

SEBI AND THE REFORM ON SUSTAINABLE FINANCE (Part 1 of 3)



Pradeep Ramakrishnan
General Manager
Department of Debt and Hybrid Securities
Securities and Exchange Board of India, Mumbai
pradeepr@sebi.gov.in



Nikhil Chaudhary
Manager
Securities and Exchange Board of India
Mumbai
Nikhilc@sebi.gov.in



Priyanka Meena
Assistant Manager
Securities and Exchange Board of India
Mumbai
Priyankameena@sebi.gov.in

Green bonds and SEBI:

The first part of the article discusses the concept of sustainable finance and the evolution of the green bond framework.

Abstract

Frequent environmental disasters and extreme weather events have led to the crying need for dealing with climate change and the need to finance the same sustainably. Corporate finance being driven purely by wealth maximization / profit motive, without considering the environmental and social impacts of the activities of the firms, has alleviated the need for sustainable finance.

To provide for the avenues to both issuers and investors for sustainable finance, Governments and Capital Market Regulators across the globe have come up with various policy measures including frameworks pertaining to sustainable finance; SEBI regulates the capital market in India and has come up with the framework for green debt securities for the listed / propose to be listed issuers and the same have been amended from time to time to cater to the changing market landscape.

While sustainable finance is gaining popularity, concerns regarding the greenwashing are also rising across the globe as there is no universal consensus on “what is green”. SEBI has addressed the issue of the greenwashing by strengthening the disclosure requirements and prescribing certain dos and don’ts to avoid the instances of the greenwashing.

The article, in three parts, focuses on the SEBI’s efforts to align its green bond framework with the updated Green Bond Principles (GBP) of International Capital Market Association (ICMA) while incorporating the domestic market needs by including “transition finance” in the definition of green debt security.

Introduction:

The clamour for finance to be sustainable is growing by the day. Sustainable finance takes into account environmental aspects and social concerns while providing finance by way

of debt or equity or while investing in securities / other instruments. The idea that finance should be sustainable is being taken into account increasingly by many investors over the past few years as investors are becoming more aware and responsible, they not only look for financial returns of their investment but also the impact that their investments have.

In 2015, landmark international agreements were concluded with the adoption of the UN 2030 agenda and sustainable development goals and the Paris climate agreement. Further, in the 2021 United Nations Climate Change Conference, more commonly referred to as COP26, held in Glasgow, Scotland, 197 Countries, including India, have made enhanced commitments towards mitigating climate change and promising more climate finance for developing countries to adapt to climate impacts. This means that sustainable finance will be the mainstay of world business, which in turn, will mean more demand for funds in this domain. This was reiterated in the CoP 27 at Egypt also.

Rating agencies forecast that global issuance of green, sustainable bonds will be around \$1tn this year¹. In this context, green bonds assume significance as one of the modes of sustainable finance.

Green bond market – a part of the corporate bond market
– The Green Bond Market is a subset of the corporate bond market. A green bond is a debt instrument issued by an entity for raising funds from investors, but what differentiates it from other bonds is that the proceeds of a Green Bond offering are specifically allocated for use towards ‘green’ projects.

An important difference between a ‘green’ bond and a regular bond is that the issuer, in its offer document – placement memorandum for private placements and prospectus for public issues – discloses that it is raising capital to fund ‘green’ or sustainable projects, assets or business activities with an environmental or Sustainable Benefit. Green bonds invest in environment-friendly projects in areas like renewable energy, waste management, clean transportation, sustainable water management and climate change adaptation.

This green / sustainable financing is gaining the attention of the institutional investor base such as mutual funds, pension funds, sovereign wealth funds, insurance companies and angel investors like private equity investors, etc.

History – Green bond framework in India:

In March 2015, The International Capital Market Association (ICMA) published a document called Green Bond Principles (GBP)².

The GBPs outlined a set of principles that delineated good practices for the process of issuing a green bond, which are divided in four components:

i. Use of proceeds:

Issuers to define and disclose their criteria for what

is considered ‘green’ i.e. which projects, assets or activities will be considered ‘eligible’ and how much funds will be spent on.

ii. Project evaluation and selection:

The process will be used to apply ‘green’ criteria to select specific projects or activities. Details of the criteria for evaluating the projects eligible for using the Green Bond proceeds and the details of the process used/will be used to apply ‘green’ criteria to selected specific projects or activities. Issuer shall also disclose the environmental sustainability objectives of the proposed assets/projects.

iii. Management of proceeds:

Details of processes and controls are in place to ensure funds are used only for the specified ‘green’ projects.

iv. Reporting:

The mode of evaluation of projects and report of progress, against both environmental and financing criteria

SEBI consultation

It was noted that lack of regulation has forced a majority of Indian players to tap the overseas market for green bonds. Hence SEBI thought fit to create a pathway for the purpose.

Accordingly, SEBI initiated a consultation process for disclosure requirements for Public Issue and Listing of Green Bonds and listing of privately placed Green Bonds. A concept paper was placed on the SEBI website on December 03, 2015, for seeking public comments. The disclosures were based upon the Green Bond Principles, 2015 of the ICMA.

SEBI’s first concept paper on green bonds³ stated that the issuance of green bonds in their present form started in year 2007 and in the initial years Green Bonds were a niche product, pioneered by a handful of development banks. It also stated that the period between 2007-2012 was featured with the issuance of green bonds by the Supranational organizations such as the European Investment Bank and the World Bank, along with few governments etc. with growing market appetite for such bonds there is increasing diversification of issuers and investors participating in Green Bonds.

