First Notes

Framework on green deposits and its use for green activities

26 May 2023

First Notes on

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Audit committee

CFO

Others

Transition

Immediately

Within the next three months

Post three months but within six months

Post six months

Forthcoming requirement

Introduction

In India, in recent times, there has been an increase in focus of the financial system to move towards green financing. Green finance means lending to and/or investing in the activities/projects that contribute to climate risk mitigation, climate adaptation and resilience, and other climate-related or environmental objectives - including biodiversity management and nature-based solutions. As stated by the Reserve Bank of India (RBI), the financial sector can play a pivotal role in mobilising resources and their allocation thereof in green activities/projects.

A key mode of green finance that has progressively gained traction is 'green deposit'. Green deposit refers to an interest-bearing deposit, received by a Regulated Entity (RE) for a fixed period and the proceeds of which are earmarked for being allocated towards green finance. The term RE would include Scheduled Commercial Banks (SCBs) and deposit taking Non-Banking Finance Companies (NBFCs) including Housing Finance Companies.

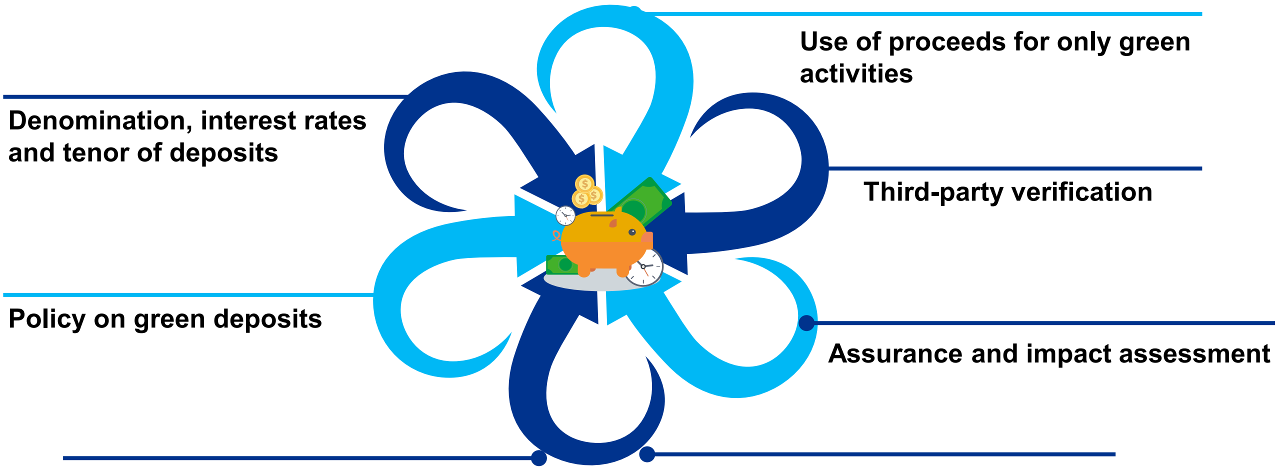
In July 2022, the RBI issued a Discussion Paper on Climate Risk and Sustainable Finance (the discussion paper). The discussion paper emphasised on the need to sensitise India's financial sector to the importance and benefits of green finance and develop related capacity building measures. Based on the feedback received from various stakeholders, RBI issued a press release dated 8 February 2023 on the 'Statement on Developmental and Regulatory Policies'. One of the guidelines proposed in the press release was on developing an overall green finance ecosystem including a broad framework for acceptance of green deposits.

Consequently, on 11 April 2023, RBI issued a Framework for Acceptance of Green Deposits (the framework). The framework is effective from 1 June 2023.

In this issue of the First Notes, we aim to discuss key elements of the green deposits.

An overview

The framework aims to direct the flow of funds to sustainable projects and initiatives, protect the interest of the depositors and address greenwashing concerns. Key themes discussed in the framework have been illustrated below:



(Source: KPMG in India's analysis, 2023 read with the RBI notification dated 11 April 2023)

I. Denomination, interest rates and tenor of deposits

The framework specifies the following:

- The REs should issue green deposits as cumulative/non-cumulative deposits
- The green deposits should be denominated in Indian Rupees only
- On maturity, the depositor would have an option to either renew or withdraw the deposit
- The tenor, size, interest rate and other terms and conditions (as applicable to the RE) would be as per the Master Direction - RBI (Interest Rate on Deposits) Directions, 2016[1], Master Direction - NBFC Acceptance of Public Deposits (Reserve Bank) Directions, 2016[2] and Master Direction - NBFC – Housing Finance Company (Reserve Bank) Directions, 2021[3] as amended from time to time.

