SEBI AND THE REFORM ON SUSTAINABLE FINANCE (Part 2 of 3)

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The new Green bond framework of SEBI

The second part of the article discusses the new green bond framework of SEBI

Abstract

In the backdrop of increasing interest in sustainable finance around the globe as well as in domestic market, SEBI after extensive consultation with market participants revised its regulatory framework for issuance and listing of green debt securities.

The Regulatory framework was revised to enhance the scope of definition of green debt security to include pollution prevention and control and eco efficient products within the ambit of eligible categories to raise funds through issuance of green debt securities. Further, the concept of Blue Bonds (related to sustainable water management and marine sector), Yellow Bonds (related to solar energy) and Transition Bonds (related to transitioning to a more sustainable form of operations) was introduced as sub categories of green debt security.

To facilitate transparency and informed investment decision making, SEBI also updated the initial and continuous disclosure requirements for issuance and listing of green debt securities. Appointment of third party auditor/certifier for reviewing/certifying the processes for project evaluation and selection criteria, post – issue management of the use of the proceeds raised through issuing green debt security etc. , impact reporting and disclosure of major elements of Business Responsibility and Sustainability Reporting are some of the major changes to the extant disclosure requirements.

SEBI's push to revise the green bond framework:

A strong and effective policy framework, as well as a transition to renewable energy, will help India accelerate its drive to net zero. And precisely, to scale the necessary finance to achieve these national targets, new innovative financial instruments such as green bonds need to scale up. The objectives of SEBI's push to revise the green bond framework were to strengthen and expand the market for green bonds in India through:

- *expanding and diversifying the issuer and investor base;*
- *a reduction in the cost of capital / debt;*
- *encouraging demand from institutional and retail investors; and*

SEBI held a series of discussions held with multiple stakeholders and also its a series of discussions held with multiple stakeholders before releasing the paper for public comments. Accordingly, the consultation paper sought public comments on the following as part of a revised green bond framework:

- *to amplify the definition of green debt securities,*
- *to introduce the concept of blue bonds*
- *to reduce the compliance cost for issuers of green debt securities with while not creating any perverse incentives that may lead to 'greenwashing'.*

Suggestions were also solicited towards increasing avenues for sustainable finance in India, while considering India's unique goals of pursuing high growth with sustainable development.

SEBI has aligned its extant green bond framework with Green Bond Principles of the International Capital market Association (ICMA).

Based on the review and after taking into account the public comments on its Consultation paper, SEBI has updated its regulatory framework to provide for the following:

- Enhance the scope of definition of green debt security by including new modes of sustainable finance in relation to pollution prevention and control, eco-efficient products, etc.;
- Introduce the concepts of:
  - blue bonds (related to water management and marine sector),
  - yellow bonds (related to solar energy) and
  - transition bonds as a sub category of green debt securities

Accordingly, 'green debt securities' refers to a security, the funds raised through which are used for the all or any of the following purposes:

i. renewable and sustainable energy including wind, bioenergy, other sources of energy which use clean technology,

ii. clean transportation including mass/public transportation,

iii. climate change adaptation including efforts to make infrastructure more resilient to impacts of climate change and information support systems such as climate observation and early warning systems,

iv. energy efficiency including efficient and green buildings,

v. sustainable waste management including recycling, waste to energy, efficient disposal of wastage,

vi. sustainable land use including sustainable forestry and agriculture, afforestation,

vii. biodiversity conservation,

viii. pollution prevention and control (including reduction of air emissions, greenhouse gas control, soil remediation, waste prevention, waste reduction, waste recycling and energy efficient or emission efficient waste to energy) and sectors mentioned under the India Cooling Action Plan launched by the Ministry of Environment, Forest and Climate Change,

ix. circular economy adapted products, production technologies and processes (such as the design and introduction of reusable, recyclable and refurbished materials, components and products, circular tools and services) and/or eco efficient products,

x. *blue bonds* which comprise of funds raised for sustainable water management including clean water and water recycling, and sustainable maritime sector including sustainable shipping, sustainable fishing, fully traceable sustainable seafood, ocean energy and ocean mapping,

xi. yellow bonds which comprise of funds raised for solar energy generation and the upstream industries and downstream industries associated with it,

xii. transition bonds which comprise of funds raised for transitioning to a more sustainable form of operations, in line with India's Intended Nationally Determined Contributions, and

xiii. any other category, as may be specified by the Board from time to time.

Nationally Determined Contributions (NDCs)[1]

India's updated Nationally Determined Contributions (NDCs) are to be communicated to the United Nations

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

Framework Convention on Climate Change (UNFCCC)[2]. 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 short, 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.

In its INDCs, 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.

Major changes in the new requirements:

SEBI has also made major changes to the extant requirements for entities desirous of borrowing funds through SEBI's green bond framework, including disclosure requirements:

1. Appointment of a third party auditor/ certifier

The SEBI requirement states that an issuer shall appoint an independent third party reviewer/ certifier, for reviewing/ certifying the processes including project evaluation and selection criteria, project categories eligible for financing by green debt securities, etc. The third party reviewer shall certify the following:

1.1 Post-issue management of the use of proceeds from the green debt security,

1.2 verification of the internal tracking and impact reporting.

This requirement of appointing a third party reviewer/ certifier is applicable on a 'comply or explain' basis for a period of two years. While this requirement was voluntary under the earlier green bond framework, SEBI thought it fit to make it on a 'comply or explain basis before making it mandatory because it is one of the important aspects of certification that yields itself to independence and consequent trust for the discerning investor. One of the reasons cited for investors shying away from investing in India's green bonds was the absence of independent certification. SEBI has plugged the gap by introducing this requirement.

'Comply or explain' for this purpose, would mean that the issuer shall endeavour to comply with the provisions and achieve full compliance by two years from the date of issuance of the circular. In case the entity is not able to achieve full compliance with the provisions till such time, the issuer shall in its annual report, explain the reasons for such non-compliance/ partial compliance and the steps initiated to achieve full compliance

2. Impact reporting

An impact report is but a means of communicating that intends to convey the change caused due to an activity – the 'before' and 'after' a reform / law / project. Essentially, this is but a measurement of an organisation's activities – in this case, the funds and the projects in which they were gainfully employed in and the effect of the same.

The SEBI requirement on impact reporting is that information, on a project-by-project basis, pertaining to reporting of the environmental impact of the projects financed by the green debt securities. Reporting standards or taxonomies followed by the issuer with regard to reporting of environmental impact, if any, shall also be disclosed. In impact reporting, metrics, data / information and communication are paramount. There is a need to align impact based goals between investors and the issuers of green bonds. Impact reporting facilitates this.

3. Disclosure of major elements of Business Responsibility and Sustainability Reporting (BRSR)

While issuers with a market capitalization of Rs.1000 crore and above have to comply with the requirements of filing Business Responsibility and Sustainability reports as part of their Annual reports, the same was hitherto not applicable for issuers of bonds. MA

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