BODHIVRUKSHA JOURNAL OF DIVERSE DISCIPLINE (BJDD)
An Open-Access, Peer-Reviewed, Multidisciplinary Scholarly Journal | Bi-Monthly | Multilingual | Academic Research
Vol 2, Issue 6 (November-December 2026) (Special Issue 2) | ISSN: 3139-1486 (Online) | ISSN: 3139-9819 (Print)

Green Finance and Sustainable Lending Practices in Indian Banks: Emerging Trends, Challenges and Policy Perspectives

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Abstract

In the transition to the sustainable economy, significant amounts of financial resources are needed for the implementation of renewable energy, energy efficiency, adaptation and mitigation to climate change, pollution control and environmentally responsible business activities. Banks are vital in this transition as they decide where to allocate financial resources in the economy. Green finance and sustainable lending have thus become important banking innovation and responsible financial intermediation aspects. The Reserve Bank of India has taken up various measures in India, including the Framework for Acceptance of Green Deposits, and credit flow for the priority sector includes renewable energy. There are however, challenges associated with expanding the sustainable lending product which include environmental risk assessment, identification of green projects, borrower awareness, financing costs, and the availability of data as well as the risk of greenwashing. This conceptual paper addresses green finance in the Indian banking sector, reviews recent trends in sustainable banking lending and highlights key challenges in its implementation and proposes measures to reinforce the role of banks in sustainable economic development. The study methodology is conceptual with the use of secondary sources, such as the regulatory documents, publications of policies and academic literature. The analysis points to the need to take environmental and climate aspects beyond the specific scope of sustainable financing of projects to integrate them into the credit appraisal, risk management and portfolio management processes. The paper suggests a coherent approach that brings together regulatory support, environmental assessment, sustainable credit allocation, and impact measurement and financial inclusion. It believes that the institutional capacity, reporting and financial instruments and stakeholder coordination are key factors for building a credible and inclusive green finance landscape in India. Indian banking sector is facing the challenge of integrating climate risk into their business and transitioning to green economy through green finance.

Keywords: Green Finance, Sustainable Lending, Indian Banking Sector, Climate Risk, Green Deposits, Sustainable Development

1. Introduction

Financial institutions are more and more relied upon to invest funds that can improve long-term economic growth and mitigate environmental and social issues. Businesses, households and financial systems face climate change risks, such as those surrounding resource depletion, pollution, and degradation of ecosystems. The challenges also create opportunities to invest in renewable energy, energy efficiency, sustainable infrastructure, clean transportation and environmentally responsible production.

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Banks are in a pivotal role in this transformation. Their lending and investment choices affect the economic activities that will receive financial support, the terms of the credit extension and the level of risk for project evaluation. The banking sector can therefore act in support of sustainable development, especially by financing environmentally friendly activities, and by reflecting the environment in the traditional credit process.

In general, green finance is financial activities which are conducive to climate mitigation, climate adaptation, environmental protection and related sustainability goals. There is a broader definition of sustainable lending, such as the inclusion of environmental and, if applicable, social and governance criteria in lending policies, in credit appraisal, in the monitoring of a loan and in the management of the loan portfolio.

The demand for sustainable finance in India is especially significant as it is essential to meet the development needs while also promoting energy efficiency, scaling up renewable energy generation, enhancing climate change resilience, and addressing environmental pressures. These goals will need significant investments from public institutions, private companies, financial markets and banks.

The Reserve Bank of India (RBI) has made efforts to promote a green finance ecosystem. On April 11, 2023 it released its Framework for Acceptance of Green Deposits, which sets out the requirements for green deposits to be accepted by eligible regulated entities, such as financing frameworks, allocation of funds, and verification and impact assessment. The framework came into force from June 1, 2023 (Reserve Bank of India [RBI], 2023a). The RBI has also acknowledged the financial risks associated with climate change and the need for financial institutions to build the necessary financial risk management capabilities (RBI, 2023b).

But there are obstacles to sustainable lending in practice. Banks need to determine which projects qualify and determine their financial feasibility, as well as evaluate claims that are not substantiated and manage the risks of new technologies. Even when small businesses can provide environmental benefits, they may not have the environmental data or needed technical expertise, or be able to access affordable financial capital.

Keeping this background in mind, the current paper reviews green finance and sustainable lending in Indian banks, highlights the significant opportunities and constraints, and proposes some recommendations to enhance sustainable financial intermediation.