II. Policy on green deposits

The framework provides that a comprehensive Board-approved policy on green deposits should be developed for the issuance and allocation of green deposits, and a copy of the same must be made available on the website of the RE.

III. Financing framework for allocation of proceeds

It has been provided that a Board-approved Financing Framework (FF) should be developed by the RE. It should incorporate following details:

- **Eligible green activities/projects:** The eligible green activities/projects that could be financed out of the proceeds raised through the issue of green deposits
- **Project evaluation and selection:** The process for project evaluation and selection by the RE, including identifying the projects fit for lending/investing within the eligible categories, monitoring and validating the sustainability information provided by the borrower
- **Third party verification/assurance and impact assessment:** The allocation of proceeds of green deposits and other details including its reporting, third-party verification/assurance and impact assessment

[1] Dated 3 March 2016
[2] Dated 25 August 2016
[3] Dated 17 February 2021

- **Temporary allocation of funds:** The particulars of the temporary allocation of green deposit proceeds[4], pending their allocation to the eligible activities/projects.

A copy of the FF covering the above aspects should be made available on the website of the RE. The RE should arrange to carry out an external review of the FF and make available the reviewer's opinion along with the duly approved framework on the website, before implementing the same.

IV. Responsibility of REs

a. Use of proceeds

The framework provides that the allocation of proceeds raised from green deposits shall be based on the official Indian green taxonomy. However, the taxonomy is yet to be finalised. Therefore, in the interim, the proceeds raised from the issue of green deposits should be allocated towards activities/projects in the following sectors:

- Renewable energy
- Energy efficiency
- Clean transportation
- Climate change adaptation
- Sustainable water and waste management
- Pollution prevention and control
- Green buildings
- Sustainable management of living natural resources and land use
- Terrestrial and aquatic biodiversity conservation.

Further, the framework has also prescribed certain projects which are excluded from the list of eligible projects such as those involving usage of fossil fuels, nuclear power generation, direct waste incineration, landfill projects, etc.

A detailed list of activities/projects with respect to the aforementioned sectors for allocation of proceeds raised from green deposits has been specified in the Annexure at the end of the First Notes.

b. End use of funds

The framework provides that it is ultimately the responsibility of the RE to ensure the end use of funds. REs are responsible for the following:

- Laying down the procedures of internal checks and balances that would have to followed similar to other loan agreements
- Frame the related terms and conditions which would additionally be required to be fulfilled by the borrowers.

c. Third-party verification/assurance

The framework specifies that the allocation of funds raised through the issue of green deposits by REs during a Financial Year (F.Y.) must be subject to an independent third-party verification/assurance, which must be conducted annually. The third-party verification/assurance report should, at a minimum, cover the following details:

- The proceeds raised through the issue of green deposits are utilised in accordance with the eligible green activities/projects, as specified above, and
- Details such as the relevant policies and internal controls with respect to project evaluation and selection, management of proceeds, validation of the sustainability information provided by the borrower to REs along with appropriate reporting and disclosures.

d. Annual impact assessment: REs, with the assistance of external firms, should conduct an annual impact assessment of the funds lent for or invested. The impact assessment exercise would be voluntary for F.Y. 2023-24. However, this would become mandatory from F.Y. 2024-25 onwards.

[4] The framework specifies that the temporary allocation of the green deposits proceeds would only be allowed in the liquid instruments up to a maximum original tenure of one year

The framework has provided following illustrative list of impact indicators for the purpose of impact assessment report:

Eligible project category	Impact indicators – Examples
Renewable energy	Total renewable capacity (in MWh)
	Energy generated per year (MWh)
	Green House Gas (GHG) emissions avoided per year (measured in tonnes CO2 equivalent, tCO2e)
Waste management	Waste diverted from landfill per year (tonnes)
Clean transportation	GHG emissions avoided per year (tCO2e)
	New clean transportation infrastructure built (km)
	Number of electric or low emission vehicles produced
Energy efficiency	Energy savings per year (MWh)
	GHG emissions avoided per year (tCO2e)
Afforestation/Reforestation	GHG emissions reduced/carbon sequestration achieved (measured in tCO2e)

V. Reporting and disclosures

The framework provides that the RE should place before its Board of Directors, a review report within three months of the end of the F.Y. incorporating the following details:

- **Total amount raised:** The amount raised under green deposits during the previous F.Y.
- **List of green activities/projects:** List of green activities/projects to which proceeds have been allocated, along with a brief description of the projects
- **Amount allocated:** The amounts allocated to the eligible green activities/projects
- **Third-party verification/assurance report and the impact assessment report:** A copy of the third-party verification/assurance report and the impact assessment report
- **Disclosure in annual financial statements:** Appropriate disclosures should be provided in the annual financial statements with regard to the portfolio-level information of the use of green deposit funds.
- **Impact assessment:** In case REs are not able to quantify the impact of their lending/investment, they should disclose, at the minimum, the reasons, difficulties encountered and time-bound future plans to address the same
- **Disclosure on website:** The report of the third-party verification/assurance and the impact assessment report should be made available on the website of the RE.

