# TRANSITION BONDS AND SEBI

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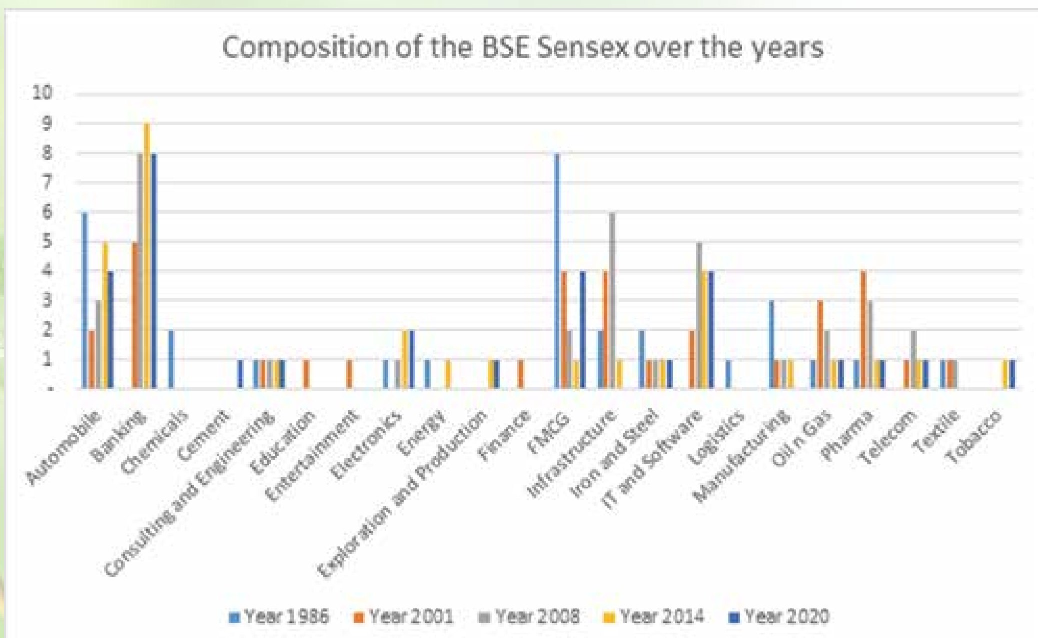
**Abstract**

*Transition Finance is that which assists a company to move from a 'carbon-intensive' nature of operations to 'carbon-neutral' nature of operations. This transition eventually helps the industry and the nation in moving to net zero. Finance needed for this transition is known as 'transition finance'. Recently, SEBI has brought in a new green bond framework of which transition finance is also an important part. This article discusses the nuances of the SEBI green bond framework pertaining to transition finance.*

### What is transition finance?

Businesses have evolved. There was a point in time when business was all about making more money for stake holders. Essentially, investors felt that the higher the stock price of the company, the more value it created for them. Maybe rightly so as any investor would like to see their investment appreciate – this is what would constitute value for them. So businesses of all hue and colour started taking public money.

The following graph shows the sector-wise composition of the BSE Sensex over the past few decades:




The Sensex made its debut on April 1, 1979 with a base value of 100. The BSE started publishing values of the Sensex in 1985[1]. Specifically, if one compares the years 1986 and 2020, the following is the sector-wise composition of companies over the years:

[1] https://www.financialexpress.com/market/sensex-journey-from-100-to-39000-in-just-40-years-ten-landmarks/1535393

| | Year 1986 | Year 2020 |
|---|---|---|
| **Automobile** | 6 | 4 |
| **Banking** | - | 8 |
| **Chemicals** | 2 | - |
| **Cement** | - | 1 |
| **Consulting and Engineering** | 1 | 1 |
| **Education** | - | - |
| **Entertainment** | - | - |
| **Electronics** | 1 | 2 |
| **Energy** | 1 | |
| **Exploration and Production** | - | 1 |
| **Finance** | - | - |
| **FMCG** | 8 | 4 |
| **Infrastructure** | 2 | |
| **Iron and Steel** | 2 | 1 |
| **IT and Software** | - | 4 |
| **Logistics** | 1 | - |
| **Manufacturing** | 3 | - |
| **Oil n Gas** | 1 | 1 |
| **Pharma** | 1 | 1 |
| **Telecom** | - | 1 |
| **Textile** | 1 | - |
| **Tobacco** | - | 1 |

One can see the changing nature of the sectors that are part of the index. If one does an analysis of indices around the world one would get a similar picture. Notwithstanding the sector, the reason these companies managed to be in the Sensex was because of the value they created for the investors. But over a period of time, ever since global warming and climate change became household terms, there has been a change in the expectation of investors. They want companies to adopt a ESG linked approach to business. Various legislations – the Companies Act, the SEBI Listing Regulations etc. have recognised the need for businesses to be socially responsible.

