities</li> </ul>	<ul style="list-style-type: none"> <li>• To IFC Performance Standards on biodiversity, especially in non-OECD countries</li> <li>• Works with clients to increase the proportion of supply chain aligned to mitigation of these risks, via verified sourcing</li> <li>• FPIC from communities, where local legislations fall short of Rabobank’s principles</li> </ul>	<ul style="list-style-type: none"> <li>• Transparent reporting of impacts, especially negative impacts, on ecosystems</li> </ul>

## DBS, Singapore

DBS’s approach to palm oil financing, given its risks, covers the following:

- Supports companies that have good ESG practices in place, or who are investing to build capacity of their employees around ESG
- Requires palm oil companies to have NDPE commitment in place
- Avoids palm oil companies that are in violation of HCV, HCS, FPIC, peatland planting, land clearance by burning, forced labour, and coal
- Prefers companies to have RSPO certification; and encourages them to procure this if not already certified
- Its Sustainable and Transition Finance Framework offers a science-based approach to reduce the chances of greenwashing
- Monitors and reports the number of customers falling under ESG risk categories
- Sustainable finance commitment of SGD 50 billion from 2021 to 2024

## Access Bank, Nigeria

Nigeria is reviving its domestic palm oil sector to the levels last seeing during the 1960s, in order to diversify exports and reduce the dependence on crude oil/petroleum. Resultantly, while Nigerian banks were not looking specifically at palm oil-based screening, Access Bank, Nigeria's largest by AUM, was the issuer of the continent's first green bond and is, by far, leading the African banking sector (outside of South Africa) in terms of ESG integration and screening in lending decisions. Towards this, Access Bank's approach to screening ESG-related risks covers the following:

- Ensuring low environmental impact in the markets it operates in, by ensuring its wholesale and retail clients reduce their E&S impacts and costs
- ESG screening covers the supply chain, not just direct operations. In supply chains, it enforces policies on business and human rights, labour rights and environment
- Applies a bank-wide E&S Risk Management policy across all lending decisions



## List of stakeholders consulted

1. Martin Lemoine, Unit Head of Agribusiness at Asian Development Bank
2. Johannes Kieft, Senior Technical Specialist, UN Environment and Head, Tropical Landscapes Financing Facility
3. Wei Yuan, Asia Program Co-lead & Senior Environmental Specialist, IFC
4. Ajith Radhakrishnan, Senior Specialist at 2030 Water Resources Group, World Bank
5. KG Ranjit Kumar, General Manager of Climate Change team at NABARD
6. Chandru Badrinarayanan, Managing Partner at ECube Investment Advisors
7. Aloka Majumdar, Head of Corporate Sustainability at HSBC India
8. Arindom Datta, Executive Director of Rural & Development Banking/Advisory at Rabobank
9. Abhejit Agarwal, Head of ESG and Sustainability at Axis Bank
10. Urvi Desai, Impact, DFIs & Multilaterals at Axis Bank
11. Hari Prakash, Head, Enterprise Risk, RBL Bank
12. Srividhya Kumaraswami, Analyst, Sustainability and ESG Risk, IndusInd Bank
13. Priyanka Dhingra, Sr. Manager of ESG at SBI Mutual Fund
14. Hari Rajagopal, Head of Capital Markets & Strategic Initiatives, Samunnati Financial Intermediation
15. Jinesh Shah, Partner and Co-Founder of Omnivore Capital
16. Emmanuel Murray, Senior Advisor with Caspian Impact Investment
17. Raakhee Kulkarni, Principal & Head of ESG of South Asia at GEF Capital Partners
18. Manoj Rawat, Founder and CEO of ValueFin India Credit Services
19. Rajashree Padmanabhi, Lead, Climate Finance, Climate Policy Initiative

## V. GLOSSARY

- **Active engagement:** Engaging in dialogue between investors and companies on ESG considerations, in order to nudge the companies to effect positive changes
- **Basel Committee on Banking Supervision:** A committee of banking supervisory authorities that sets the standards for prudential regulations of banks
- **Blended finance:** Strategic use of public/philanthropic finance as credit enhancement or technical assistance, to mobilise private sector/commercial finance towards sustainable development
- **Carbon cross-border tax:** Tax charged on carbon emissions imposed on imported goods from sources with less strict climate policies, to destinations with stricter climate policies
- **Carbon footprint:** Amount of GHG emissions generated by an organisation due to its activities
- **Carbon offsetting:** Compensating for emissions created by funding an equivalent carbon dioxide saving elsewhere
- **Carbon pricing:** Setting a price on carbon by defining a tax rate on emissions, to capture the external costs associated with emissions
- **Carbon sequestration:** Capturing and storing atmospheric carbon dioxide in solid or liquid form
- **Climate finance:** International public finance, that supports mitigation and/or resilience-building activities, and which typically has some degree of concessionality (World Bank)
- **Credit Appraisal Memorandum (CAM):** A documented appraisal of a loan proposal, to assess a loan application and gauge the repayment ability of the applicant
- **Equator Principles:** A risk management framework adopted by financial institutions to gauge ESG considerations. It has 10 principles
- **ERM:** A business-wide strategic approach to identify, prepare and mitigate risks to finances, operations, talent and overall continuity
- **Green finance:** Finance for achieving economic growth while reducing pollution, GHG emissions, minimizing waste and improving efficiency in the use of natural resources (OECD)
- **Greenwashing:** Conveying a false or misleading position on a company's ESG progress
- **Intergovernmental Panel on Climate Change (IPCC):** An international body established for the scientific assessment of climate change
- **Kyoto Protocol:** An international treaty, adopted during the Kyoto COP in 1997, commits parties to reduce emissions, based on scientific consensus that human-induced emissions are the key driver of global warming. Mechanisms under this include emissions trading CDM and Joint Implementation
- **Net zero target:** Target to ensure net zero emissions by reducing emissions, and balancing any emissions with absorption of an equivalent amount from the atmosphere to meet the 1.5°C goal
- **Outcome-based finance:** Funds are allocated to the project/investee by an outcomes-based investor, who is then repaid, typically by a public or philanthropic funder, when the pre-defined outcomes are achieved and verified
- **Stranded assets:** Loan or investment assets that have suffered, or may suffer, from premature write-downs, devaluation or conversion to liabilities owing to risks; in this case, climate risks
- **Sustainability-linked loans:** General purpose loans extended to corporates to improve their performance on ESG targets and link this to the interest rate
- **Sustainable finance:** The process of taking due account of ESG considerations during investment decisions, leading to longer-term investments into sustainable economic activities and projects (EU)
- **Taskforce on Climate-related Financial Disclosure (TCFD):** A standard developed by the Financial Stability Board for climate-related financial risk disclosures by companies, banks, and investors
- **Taxonomy:** A classification system that establishes a list of sustainable economic activities, that must be adhered to for sustainable business/finance activities
- **Transition finance:** Financial support that helps high-carbon companies in hard to abate 'brown' sectors start to implement long-term decarbonization changes to become greener (HSBC)



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