The format of disclosing portfolio-level information has been specified below:

(Amount in INR crore)

Particulars	Current F.Y.	Previous F.Y.	Cumulative*
Total green deposits raised (A)			
Use of green deposit funds**			
(1) Renewable energy			
(2) Energy efficiency			
(3) Clean transportation			
(4) Climate change adaptation			
(5) Sustainable water and waste management			
(6) Pollution prevention and control			
(7) Green buildings			
(8) Sustainable management of living natural resources and land use			
(9) Terrestrial and aquatic biodiversity conservation			
Total green deposit funds allocated (B = Sum of 1 to 9)			
Amount of green deposit funds not allocated (C = A – B)			
Details of the temporary allocation of green deposit proceeds pending their allocation to the eligible green activities/projects			

(Source: RBI framework for acceptance of green deposits – Annexure 2)

* This shall contain the cumulative amount since the RE started offering green deposits. For example, if a bank has commenced raising green deposits from 1 June 2023, then the annual financial statement for the period ending 31 March 2025 would contain particulars of deposits raised and allocated from 1 June 2023 till 31 March 2025.

** Under each category, REs may provide sub-categories based on the funds allocated to each subsector. For example, REs may provide sub-categories like solar energy, wind energy, etc. under “Renewable energy”.

Our comments

The REs operating in the financial services sector can now offer schemes of green deposits to customers. They are also responsible to protect the interest of the depositors and help address concerns relating to green washing. The framework appears comprehensive, though there are various areas and topics which will require more deliberation and guidance on implementation of the framework by REs, some of these areas are discussed below:

- **Ultimate responsibility of RE for end use of funds:** The framework lays down clearly that even though REs may involve third-party for verification of end use of funds, this will not absolve the RE of its responsibility for monitoring the end use of funds. As this is a new area of work, REs will need to build robust internal processes for tracking the end use of funds. Further, contractual terms and conditions would need to be embedded in the contract between the borrower and RE in case of breach of loan covenants and action to be undertaken by the RE in case of loan default. Also, the term ‘breach’ would need to be defined for green activities/projects, as banks would need to assess that funds are appropriately utilised and aiming towards the goals of the green projects.

- **Annual impact assessment:** The framework provides that the RE, with the assistance of external firms, should conduct an annual impact assessment of the funds lent for or invested through an impact assessment report. Impact assessment refers to the independent review of the outcomes and impacts generated by implementing a specific project/initiative by the third party. Additionally, the impact assessment exercise would entail a blend of both quantitative and qualitative factors, REs would need more guidance on the standards and metrics to be applied for conducting an effective impact assessment exercise.

- **Nature of assurance and assurance standards:** The framework specifies that third-party verification/assurance should be conducted annually with respect to the allocation of funds raised through green deposits. However, the framework in its present form and content does not provide any guidance regarding the nature of assurance required (limited or reasonable assurance) and the assurance standards which need to be complied with by the practitioner.

- **Capacity and awareness building:** Since green finance is an emerging area both for lenders as well as investors, the REs will have to focus and invest on skill set development and educating the subject both to staff and to customers. It will have to continuously broadcast the importance and significance of this product in context of India’s commitment to climate and other green initiatives. Further there would be a need to build information infrastructure so as to enable various reporting requirement both to regulators and other stakeholders.

- **Costs of compliance:** RBI requires REs to incorporate necessary checks and balances towards providing comfort to investors as well as reduce risk of green washing. Nonetheless, policy formulation, tracking of end use, assurance, impact assessment as well as reporting and disclosures would add to costs for managing green deposits by a RE. These additional procedures and cost implications may discourage REs from accepting green deposits. Therefore, the Ministry of Finance could consider certain measures to make these areas attractive for REs or the RBI could provide benefits of lower Statutory Liquid Ratio (SLR)/ Cash Reserve Ratio (CRR) maintenance on such deposits.