2. Objectives of the Study

1. To examine the concept and significance of green finance and sustainable lending practices in the Indian banking sector.
2. To analyse emerging regulatory initiatives and banking practices supporting green finance in India.
3. To identify the major challenges faced by Indian banks in implementing sustainable lending practices.
4. To suggest measures for strengthening green finance and sustainable lending to promote inclusive and sustainable economic development.

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3. Research Methodology

This study is descriptive and conceptual with secondary data approach. The analysis is based on the documents of the RBI's regulatory framework, the official publications of RBI policies, and the academic literature on green finance, sustainable banking, and climate-related financial risks.

The paper analyzes the instruments of green finance, sustainable credit assessment processes, regulatory initiatives and institutional capacities for successful implementation. It adopts the method of thematic analysis to pinpoint opportunities, operational issues and policy measures in the Indian banking system.

No primary survey data or quantitative analysis of the banks is used in the study. Therefore, the results are presented as conceptual interpretations based on the literature search and policy framework, and are not the result of statistical testing of relationships or measured impacts of Indian banks.

4. Conceptual foundations of Green Finance and Sustainable Lending

4.1 Green Finance

Green finance is any financing that goes towards activities and projects that support environmental goals. They can be related to renewable energy, energy efficiency, sustainable water and waste management, pollution prevention, clean transportation, green buildings and conservation of natural resources.

The financial provision of green finance can be offered through various financial products, such as loans, bonds, deposits, credit facilities and investments. Banks provide support by bringing savings, evaluating projects, providing credit and supervising borrowers.

The RBI's green deposit framework defines green finance as a finance approach that relates to activities and projects that are eligible under the framework, such as for climate change mitigation, adaptation and resilience, or other climate-related or environmental goals including biodiversity management and nature-based solutions (NBs) (RBI, 2023a).

Green finance is not identical to the sum of the corporate social responsibility or to the overall spending on the environment. A viable green financing arrangement must have a clear environmental goal, eligibility requirements and sufficient evidence of funds usage.

4.2 Sustainable Lending Practices

Sustainable lending includes the integration of sustainability aspects into the lending process. It encompasses financing projects that will improve the environment and taking into account environmental risks to borrower and project when assessing projects and borrowers.

Important practices include:

- Determining eligibility of green projects/activities.
- Accessibility of credit risk related to the environment and climate changes in the credit assessment process.
- Evaluating borrowers' capacity to comply with environmental laws and regulations, and their ability to manage environmental risks.

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- Providing suitable financial products for renewable energy and resource efficiency.
- Tracking of funds and project performance.
- Providing relevant sustainability information.
- Measuring environmental impact of financed actions.

Sustainable lending should be an add-on to and not a substitute for traditional credit analysis. A project should still show that it has the capacity to re-pay and financial viability. Commercial, operational and credit risks do not go away because of the environmental benefits.

4.3 Relationship Between Green Finance and Sustainable Development

This is part of the Sustainable Development and Climate Change Research Group's activities. This is a part of Sustainable Development and Climate Change Research Group's activities.

Green finance is the linkage of the financial system and long-term environmental and economic goals. Loans for renewable energy can help facilitate energy transition, and loans for energy-efficient equipment can decrease the operational and resource costs. The sustainable waste management can have a positive impact on resource recovery and create new business opportunities.

The activities may tie in with the United Nations Sustainable Development Goals, specifically Goal 7: Affordable and Clean Energy, Goal 9: Industry and Innovation, Goal 12: Responsible Consumption and Production, and Goal 13: Climate Action (United Nations, 2015).

But the role of green finance relies on the use of the funds and the projects financed yielding real environmental benefits. Therefore, transparency of selection criteria and monitoring and impact assessment are key.

5. Emerging Green Finance and Sustainable Lending Practices in

5.1 RBI Framework for Green Deposits.

RBI had launched the Framework for Acceptance of Green Deposits in April 2023 for promoting fund mobilization for green activities or projects by eligible regulated entities. The framework covers certain scheduled commercial banks (small finance banks), to eligible deposit-taking non-banking financial companies (including housing finance companies), and excludes other scheduled commercial banks (regional rural banks, local area banks and payments banks) (RBI, 2023a).

The framework defines green deposits as interest-bearing deposits which serve to finance projects falling under the eligible projects for green financing. The framework will require regulated entities to establish suitable policies and financing mechanisms for allocation of proceeds.