First green bond framework of SEBI

After taking public comments from stakeholders into account, SEBI brought a green bond framework in May 2017⁴. Broadly, the requirements of the framework were:

Definition of green debt security

The framework provided that a security would be considered ‘green’ if proceeds from its issue were to be utilised for project(s) and/or asset(s) falling under any of the following broad categories:

- a. *Renewable and sustainable energy including wind, solar bioenergy, other sources of energy which use*

¹ <https://www.climatebonds.net/2022/01/500bn-green-issuance-2021-social-and-sustainable-acceleration-annual-green-1tn-sight-market>

² http://www.icmagroup.org/assets/documents/Regulatory/Green-Bonds/GBP_2015_27-March.pdf

³ https://www.sebi.gov.in/sebi_data/attachdocs/1449143298693.pdf

⁴ https://www.sebi.gov.in/legal/circulars/may-2017/disclosure-requirements-for-issuance-and-listing-of-green-debt-securities_34988.html

- clean technology etc.*
- b. *Clean transportation including mass/ public transportation etc.*
- c. *Sustainable water management including clean and/ or drinking water, water recycling etc.*
- d. *Climate change adaptation*
- e. *Energy efficiency including efficient and green buildings etc.*
- f. *Sustainable waste management including recycling, waste to energy, efficient disposal of wastage etc.*
- g. *Sustainable land use including sustainable forestry and agriculture, afforestation etc.*
- h. *Biodiversity conservation*

Plus, the following had to be undertaken by an issuer of green debt securities:

Initial disclosures in Offer Document

An issuer of a green debt security shall make disclosures in the offer document with regards to the environmental objectives of the issue, brief details of decision-making process followed/would be followed for determining the eligibility of project(s), system/procedures to be employed for tracking the deployment of the proceeds of the issue etc.

Continuous disclosure requirements:

An issuer of a green debt security shall make continuous disclosures, in financial results and annual report, about the usage of green bond proceeds, details of the projects financed, environmental impact of green financing etc.

Reliance on Global Norms

If the issuer or any agent appointed by the issuer, follows any globally accepted standard(s) for the issuance of Green Debt Securities including measurement of the environmental impact, identification of the project(s) and/or asset(s), utilisation of proceeds, etc., same shall be disclosed in the offer document/ disclosure document and/or as part of continuous disclosures.

Further evolution of the SEBI green bond framework, including requirements for green debt securities

India has set ambitious renewable energy goals to improve energy access and energy security while taking action on climate change. India has set a net zero target by 2070⁵. Net zero, or becoming '*carbon neutral*', implies not adding greenhouse gases to the atmosphere.

In order to avert the worst impacts of climate change and preserve a livable planet, global temperature increase needs to be limited to 1.5°C above pre-industrial levels⁶. It means that cutting greenhouse gas emissions to as close to zero as possible, with any remaining emissions re-absorbed from the atmosphere, by oceans and forests for instance⁷.

⁵ <https://www.weforum.org/agenda/2022/09/net-zero-challenges-in-dia-target/>

⁶ Refer Inter-governmental panel of climate change - <https://www.ipcc.ch/sr15/>

⁷ <https://www.un.org/en/climatechange/net-zero-coalition>

But India is the world's third largest emitter of greenhouse gases⁸. A greenhouse gas is a gas that absorbs and emits radiant energy within the thermal infrared range, causing the greenhouse effect. The primary greenhouse gases in Earth's atmosphere are carbon dioxide, methane, nitrous oxide, hydrochlorofluorocarbons (HCFCs), hydrofluorocarbons (HFCs) and ozone⁹. The World Economic Forum says that India faces many challenges including a heavy dependence on coal and a lack of funding.

At the COP-26 summit in Glasgow, India had made the following commitments towards its climate change goals¹⁰:

- a. *Raising non-fossil fuel based energy capacity to 500 GW.*
- b. *Lowering total projected carbon emission by one billion tons.*
- c. *Meeting 50% of the country's energy needs through renewable sources.*
- d. *Reduce the carbon intensity of the economy to sub 45% level.*
- e. *Commitment to achieve net-zero emissions by 2070.*

The Indian Government has initiated the following schemes/policies in pursuit of the goals towards COP-26 targets:

- a. *Commission on Air Quality Management (CAQM) - phasing out of coal use in National Capital Region from January 2023, but exempting thermal power plants using low-sulphur coal.*
- b. *National Biomass Co-firing policy to use biomass like paddy stubble and cow-dung in coal power plants¹¹.*
- c. *Mandate the use of flue gas desulphurization (FGD) techniques in both existing and upcoming thermal power plants.*
- d. *Government has targeted to achieve 100 Million Tonnes of Coal Gasification by 2030¹².*
- e. *National Mission on Transformative Mobility and Battery Storage¹³.*
- f. *Productivity Linked Incentives (PLI) Scheme on Advanced Cell Chemistry and Battery Storage¹⁴.*
- g. *India Cooling Action Plan¹⁵. MA*

⁸ <https://www.carbonbrief.org/the-carbon-brief-profile-india/>

⁹ Refer World Meteorological Organisation - <https://public.wmo.int/en/our-mandate/focus-areas/environment/greenhouse-gases>

¹⁰ https://www.mea.gov.in/Speeches-Statements.htm?dtl/34466/National_Statement_by_Prime_Minister_Shri_Narendra_Modi_at_COP26_Summit_in_Glasgow

¹¹ https://powermin.gov.in/sites/default/files/Revised_Biomass_Policy_dtd_08102021.pdf

¹² <https://pib.gov.in/Pressreleaseshare.aspx?PRID=1650096>

¹³ <https://www.niti.gov.in/e-mobility-national-mission-transformative-mobility-and-battery-storage>

¹⁴ <https://www.niti.gov.in/sites/default/files/2022-02/Need-for-ACC-Energy-Storage-in-India.pdf>

¹⁵ <https://www.iea.org/policies/7455-india-cooling-action-plan-icap>