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GREEN BANKING, ESG POLICIES AND SUSTAINABLE DEVELOPMENT IN INDIA

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ABSTRACT

The objective of this paper is to look into how India's new green banking and ESG compliance regulations relate to the country's sustainable development doctrine. It also examines the extent to which the RBI and the SEBI rules and guidelines subject financial institutions and businesses to sustainable development obligations.

The author thinks that though the regulation and implementation of green banking are primarily policy-driven, there is more to it than that.. Furthermore, formal accountability mechanisms in the area of corporate governance practices have been treated as developed as a result of the implementation of the ESG disclosure requirements under the Business Responsibility and SRG.

In light of the constitutional doctrine of sustainable development, which views sustainable development as an essential component of Article 21 of the Indian Constitution, the new regulatory framework for green banking and ESG compliance has been examined and discussed. Looking at the new regulatory framework in relation to green banking and ESG compliance indicates that it depends mainly on soft laws, which limits its enforceability and compliance.

In the end, whereas green banking and ESG compliance implementation and regulation are significant steps towards developing a more responsible approach to finance and corporate practices in India, their success hinges on the development and encouragement of an effective regulatory system that are capable of connecting environmental sustainability and economic governance practices in India.

KEYWORDS

Green Banking, ESG, Sustainable Development, Financial Regulation, India

INTRODUCTION

The interface of finance, corporate law, and environmental sustainability has proved to be one of the defining legal challenges of our era. With climate change, biodiversity loss, and resource exhaustion becoming an increasing cause for concern around the world, nation-states are now beginning to rethink and reimagine their laws and regulations in such a manner as to incorporate environmental considerations into their economic decision-making processes. An ideal illustration of this would be the case of India, which finds itself caught in the midst of rapid development as well as environmental fragility.

In recent times, the concept of green banking, essentially, incorporating environmental and climate risks into bank policies and investment decisions, has witnessed considerable interest among regulators in India. Additionally, the emergence of ESG reporting through the BRSR framework introduced by SEBI has helped institutionalize the practice of corporate accountability, going far beyond the traditional metrics of financial performance.

The Supreme Court of India has given the idea of sustainable development constitutional status via a number of groundbreaking rulings, based on the Right to Life and Personal Liberty under Article 21. This makes the constitutional nature of these reforms particularly significant. The regulatory actions made by RBI and SEBI have gained additional legal legitimacy under this constitutional structure since they are now considered constitutional obligations.

The present paper aims to conduct an exhaustive study on green banking and ESG compliance regime in India with respect to their structural architecture, relationship with the constitutional doctrine of sustainable development and limitations in making these effective in practice. The paper shall be divided into seven sections as follows. **Section II** will discuss about the concept and legal aspect of green banking and ESG. **Section III** will examine the RBI's regulatory stance. **Section IV** shall analyse SEBI's ESG Disclosure Regime. **Section V** will discuss the relationship of these concepts with the constitutional doctrine of sustainable development. **Section VI** shall deal with the limitations faced by these regimes and finally, **Section VII** shall conclude the paper.

Reserve Bank of India, *Discussion Paper on Climate Risk and Sustainable Finance* (2021), <https://www.rbi.org.in/Scripts/PublicationReportDetails.aspx?UrlPage=&ID=1218>.

2. CONCEPTUAL AND LEGAL FOUNDATIONS OF GREEN BANKING AND ESG

2.1 ESG: Framework & Legal Significance

ESG is a three-pronged framework that measures the non-financial performance of firms. The ESG criterion on the environment looks at aspects like carbon emissions, energy efficiency, waste management, use of water, and climate risk exposure. The ESG criterion on society covers issues like labor, human rights, community engagement, and supplier policies. The ESG criterion on governance looks at the board structure, executive compensation, anti-bribery policies, and shareholding.

From the perspective of law, the importance of ESG is derived from its role in the convergence of corporate law, securities law, and environmental law. The mandatory ESG disclosure requirement that is part of BRSR, for instance, can be described as a regulatory intervention that leverages on information asymmetry correction as an instrument of accountability. The idea here is to compel companies to disclose their ESG data to ensure that investors, creditors, and other interested parties make well-informed decisions, hence indirectly incentivizing good performance through markets.