It contains provisions on activities allowed, project evaluation and selection, funds allocation, third party verification or assurance, impact assessment and reporting. These provisions are crucial as it enhances transparency and mitigates greenwashing concerns.

The framework helps create a regulatory environment for channelling savings into environmental goals. Whether it works is more dependent on the capacity of regulated entities to find projects to fit the bill and

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assess the projects' environmental qualities and to let the public know how much the funds are used and how they affect the environment.

5.2 Priority Sector Lending and Green Activities

Priority sector lending is among the important policy measures adopted to ensure availability of bank credit in the priority sectors in the economy which are viewed as important for economic and social development. Renewable Energy is one of the priority sectors under the RBI's Priority Sector Lending Directions, 2025, with the specific eligibility criteria as mentioned in the Directions (RBI, 2025).

This will provide a pathway for bank financing of eligible renewable energy projects. Credit can be used for renewable energy installations and eligible infrastructure, among other activities, depending on the rules and project specifics.

Priority sector lending and green finance have a relationship, but it is not a one-to-one correspondence between the two. Not all of the priority sector loans are green loans and not all green loans are necessarily priority sector loans. Eligibility criteria will be considered individually by banks.

A suitable strategy should blend-in suitable priority sector lending coupled with environmental screening and project monitoring. This can assist banks in contributing to the desired development goals and in the shift towards sustainable economic activities.

5.3 Financing Renewable Energy

Sustainable bank lending is an important field of renewable energy. Banks can access loans for solar, wind and other Renewable Energy projects that would be eligible, such as appropriate installations for businesses, institutions and households.

For borrowers, financing renewable energy can assist diversify their energy sources and limit their exposure to some of the costs of traditional energy. But lenders need to assess project costs, technology reliability, maintenance needs, the ability to repay and the relevant regulatory conditions.

The costs for starting up a small business or household may be problematic. The feasibility of such projects can be enhanced with the use of appropriate loan structures, providing information on what savings can be expected and reliable technical assistance.

5.4 Energy Efficiency and Green Infrastructure

A bank can provide financing for investments in energy-efficient machinery, buildings, lighting, cooling systems, and other technologies that reduce resource consumption. Financing of this kind may be relevant to manufacturing companies, commercial establishments, and service-sector businesses. Investing in energy-efficiency projects can have economic and environmental benefits. However, estimating the savings is not always straightforward. It is possible that banks will require technical assessments, credible cost estimates, and performance information. Financing for green buildings, sustainable transport and water-management infrastructure also provides opportunities for banks to support long-term environmental objectives. These projects may require specialised appraisal skills and coordination with technical experts.

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5.5 Sustainable Finance for MSMEs

Micro, small and medium enterprises are important contributors to employment and economic activity. Many MSMEs could improve their environmental performance through energy-efficient equipment, cleaner production methods, waste reduction and water conservation.

However, smaller enterprises may have limited access to specialised sustainability advice and may find it difficult to prepare detailed environmental documentation. Their financing needs may also be relatively small, making individual project appraisal costly for banks.

Banks could explore simplified assessment procedures for eligible small-scale projects, standardised documentation, technical partnerships and suitable credit products. Such measures should preserve appropriate credit and environmental safeguards while reducing unnecessary administrative barriers.

5.6 Climate Risk Assessment in Credit Decisions

Climate-related risks can affect borrowers' cash flows, assets, insurance costs and ability to repay loans. Physical risks may arise from floods, extreme weather and other climate hazards. Transition risks may result from changes in technology, regulation, consumer preferences and the cost of moving towards a lower-carbon economy.

The RBI has highlighted the need for financial institutions to develop capabilities for identifying and managing climate-related financial risks (RBI, 2023b). Banks can respond by identifying material exposures, evaluating vulnerable sectors and considering climate-related factors within their risk-management systems.

Such assessment should be proportionate to the nature and scale of the exposure. Banks also need reliable data, suitable analytical tools and trained personnel. Climate risk assessment should strengthen conventional risk management rather than become a separate, disconnected exercise.

6. Major Challenges in Implementing Sustainable Lending

6.1 Inadequate standardised assessment criteria.

One of the major issues is to define green and sustainable. Different projects could be classified as different types if banks employ different definitions. Lack of due care can also open the door for borrowers to claim routine business operations as green.