- **Incentivise and encourage green deposits investors:** Investors out of environmental consciousness may choose green deposits over conventional deposits. In the current situation, it is crucial that we channelise funds towards climate risk mitigation. Therefore, certain incentives could be provided to investors by the Ministry of Finance in the form of any tax benefit on interest earned through such deposits.

- **Broadening of scope of coverage:** While specific guidance on green deposits is clearly welcome, there are a number of other sustainability causes – such as social, transition, etc., for which it is important to ensure greater funds deployment and guidance. We expect regulators to provide more specific guidance on deployment of funds covering a range of sustainability causes.

- **Applicability of the framework to existing green deposits schemes:** RBI notification states that the framework would become applicable with effect from 1 June 2023. However, the framework does not cover guidance with respect to the existing schemes of green deposits being offered by REs currently. The RBI should clarify the transitional provisions for the existing green deposits and the applicability date of the framework for such schemes.

Our comments (continued)

- **Business Responsibility and Sustainability Reporting (BRSR):** Entities reporting on BRSR have to explain an entity's material responsible business conduct and sustainability issues. This section requires entities to explain issues pertaining to environment and social matters that present a risk or an opportunity to their business. RBI in its discussion paper on climate risk and sustainable finance has identified climate change as a source of financial risk for REs. It recognises that REs should steadily manage the risks and opportunities that may arise from climate change and environmental degradation.

  Sustainable finance through green deposits framework will form part of REs' BRSR as there is an increasing threat of climate change and the associated physical damage, change in market perception and shift in preferences towards more environmental-friendly products and services.

Annexure

The framework specifies the following list of green activities/projects towards which REs must allocate the proceeds raised through green deposits:

Sector	Description
Renewable energy	• Solar/wind/biomass/hydropower energy projects that integrate energy generation and storage • Incentivising adoption of renewable energy.
Energy efficiency	• Design and construction of energy-efficient and energy-saving systems and installations in buildings and properties • Supporting lighting improvements (For example, replacement with LEDs). • Supporting construction of new low-carbon buildings as well as energy-efficiency retrofits to existing buildings • Projects to reduce electricity grid losses.
Clean transportation	• Projects promoting electrification of transportation • Adoption of clean fuels like electric vehicles including building charging infrastructure
Climate change adaptation	• Projects aimed at making infrastructure more resilient to impacts of climate change
Sustainable water and waste management	• Promoting water efficient irrigation systems • Installation/upgradation of wastewater infrastructure including transport, treatment and disposal systems • Water resources conservation • Flood defence systems.
Pollution prevention and control	• Projects targeting reduction of air emissions, greenhouse gas control, soil remediation, waste management, waste prevention, waste recycling, waste reduction and energy/emission-efficient waste-to-energy[5].
Green buildings	• Projects related to buildings that meet regional, national or internationally recognised standards or certifications for environmental performance
Sustainable management of living natural resources and land use	• Environmentally sustainable management of agriculture, animal husbandry, fishery and aquaculture • Sustainable forestry management including afforestation/reforestation • Support to certified organic farming • Research on living resources and biodiversity protection.
Terrestrial and aquatic biodiversity conservation	• Projects relating to coastal and marine environments • Projects related to biodiversity preservation, including conservation of endangered species, habitats and ecosystems.

Exclusions

- Projects involving new or existing extraction, production and distribution of fossil fuels, including improvements and upgrades; or where the core energy source is fossil-fuel based
- Nuclear power generation
- Direct waste incineration
- Alcohol, weapons, tobacco, gaming, or palm oil industries
- Renewable energy projects generating energy from biomass using feedstock originating from protected areas
- Landfill projects
- Hydropower plants larger than 25 MW.

[5] Feedstock will primarily include: sewage, manure, wastewater, bagasse, biomass, wood pellets, etc.

KPMG in India offices

Ahmedabad
Commerce House V, 9th Floor,
902, Near Vodafone House,
Corporate Road,
Prahlad Nagar,
Ahmedabad – 380 051
Tel: +91 79 4040 2200

Bengaluru
Embassy Golf Links Business Park,
Pebble Beach, ‘B’ Block,
1st & 2nd Floor,
Off Intermediate Ring Road,
Bengaluru – 560071
Tel: +91 80 6833 5000

Chandigarh
SCO 22-23 (1st Floor)
Sector 8C, Madhya Marg
Chandigarh – 160 009
Tel: +91 172 664 4000

Chennai
KRM Towers, Ground Floor,
1, 2 & 3 Floor, Harrington Road
Chetpet, Chennai – 600 031
Tel: +91 44 3914 5000