Importantly, the nature of the ESG obligation, which could either be simply a disclosure requirement or substantive obligation, has important consequences for liability and enforcement. This crucial aspect distinguishes between procedural and substantive ESG obligations, which will be demonstrated as an essential source of criticism regarding the existing regulatory framework in India.

2.2 The Theoretical Nexus between Finance and Environmental Law

The increasing incorporation of environmental concerns within financial regulation is a reflection of a wider theoretical trend in legal discourse regarding the use of finance to facilitate sustainability transitions. The conventional perspective on financial regulation as a discipline that focuses only on stability, integrity, and the protection of investors is gradually giving way to an understanding that includes finance as a tool of social and environmental policy-making. This paradigm shift is in tune with the principle of 'sustainable finance,' which has become a recognized practice internationally due to frameworks such as the SFDR, TCFD, and UN-PRI. India's green banking and ESG policies can be seen as a part of this worldwide regulatory

trend.

3. THE RBI'S REGULATORY FRAMEWORK FOR GREEN BANKING

3.1 Evolution of RBI's Green Banking Policy

However, the Reserve Bank of India's involvement in green banking has been an incremental process, marked by various regulatory initiatives, rather than by legislation. The first major initiative involved including small-scale renewable energy projects under the Priority Sector Lending (PSL) policy, which mandates scheduled commercial banks to extend a certain percentage of their loans to specific sectors.

The Reserve Bank of India's Advisory Committee on Flow of loan to Agriculture and Related Activities initially brought attention to the necessity of include environmental risk assessment in loan decisions in 2004. But it took a further three years for the RBI to recognise the significance of these risks in its 2007 circular, in which the bank recommended that these risks be taken into account as part of banks' risk management procedures.

July 2021 marked the release of the RBI's Discussion Paper on Climate Risk and Sustainable Finance, which was a turning point in its stance toward climate risk management. The Discussion Paper accepted that the risks posed by climate change, including physical risks (from the effects of climate change) and transition risks (as a result of transitioning to a green economy), represent material risks to the stability of the financial system.

3.2 Priority Sector Lending and Green Finance

The RBI's most significant operational tool for directing bank loans toward environmentally beneficial activities is PSL. The Master Directions on Priority Sector Lending provide that, subject to specific maximum lending restrictions, loans to renewable energy projects, such as solar, wind, biomass, and small hydropower facilities, may be included within priority sector financing.

Despite the fact that PSL has succeeded in diverting considerable bank credit into renewable energy, there are several inherent limitations to the utility of PSL as an instrument of green banking. Firstly, the PSL mechanism is sector-specific, which means that while it provides a positive incentive to lend to renewable energy projects, it does not provide any negative incentive to avoid lending to environmentally harmful projects.

Reserve Bank of India, *Master Directions – Priority Sector Lending (PSL) Directions, 2025*, <https://www.rbi.org.in/commonman/English/Scripts/Notification.aspx?Id=3385>.

Secondly, the PSL mechanism works through a mandatory allocation approach, but not through risk pricing, meaning that PSL fails to encourage banks to carry out proper environmental risk assessments of their lending portfolio. Thirdly, penalties for non-compliance with PSL requirements, such as payments to the Rural Infrastructure Development Fund (RIDF), are insufficiently severe to act as deterrents.

3.3 Climate Risk Integration & Stress Training

Following the publication of its Discussion Paper in 2021, the RBI has made efforts to include climate risks in its regulatory framework. The RBI has shown its commitment to mandating climate risk stress tests for banks, defined as scenario analysis that examines the ability of banks' balance sheets to withstand climate change scenarios. Such a move aligns with the approaches suggested by the (NGFS), which the RBI joined in April 2021.

Despite the progress that has been made, the RBI's climate risk regulatory framework is still at an early stage of implementation. The lack of climate risk disclosure obligations for banks, the unavailability of methodologies for quantifying climate risk, and the voluntary nature of existing guidelines constrain the real-world effectiveness of such initiatives. There is much room left for banks to exercise discretion in defining climate risk management approaches.