To foster the credibility of sustainable lending, clear eligibility criteria, together with sector-specific guidance and consistent documentation are required. Banks should also be careful to differentiate between projects that can provide direct environmental benefits and those that are only promoting general sustainability benefits.

6.2 Limited Environmental Data

The usual aspects of credit appraisal include financial statements, collateral, creditworthiness of the borrower and business risk. Sustainable lending could include extra data related to energy use, emissions, water usage, waste management and climate risk exposure.

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It is unlikely that many small borrowers will keep such information in a normalised format. The process of gathering and substantiating environmental information can raise the expense for both banks and borrowers.

Banks can mitigate this challenge by implementing proportional reporting requirements, using a common assessment template, establishing technical partnerships and making incremental progress in data collection**.**

6.3 High initial investment and uncertainty of the project.

There are some green projects that involve a high initial investment, a longer payback period or technologies that have short operating experience. These factors can cause difficulty in making predictions about repayment and create a higher risk for a lender.

Banks have to differentiate projects that are not financially viable from projects that need better project structuring, technical assessment or an appropriate financing term. The cash-flow profile of the project should be taken into account in the design of the loan and not ignored, while ensuring sound lending practices are observed.

6.4 Limited Technical Expertise

The expertise of renewable energy, energy efficiency, waste management, climate adaptation, and other specific areas may be needed for environmental project appraisal. Traditional credit teams might not be experienced in reviewing all projects in isolation. Training, internal sustainability teams, collaboration with experts and standardised technical assessment processes can help build the capacity of banks.

6.5 Greenwashing Risks

Greenwashing is a situation where a financial product or project is marketed as being green, but the product or project has not met the relevant criteria, and the evidence is insufficient to support the claim.Low-quality project selection, project-related environmental claims that are not backed up by funds, and unclear allocation of funds can result in a loss of depositor confidence in green finance. The RBI's green deposit framework tackles this concern by introducing financing frameworks, verification or assurance, and impact assessment and reporting requirements (RBI, 2023a).

Banks need to ensure that environmental claims are substantiated by sound evidence and that disclosures are accurate in their description of the scope and limitations of financed activities.

6.6 Affordability and Financial Inclusion

Small businesses, farmers and households may not have the assets, documentation or credit history to qualify for traditional loans for sustainable investments.The benefits of sustainable finance might be unevenly distributed if it is only available for large enterprises. As banks examine how to implement proportionate assessment, they should look for appropriate products and assessment for eligible smaller borrowers that reflects the same strong credit standards.But clarity in communication is also important to financial inclusion. The borrowers need to be aware of the expenses, terms, and hazards of green loans and other environmentally friendly financial products.

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6.7 Measuring Environmental Impact

Just the number and/or value of green loans do not prove their environmental effectiveness. A bank can fund a project that is called ‘green' but in which the actual ‘green' impacts have not been measured sufficiently. The need for appropriate indicators, baseline data and standard methods of reporting is fundamental to impact assessment. Renewable energy produced, energy saved, emissions avoided, water saved or waste recovered are examples of indicators depending on the project.Environmental impacts can also be challenging to link to a specific financing contract, which is why banks should also remember that environmental impacts cannot only be attributed to one contract. Therefore, assumptions, methods used for estimation, limitations in impact reporting should be made clear.

7. Strategies for Strengthening Green Finance in Indian Banks

7.1 Development planning for Sustainable Growth

Material environmental and climate-related risks need to be taken into account in the credit appraisal and portfolio monitoring of banks. Proportionate procedures for assessment may be used depending on the borrowers' size and sector and risk profile.

Standardised checklists can be used to identify environmental compliance problems and climate vulnerability and potential for resource efficiency. Banks may request professional evaluations when a project has considerable technical intricacy.

7.2 Developing Suitable Green Financial Products

Renewable energy, energy efficiency and pollution control, sustainable water management and other environmental projects are eligible for green loans and other financing options for banks.The cash-flow behaviour of borrowers and the actual needs of the financed activity should be taken into account for the design of the product. The eligibility, pricing, repayment terms and environmental reporting requirements must be clearly communicated to banks.

7.3.1 Enhance the capability of GDA (green deposit allocation) and Reporting.

Improve capacity in GDA (green deposit allocation) and Reporting.The provisions of the relevant RBI framework should be implemented for the regulated entities taking green deposits. Enhanced transparency can be achieved by the clear project selection process, allocation records, verification, impact assessment and public disclosures. Banks also need to report on project proceeds, and not overstate their environmental benefits.