*A director of a company shall act in good faith in order to promote the objects of the company for the benefit of its members as a whole, and in the best interests of the company, its employees, the shareholders, the community and for the protection of environment.*

*- Section 166 (2) of the Companies Act, 2013*

*Members of the board of directors shall act on a fully informed basis, in good faith, with due diligence and care, and in the best interest of the listed entity and the shareholders.*

*- Regulation 4(2)(f)(iii)(3) of the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015*

Thus companies that generate revenue and consequently value have to ensure that the industry in which they operate is not a sin industry (or the contribution of the *'sin'* (e.g. tobacco, alcohol etc.) portion of the industry is reducing owing to the company trying to diversify). Moreover, there is an imperative need that companies move from a '*carbon-intensive*' nature of operations to '*carbon-neutral*' nature of operations. This is what one calls as *transition*. This transition eventually helps the industry and the nation in moving to net zero. Finance needed for this transition is known as '*transition finance*'.

### What are INDCs[2]?

*Intended Nationally Determined Contributions (INDCs)* refer to the climate targets determined by India under the Paris Agreement at the Conference of Parties 21 in 2015, and at the Conference of Parties 26 in 2021, as revised from time to time.

India's updated Nationally Determined Contributions (NDCs) are communicated to the United Nations Framework Convention on Climate Change (UNFCCC)[3]. NDCs embody efforts by each country to reduce national emissions and adapt to the impacts of climate change. The Paris Agreement (Article 4, paragraph 2) requires each Party to prepare, communicate and maintain successive nationally determined contributions (NDCs) that it intends to achieve. Parties shall pursue domestic mitigation measures, with the aim of achieving the objectives of such contributions.

In its INDC, India has pledged to:

- improve the emissions intensity of its GDP by 33 to 35 per cent by 2030 below 2005 levels.
- increase the share of non-fossil fuels-based electricity to 40 per cent by 2030.
- agreed to enhance its forest cover which will absorb 2.5 to 3 billion tonnes of carbon dioxide ($CO_2$, the main gas responsible for global warming) by 2030.

India's updated NDC also represents the framework for India's transition to cleaner energy for the period 2021-2030. It proposes 'LIFE'– '*Lifestyle for Environment*' as a key to combating climate change. The vision of LIFE is to live a lifestyle that is in tune with our planet and does not harm it. India's updated NDC also captures this citizen centric approach to combat climate change.

In this regard, India has also presented, at the CoP 26, a concept of *'Panchamrit' ('five nectar elements')*

[2] *https://pib.gov.in/PressReleaseIframePage.aspx?PRID=1847812*

[3] *https://unfccc.int/process-and-meetings/the-paris-agreement/nationally-determined-contributions-ndcs*

- Reach 500 GW Non-fossil energy capacity by 2030.
- 50 per cent of its energy requirements from renewable energy by 2030.
- Reduction of total projected carbon emissions by one billion tonnes from now to 2030.
- Reduction of the carbon intensity of the economy by 45 per cent by 2030, over 2005 levels.
- Achieving the target of net zero emissions by 2070.

This is expected to help India usher in low emissions growth pathways and safeguard its future development needs based on the principles and provisions of the United Nations Framework Convention on Climate Change (UNFCCC).

India had also made a commitment to increase its carbon sink by 2.5 to 3 billion tonnes of carbon dioxide equivalent by 2030 through the creation of additional forest and tree cover. A carbon sink is nothing but a green tree cover that will absorb the carbon dioxide link a sink.

**Additional requirements for issuers of transition bonds[4]:**

Since transition bonds are *green debt securities* as per the NCS Regulations, SEBI felt a need to ensure that the funds raised for transition finance through transition bonds are indeed used for the purpose. Accordingly, certain stipulations additionally have been brought in by SEBI for issuers of transition bonds.