3.4 Green Bonds & Sustainable Debt Instruments

Green bond regulations by the RBI for banks and other regulated entities that issue green bonds to fund eligible green projects can be viewed as another aspect of the RBI's green banking policy framework with the RBI acting as the issuing agency, the Government of India made news in 2023 when it issued its first Sovereign Green Bond. While this move is certainly a step forward in highlighting the government's intentions regarding climate change policies, it does little to tackle the bigger picture of integrating green practices into bank lending and investments.

In addition to this, the RBI has provided guidelines on the issuance of green bonds by regulated entities, which must comply with international green bond principles. Nevertheless, green washing remains a major concern due to the lack of third-party verification and the RBI's inability to undertake environmental due diligence at the project level.

Ministry of Finance, *Sovereign Green Bonds Framework* (2022),
<https://dea.gov.in/sites/default/files/Final%20SGB%20Framework.pdf>

4. THE CONSTITUTIONAL DOCTRINE OF SUSTAINABLE DEVELOPMENT

4.1 Sustainable Development as Constitutional Mandate

The constitutionalisation of sustainable development in India can be seen as an interesting aspect of its environmental law jurisprudence. While most other jurisdictions consider sustainable development as merely a policy goal or an international law principle, the Indian courts, especially the Supreme Court, have increasingly constitutionalised sustainable development and view it as an integral part of the fundamental rights enshrined in the Constitution of India.

The landmark decision of **Vellore Citizen Welfare Forum vs. Union of India** is often considered to be the beginning of this trend. In this case, a Constitution Bench of the Supreme Court held that the principles of precaution and polluter pays, which the Court viewed as the necessary constituents of sustainable development, were accepted as principles of customary international law and were thus applicable as domestic law in India due to lack of any conflicting domestic laws.

In subsequent rulings, the foundation of this constitutional framework was further entrenched. In the case of **M.C. Mehta vs. Union Of India**, the Supreme Court unequivocally established the nexus between the right to a healthy environment and the right to life under Article 21 of the Constitution, and thus, made it clear that environmental conservation is an absolute mandate and not just a policy or legislative issue. The judicial process reached its zenith with the establishment, in various rulings, of the positive duty of the state under Article 21 to adopt sustainable development.

A particularly important recent judicial development in this chain of events was the Supreme Court's historic judgement in **M.K. Ranjitsingh and Others v. Union of India (2024)**. In the case relating to the critically endangered Great Indian Bustard, the Supreme Court, sitting in a three-judge bench, established an innovative constitutional jurisprudence in declaring a 'right to protection from harm caused by climate change' as a stand-alone fundamental right guaranteed under Articles 14 and 21 of the Constitution. It was held in the judgement that the state had a positive obligation to ensure that necessary action was taken by the state to mitigate the impact of climate change and that the regulatory policy of the state on matters ranging from energy production and industrial activities to finance was in accordance with the necessity to protect the environment. From the point of view of green banking and ESG regulation, this judgement holds great importance. According to the judgement, insufficient regulation of the

financial sector leading to carbon-intensive investments amounts to a breach of the right to life enshrined in the Constitution.

The above-mentioned constitutional acknowledgment of climate rights has been bolstered by the recent development witnessed in the case of **Ridhima Pandey v. Union of India**, where a minor applicant filed for directions to the Government of India on conducting a risk assessment in relation to the impact of climate change caused due to industrial and economic pursuits before the National Green Tribunal, which then led the case to be brought before the Supreme Court. The request was not granted, but the case did prompt several discussions regarding the justice ability of climate obligations in India, and M.K. Ranjitsinh is a testament to that.

4.2 The Doctrine's Application to Financial Regulation

The use of the constitutional doctrine of sustainable development for regulating finance has not received much scholarly attention in the context of Indian constitutional law. As has traditionally been understood, the doctrine has had a narrow application in the realm of land-use policy, industrial pollution, and natural resources. The applicability of the doctrine to issues of banking and corporate governance necessitates a wider appreciation of the constitutional duties of the state in the economic sector.

Nonetheless, there are ample doctrinal grounds for making such an extension. On the premise that Article 21 creates a positive duty upon the state to guarantee the right to a healthy environment, and considering that climate change and environmental destruction are some of the major threats to this right, it becomes clear that the state's machinery of regulation should aim at reducing these risks. Financial institutions being among the primary mechanisms of allocating money within the economy, their operations determine what economic projects get funding and thus contribute to environmental problems.