7.4 Improving Climate Risk Management

Banks should enhance their capacity of identifying material physical and transition risks. This can include a sector-level exposure analysis, borrower assessment, scenario analysis and the creation of appropriate internal reporting. Climate risk assessment needs to be embedded into the existing credit, operations and strategic risk-management processes. Training and supervision of staff are important for consistent implementation.

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7.5 Support MSMEs and Smaller Borrowers

Banks can engage with relevant government agencies, industry associations and technical institutions as partners to assist smaller enterprises in identifying eligible investments in sustainability. Practical support might involve making documentation simple where appropriate, information sessions, and technical referrals and financing products tailored to realistic project cash flows. These can contribute to extending sustainable finance and ensuring sound risk assessment of credit and environmental impact.

7.6 Building Staff Capacity

To become a sustainable lender, one needs to be knowledgeable of banking and environmental performance. Banks should offer training and education in green project identification, in the risks associated with the climate, in environmental indicators, in the products of sustainable finance, and in the prevention of greenwashing.

Clear internal policies and responsibilities about staff development should be provided to support staff development. It can enhance the uniformity of the credit decisions and quality of the sustainability disclosures.

7.7 Promoting Collaboration

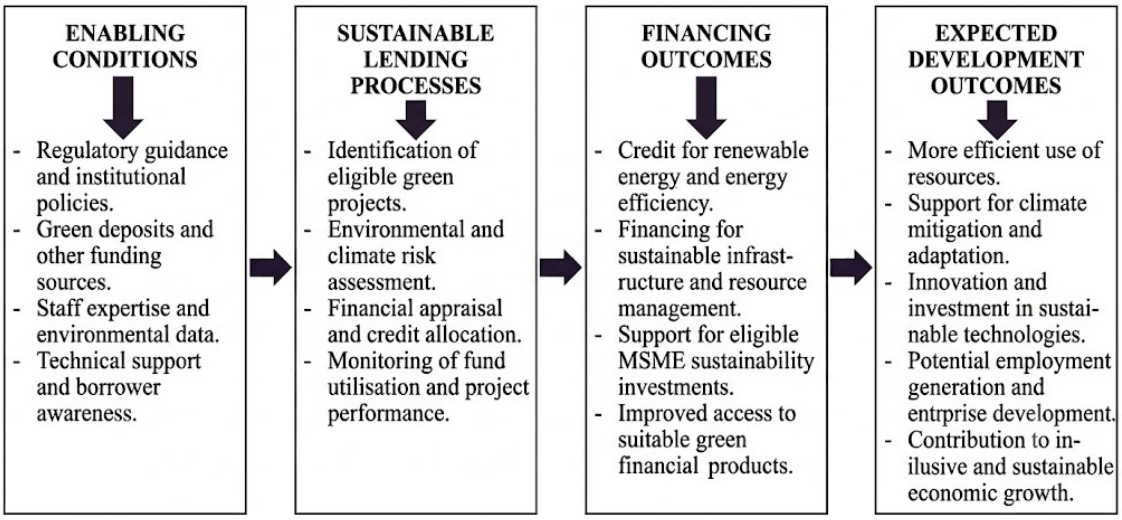
It would be impossible for banks to overcome all technical and market challenges to green finance on their own. Regulators, government agencies, research institutions, technical service providers and industry bodies can work together to better understand the project, and to increase borrower awareness. These partnerships can also be used to contribute to the creation of standardised information, as well as to identify potential projects and enhance the quality of the environmental impact assessment.

8. Proposed Conceptual Framework

The proposed framework explains how sustainable lending practices can contribute to environmental and economic outcomes.

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CONCEPTUAL FRAMEWORK FOR SUSTAINABLE LENDING AND DEVELOPMENT OUTCOMES



The framework indicates that regulatory support and green funding alone are insufficient. Effective outcomes also depend on sound credit appraisal, reliable environmental information, project viability, transparent monitoring and borrowers' ability to implement the proposed activities.

The framework is conceptual and requires empirical testing through bank-level studies, interviews with credit officers or analysis of green lending portfolios.