1. On February 2, 2023, the revised definition of *'green debt security'* was notified in the SEBI (Issue and Listing of Non-Convertible Securities) Regulations, 2021[5]. On February 6, 2023, SEBI issued the revised disclosure requirements for such issuances.
2. As mentioned earlier, *'Transition bonds'* is one of the sub categories of the revised definition of '*green debt security'*. As per the SEBI (Issue and Listing of Non-Convertible Securities), transition bonds comprise of:

   *"funds raised for transitioning to a more sustainable form of operations, in line with India's Intended Nationally Determined Contributions."*
3. The present size of the transition finance market is around USD 3.5 billion[6]. Essentially it is moving from operations that are carbon intensive to carbon neutral. For transition, a significant helping hand through funding is required for carbon-intensive sectors to decarbonize. SEBI believes that transition bonds find their use in this space.
4. In order to facilitate transparency and informed decision making amongst the investors in the transition bonds and to ensure that the funds raised through transition bonds are not being misallocated, SEBI decided to prescribe certain additional requirements for issuance and listing of *transition bonds*, as follows:

[4] *https://www.sebi.gov.in/legal/circulars/may-2023/additional-requirements-for-the-issuers-of-transition-bonds_70937.html*
[5] *See Regulation 2(1)(q) of the SEBI NCS Regulations, 2021*
[6] *https://www.climatebonds.net/files/reports/cbi_sotm_2022_03c.pdf*

SEBI brought a circular on May 5, 2023, requiring an issuer desirous of issuing transition bonds to make the following additional disclosures:

**Disclosure in the offer document for public issues / private placements of such transition bonds:**

a. To differentiate transition bonds from other categories of green debt security, Issuer of transition bonds shall use a denotation ***'GB-T'***. The denotation shall be disclosed in the offer documents on the cover page and in *type of instrumen*t field in the term sheet.
b. Transition Plan, which shall contain the following:
   i. *Details of interim targets / milestones along with an indicative timeline for achieving the targets.*

      *(interim targets should also reflect the indicative figure regarding how much emissions the issuer is envisaging to reduce)*
   ii. *Brief of the project implementation strategy*
   iii. *Details regarding the usage of technology for the project implementation*
   iv. *Mechanism to oversee the utilization of the funds raised through transition bonds and the implementation of the transition plan. Issuers may form a committee to oversee the implementation and ensure timely completion of the defined targets.*

**Disclosure in the Centralised Database for corporate bonds:**

An issuer shall disclose the denotation in the Centralized Database for corporate bonds/ debentures by filling the denotation i.e. **GB-T** in sub point 6 i.e. *Others (Please specify)* of point 10. i.e. *Type of Instrument* of Annex-XIV-A to Chapter XIV (Centralized Database for corporate bonds/ debentures) of the Operational Circular dated August 10, 2021 (and as amended from time to time).

The Depositories shall update the denotation i.e. **GB-T** as prefix in "*instrument details"* field in Centralized Database for corporate bonds/ debentures.

**Disclosure to Stock Exchanges, in case of a revision in the transition plan:**

An Issuer of transition bonds, during the year, shall disclose the revised transition plan along with an explanation for any such revision to the already disclosed plan; if applicable.

**Disclosure in the Annual report:**

The Issuer, shall disclose the transition plan along with a brief on the progress of the implementation of the transition plan.

**Transition finance – steps:**

The International Platform on Sustainable Finance (IPSF) was launched on 18 October 2019. Its members are public authorities from Argentina, Canada, Chile, China, India, Indonesia, Kenya, Morocco, Norway, Switzerland and the European Union, representing almost half of the world's greenhouse gas emissions. The International Platform aims to[7]:

- *Exchange and disseminate information to promote best practices in environmentally sustainable finance;*
- *Compare the different initiatives and identify barriers and opportunities to help scale up environmentally sustainable finance internationally;*
- *While respecting national and regional contexts, enhance international coordination where appropriate on environmentally sustainable finance issues. Where appropriate, some willing members could strive to align initiatives and approaches.*

The IPSF offers a multilateral forum of dialogue between policymakers that are in charge of developing sustainable finance regulatory measures to help investors identify and seize sustainable investment opportunities that truly contribute to climate and environmental objectives[8]. The IPSF has suggested the following steps in transition finance adoption and use including reporting to investors[9]**:**


**Conclusion:**

Transition finance is sitting at the cusp of being one of the most tapped avenues of finance in the country. Funds from these bonds can be used for any project, provided certain requirements as laid down by SEBI and sustainability improvements are met — for example, reducing emissions by a set amount within a predetermined deadline, moving from fossil fuel power to renewable power etc. The Transition bond framework of SEBI aims to bridge the fiancé gap by being a source of finance to take care of the company's green energy needs. MA

[7] *https://www.switch-asia.eu/resource/international-platform-on-sustainable-finance-ipsf/*
[8] *https://finance.ec.europa.eu/sustainable-finance/international-platform-sustainable-finance_en.*
[9] *https://finance.ec.europa.eu/system/files/2022-11/221109-international-platform-sustainable-report-transition-finance_en.pdf*