Gurugram
Building No.10, 8th Floor
DLF Cyber City, Phase II
Gurugram, Haryana – 122 002
Tel: +91 124 307 4000

Hyderabad
Salarpuria Knowledge City, 6th
Floor, Unit 3, Phase III, Sy No. 83/1,
Plot No 2, Serilingampally Mandal,
Ranga Reddy District,
Hyderabad – 500 081
Tel: +91 40 6111 6000

Jaipur
Regus Radiant Centre Pvt Ltd.,
Level 6, Jaipur Centre Mall,
B2 Bypass Tonk Road
Jaipur – 302 018.
Tel: +91 141 - 7103224

Kochi
Syama Business Centre
3rd Floor, NH By Pass Road,
Vytilla, Kochi – 682 019
Tel: +91 484 302 5600

Kolkata
Unit No. 604,
6th Floor, Tower – 1,
Godrej Waterside,
Sector – V, Salt Lake,
Kolkata – 700 091
Tel: +91 33 4403 4000

Mumbai
2nd Floor, Block T2 (B wing),
Lodha Excellus,
Apollo Mills Compound
N. M. Joshi Marg,
Mahalaxmi, Mumbai – 400 011
Tel: +91 22 3989 6000

Noida
Unit No. 501, 5th Floor,
Advant Navis Business Park
Tower-A, Plot# 7, Sector 142,
Expressway Noida,
Gautam Budh Nagar,
Noida – 201 305
Tel: +91 0120 386 8000

Pune
9th floor, Business Plaza,
Westin Hotel Campus, 36/3-B,
Koregaon Park Annex, Mundhwa
Road, Ghorpadi, Pune – 411 001
Tel: +91 20 6747 7000

Vadodara
Ocean Building, 303, 3rd Floor,
Beside Center Square Mall,
Opp. Vadodara Central Mall,
Dr. Vikram Sarabhai Marg,
Vadodara – 390 023
Tel: +91 265 619 4200

Vijayawada
Door No. 54-15-18E, Sai Odyssey,
Gurunanak Nagar Road, NH 5,
Opp. Executive Club, Vijayawada,
Krishna District ,
Andhra Pradesh - 520008
Contact: 0866-6691000

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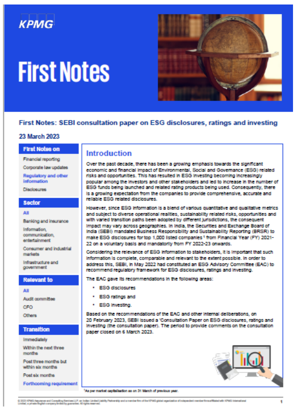
Issue no. 81 – April 2023

The topics covered in this issue are:

- Reverse factoring arrangement – presentation in the financial statements
- Climate related disclosures
- Regulatory updates

To access the publication, please click here



SEBI consultation paper on ESG disclosures, ratings and investing

23 March 2023

In India, the Securities and Exchange Board of India (SEBI) has mandated Business Responsibility and Sustainability Reporting (BRSR) to make ESG disclosures for top 1,000 listed companies (as per market capitalisation) from Financial Year (FY) 2021-22 on a voluntary basis and mandatorily from FY 2022-23 onwards.

Based on the recommendations of the ESG Advisory Committee and other internal deliberations, on 20 February 2023, SEBI issued a 'Consultation Paper on ESG disclosures, ratings and investing'. Subsequently, on 22 February 2023, SEBI issued a consultation paper to propose a regulatory framework for ERPs (ERP consultation paper).

In this issue of the First Notes, we aim to provide an overview of key proposals of the consultation papers issued by SEBI relating to regulatory framework of ESG disclosures by listed entities, ESG ratings in securities market (including regulatory framework for ERPs) and ESG investing by mutual funds.

To access the First Note, please click here

KPMG in India is pleased to present Voices on Reporting – Annual updates publication 31 March 2023

Voices on Reporting – Annual updates publication (for the year ended 31 March 2023) provides a summary of key updates from the Securities and Exchange Board of India (SEBI), the Ministry of Corporate Affairs (MCA), the Reserve Bank of India (RBI), the National Financial Reporting Authority (NFRA), the Ministry of Finance, the Institute of Chartered Accountants of India (ICAI) and the Insurance Regulatory and Development Authority of India (IRDAI).

To access the publication, please click here

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KPMG Assurance & Consulting Services LLP, Lodha Excelus, Apollo Mills Compound, NM Joshi Marg, Mahalaxmi, Mumbai - 400 011 Phone: +91 22 3989 6000, Fax: +91 22 3983 6000