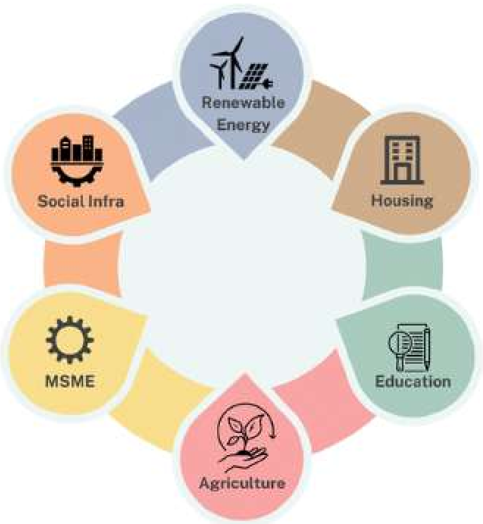
PRIORITY SECTOR LENDING : FACILITATING GREEN AND SUSTAINABLE TRANSITIONS?



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CHARTERED ACCOUNTANTS

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The Reserve Bank of India (RBI) has revised its guidelines on Priority Sector Lending (PSL), set to take effect from April 1, 2025. These guidelines, replacing the 2020 framework on PSL aim to channel more credit to critical areas of the economy, enhance financial inclusion, and boost investment in green and clean energy.

First, let us understand the Priority Sector Targets :

Different categories of banks have distinct PSL targets based on their financial standing:

- Domestic commercial banks and foreign banks with 20 or more branches must allocate 40% of their ANBC or CEOBSE towards PSL.
- Regional Rural Banks (RRBs) and Small Finance Banks (SFBs) have a higher target of 75%, ensuring greater credit flow to rural and small-scale enterprises.
- Urban Cooperative Banks (UCBs) have separate targets that reflect their operational scale and reach.

These targets are designed to ensure that financial institutions remain committed to national development priorities while maintaining a sustainable lending approach.

Sectoral Breakup - Where is the money lent :

PSL covers multiple categories, including:

- Agriculture – Farmers, agri-infrastructure, and allied activities.
- Micro, Small, and Medium Enterprises (MSMEs) – Small business financing and start-up support.
- Export Credit – Financing to boost India’s trade sector.
- Education – Loans for students pursuing higher education, including vocational courses.
- Housing – Home loans, slum rehabilitation projects, and infrastructure financing.
- Social Infrastructure – Credit for schools, hospitals, and sanitation projects.
- Renewable Energy – Funding for solar, wind, and other clean energy projects.

Failure to meet targets?

Financial institutions failing to meet their PSL targets must contribute to the Rural Infrastructure Development Fund (RIDF) and other designated funds at predetermined interest rates.

This mechanism ensures that even when banks fall short, funds still reach priority sectors.

Revision of the PSL guidelines :

The revised PSL guidelines are expected to channel more credit into critical areas of the economy. By increasing loan limits, redefining weaker sections, and adjusting targets, the RBI aims to bridge financial gaps, support small businesses, and drive sustainable economic development. Some key changes are explained below -

1. *Higher Loan Limits for Housing -*

Under the new PSL norms, the RBI has categorised housing loans based on population size. Loans up to Rs 35 lakh in areas with a population of less than 10 lakh, Rs 45 lakh in areas with a population between 10 lakh and 50 lakh, and Rs 50 lakh in cities with more than 50 lakh people will now qualify as priority sector lending.

2. *Expansion of categories under Renewable Energy –*

Bank loans up to a limit of ₹35 crore to borrowers for renewable energy-based power generation and renewable energy-based public utilities, such as street lighting systems and remote village electrification, will be eligible for priority sector classification. For individual households, the loan limit will be ₹10 lakh per borrower. However, for rural areas, the RBI has set a higher limit. Additionally, lending to Medium Enterprises, Social Infrastructure, and Renewable Energy will be considered for priority sector achievement, but only up to 15% of ANBC. Within renewable energy, the lending to Medium Enterprises, Social Infrastructure, and Renewable Energy will be considered for priority sector achievement, but only up to 15% of ANBC.

3. *Revised Targets for Urban Cooperative Banks -*

The PSL target for UCBs has been revised to 60% of Adjusted Net Bank Credit (ANBC) or Credit Equivalent of Off-Balance Sheet Exposures (CEOBSE), whichever is higher. This adjustment is expected to strengthen the role of cooperative banks in supporting priority sectors, ensuring credit flows where it is needed most.

4. *Expanded Definition of Weaker Sections -*

The revised framework also expands the list of eligible borrowers under the 'Weaker Sections' category. Notably, the existing cap on loans given by UCBs to individual women beneficiaries has been removed. This change is expected to boost financial inclusion, making credit more accessible to economically disadvantaged groups and women entrepreneurs.