Under such a reasoning, the green banking policy of the RBI and the ESG reporting framework of the SEBI can both be viewed as instances where regulatory bodies have discharged their constitutional duty to ensure that financial regulation is in sync with the principles of sustainable development. On the other hand, the inability of regulatory agencies to formulate and implement adequate green finance regulations would amount to a constitutional failure, as the state fails to fulfil its constitutional duties under Articles 21, 48A, and 51A(g).

Reserve Bank of India, *Discussion Paper on Climate Risk and Sustainable Finance* (2021),
<https://www.rbi.org.in/Scripts/PublicationReportDetails.aspx?UrlPage=&ID=1218>.

4.3 Judicial Recognition of Green Finance Obligation

The Indian judiciary has yet to address the question of constitutional legality of financial regulation vis-à-vis sustainable development. Yet, there are judgments which indicate that judges are inclined to give consideration to arguments related to sustainability. In the case of **Sagarmala Development Company Limited v. Konkan Railway Corporation Limited** the Bombay High Court made an observation in the context of a financing controversy concerning an infrastructural project that financiers owe obligations going far beyond the conventional into the realm of ecology, especially when the projects which they fund have considerable environmental consequences.

In addition, the National Green Tribunal has in some judgments placed certain conditions on financing and developing of projects that have important environmental repercussions, thereby implying that the funding mechanisms for these projects are not exempt from environmental scrutiny. Environmental lawsuits can bring about challenges to the lending and investment policies of financial institutions, making it a substantial legal danger for Indian financial institutions.

T.N. Godavarman Thirumulpad v. Union of India, which is the decades-long case of forest conservation law being heard by the Supreme Court of India, has produced other jurisprudence relevant for green finance in India. In several judgments dealing with the Compensatory Afforestation Fund and forest management funds, the Supreme Court has always emphasized that the state is a trustee of natural resources for the current generation as well as for future generations.

This means that all financial transactions linked with the usage of natural resources will have to be made in accordance with the public trust doctrine. By applying the above logic to the banks' engagement in financing of natural resource-intensive sectors, the legal duty on financial authorities emerges in such a way that they must make sure that credit allocation policies are not working against India's natural capital in any way. Consequently, the M.K. Ranjitsinh case of 2024, in combination with the Godavarman line of cases, can serve as the best possible constitutional justification for green banking.

[M.K. Ranjitsinh v. Union of India, 2024 SCC OnLine SC 995.](#)

CONCLUSION

India currently finds itself at an important crossroads in the sustainable development journey. The combination of increasing climate risks, commitment towards sustainable development in line with the Paris Agreement, and mounting pressure from the investment community and civil society make it necessary that environmental sustainability be mainstreamed into the regulatory system.

The efforts made in recent years by the RBI and SEBI towards creating a green banking structure and an ESG compliance regime can be seen as a positive step in the right direction. It represents an admission by the regulatory bodies that financial regulation cannot remain agnostic towards environmental concerns and that decisions related to capital allocation have major implications for the environmental basis of sustainable development. The BRSR is especially important because it creates a useful mechanism of environmental accountability which does not exist in many other emerging markets.

There are, however, some serious shortcomings within this regulatory framework which limit its impact. These include the dominance of soft laws over hard rules, the vulnerability of ESG reports to green washing, the neglect of transition risk in the case of banks, and finally, the absence of an enabling legislation.

In terms of constitutional law, the failure in implementation here does not constitute mere administrative ineffectiveness; rather, it poses as a serious neglect of the state's obligation to ensure sustainable development under Article 21 and the Directive Principles. As per the constitutional doctrine on sustainable development, articulated by the Supreme Court of India, more needed than mere tokenism regulatory compliance; there needs to be a concrete implementation process that prevents the systemic externality of environmental harm upon future and current generations.

This means legislation, institutional build-up, and an acceptance of moving out from the easy path of soft laws towards a realm where environmental responsibilities are actually enforced and judicially actionable for financial institutions and corporations. It is only through this approach that India's green banking and ESG compliance model can reach its full potential as a tool for realizing constitutional sustainable development goals.

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