9. Major Findings from the Conceptual Analysis

The conceptual study of green finance and sustainable lending in the banking industry of India brings a few significant findings. Green finance is important for steering financial resources towards environmentally friendly projects, such as renewable energy, energy efficiency, pollution control and conservation of natural resources. Focusing on environmental issues when making a loan decision can help banks support sustainable economic growth and mitigate new environmental and climate risks.

The initiatives taken by the Reserve Bank of India as a regulator, such as the Framework for Acceptance of Green Deposits, form a basis for fostering credible green financing practices by eligible regulated entities. Likewise, promoting eligible renewable energy activities through priority sector lending opens the door for banks to promote investments for environmental benefits. But priority sector classification and green finance classification are different and an activity classified in one would not necessarily be classified in the other.

The analysis also reveals that sustainable lending needs to incorporate environmental and climate-related considerations into the credit appraisal, risk assessment and portfolio monitoring. Green funding and the existence of the regulatory framework are not necessarily enough to ensure success. Good implementation also requires project viability, the availability of reliable environmental information, and a proper assessment of credit and of the borrowers' capacity to implement the proposed activities, and adequate monitoring.

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The lack of environmental data, limited technical expertise, and uncertainty about project performance and the potential for greenwashing are some of the obstacles to the implementation of green finance. The uncertainty of these challenges could be especially important for micro, small and medium enterprises (MSMEs) who might find financing for environmentally sustainable investments challenging. They can be better engaged in a green transition, while maintaining prudent lending standards, through the use of suitable financial products, technical assistance and proportionate assessment procedures.

In addition, the transparent reporting, environmental impact assessment, training of employees, and cooperation between banks, regulators, government institutions, and borrowers can improve the credibility of sustainable lending. The environmental impact of green finance must be assessed according to the impact of the projects financed and the measurable results.

In general, the conceptual analysis shows that the implementation of effective green finance must be based on the coordination of various key components, including regulatory support, good financial management, and the credibility of environmental assessment and access to capital. The observations need to be further explored through bank-level studies, credit officer interviews and green lending portfolio analysis. The results quoted here are conceptual and are not the statistical results of a survey of Indian banks.

10. Conclusion

In response to environmental degradation and climate-related issues, the banking sector has adopted green finance and sustainable lending practices, which have become significant aspects of its efforts to address environmental challenges. Banks have the ability to redirect financial flows and invest in sustainable and low-emission uses, such as renewable energy, energy efficiency, pollution prevention, sustainable infrastructure and conservation of resources. These programs can help in India's journey towards a more sustainable and resilient economy.

The developments made by the regulatory bodies of India, such as the Reserve Bank of India's Framework for Acceptance of Green Deposits and the addition of eligible renewable energy activities to the priority sector lending provision, offer significant support for the growth of sustainable finance in the country. However, the effectiveness of green lending goes beyond regulatory compliance or the creation of new financial products. Banks need to put in place appropriate project selection processes, factor in environmental and climate risks in their credit evaluation, have robust data and build staff capacity and have a clear reporting framework.

Another factor is the avoidance of green washing – presenting environmental benefits that are exaggerated or poorly substantiated. Banks should ensure that their sustainability claims are backed by trustworthy assessments and that environmental goals of financed projects are monitored during the duration of the credit. These can help to increase accountability, boost trust among stakeholders and further strengthen the long-term impact of green finance.

MSMEs and smaller borrowers should also be prioritized as they might face informational and financial and technical challenges in transitioning to an environmental technology. Using appropriate loan products, providing technical guidance, capacity building programmes and using proportionate assessment procedures can help enhance access to green finance without compromising credit standards. Further enhancing the collaboration of banks, regulatory bodies, government and other stakeholders will help make sustainable lending more possible.

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Going forward, empirical studies are needed to assess the level of green lending by Indian banks, drivers of green lending, credit risk and the impact of green lending on the environment of the projects financed by the green banks. A comparative study between public sector banks, private sector banks, small finance banks and other relevant financial institutions may throw light on difference in implementation, operational issues and the way to improve it.

Finally, a sustainable economic transition in India is possible when the environment is explicitly linked to the smart use of finances, with effective reporting and access to financing. Coordinated regulatory support, effective institutional practice and measurable environmental outcomes are key to developing a sustainable lending ecosystem that is robust and transparent. Indian banks can play a greater role in ensuring long-term economic resilience and sustainable development by addressing existing challenges and improving accountability.

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