5. *Addressing Regional Credit Disparities -*

To ensure credit reaches underdeveloped regions, the RBI has introduced a differential weight system. Districts with lower per capita credit flow will have a 125% weightage for PSL achievement, while those with higher credit flow will have a reduced weightage of 90%.

Analysis of the Key changes in PSL -

- According to a report by NDTV Profit, banks such as State Bank of India (SBI), HDFC Bank, ICICI Bank, and Axis Bank are expected to gain the most from the increase in housing loan limits under PSL.

  HDFC Bank had the largest retail mortgage book at Rs 8.17 lakh crore at the end of the December quarter, followed by the SBI at Rs 7.92 lakh crore, ICICI Bank at Rs 4.27 lakh crore, and Axis Bank at Rs 1.67 lakh crore.

- In the renewable energy sector, competition is expected to intensify as the RBI has expanded the scope of PSL loans in this category. The lending target of ₹35 crore is estimated to support an 8-10 MW solar installation.

- The expanded definition of "weaker sections" is aimed at fostering greater financial inclusion by empowering women entrepreneurs and individuals who require financial assistance for various personal or business needs. By eliminating the cap, RBI seeks to encourage financial institutions to provide more credit to women, thus promoting gender equality in access to banking services.

- Overall, the enhanced coverage under the revised PSL guidelines is expected to facilitate better targeting of bank credit toward priority sectors, ensuring that financial resources are directed where they are needed the most.

Sustainability initiatives of the RBI – inclusion of renewable energy financing under PSL :

According to the new guidelines on PSL, India is spearheading initiatives in renewable energy financing and incorporating such projects under priority sector lending. This is a strategic move to accelerate the nation's transition to a “low-carbon economy”. The RBI Governnor while addressing this initiative has stated that while advanced economies typically adhere to asset-neutral policies, central banks in emerging markets and developing economies have implemented directed lending strategies to channel credit toward specific sectors based on national circumstances and developmental objectives. A similar approach has been adopted by the Reserve Bank as well - India's priority sector lending guidelines have been specifically designed to facilitate credit flow to renewable energy initiatives.

Financing for small renewable energy projects such as solar, biomass-based, windmills, micro-hydel plants, and non-conventional energy-based public utilities like street lighting systems and remote village electrification, all have been included under priority sector lending.

Other initiatives and challenges in Green Lending :

One important aspect of green lending for sustainable finance is the higher credit risk associated with borrowers using new and emerging green technologies, which have a relatively limited track record in terms of reliability, efficiency, and effectiveness. Therefore, regulated entities need to develop the necessary expertise and technical know-how to better assess risks associated with financing such projects.

Climate-related financial risk modeling is highly data-intensive, yet there is limited available data to measure the financial impact of climate change. To address these constraints, the RBI had announced the creation of the Reserve Bank – Climate Risk Information System (RB-CRIS) in October last year. This repository aimed to bridge data gaps by providing standardized datasets, including hazard data, vulnerability data, and exposure data for physical risk assessment, as well as sectoral transition pathways and carbon emission intensity data for transition risk assessment. Work on this repository is currently underway.

The pivotal role of technology and finance in facilitating the transition toward a low-carbon economy has been recognised by the RBI. To foster innovation in this domain, the Governor recently announced plans to establish a dedicated 'on-tap' cohort focused on climate change risks and sustainable finance under the RBI's Regulatory Sandbox initiative, alongside preparations for conducting a special 'Greenathon' centered on climate change challenges.

The Governor also noted global progress in assessing and disclosing climate-related risks, mentioning that international organisations such as the International Sustainability

Standards Board under the IFRS Foundation have introduced climate-related disclosure standards.

Additionally, the Basel Committee on Banking Supervision has released a consultative document aimed at integrating climate risk considerations into the Basel framework's Pillar III disclosure requirements.

Moreover, the RBI has already issued draft guidelines on the Disclosure Framework for Climate-Related Financial Risks in February 2024 for public consultation.

They are currently finalising these guidelines based on feedback and is also developing a guidance note on Climate Scenario Analysis and Stress Testing for regulated entities to further strengthen the financial sector's resilience to climate-related risks.

Conclusion

According to the Sustainable Banking and Finance Network, 2021, India is in the “Developing” sub-stage of the “implementation stage” of sustainable banking and finance.

The Reserve Bank remains committed to addressing and mitigating climate-related risks to the financial system, focusing primarily on acting as a facilitator by supporting capacity building and creating a conducive regulatory framework for promoting sustainable finance.

While their role in managing financial risks posed by climate change is increasingly recognised, the extent of their involvement in facilitating green and sustainable transitions remains a subject of ongoing debate with multiple perspectives.