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GOVERNMENT OF INDIA INTRODUCES THE FRAMEWORK FOR SOVEREIGN GREEN BONDS

25 November 2022 Nations across the world are taking steps to meet their respective environmental, social and governance (ESG) commitments, pursuant to various global commitments in the backdrop of the United Nations Sustainable Development Goals (UN SDGs) and international treaties especially the 'Nationally Determined Contribution' (NDCs) adopted under the Paris Agreement.

As a step towards fulfilling its international commitment, constitutional ideal to preserve the environment and pursuant to the announcement made by the Finance Minister in the Union Budget 2022-23 of India (Budget), the Government of India has introduced a framework for governing issuance of sovereign green bonds (Framework). The Framework aims to mobilise resources for green infrastructure projects in a bid to reduce the economy's carbon intensity. This is a positive step in furtherance of India's climate action plan and 'Panchamrit' commitments as elucidated by the Hon'ble Prime Minister at the COP26 Glasgow Conference in November 2021 and India's updated NDCs valid till 2030.

The International Capital Markets Association (ICMA) in 2018 had enacted voluntary guidelines on green bonds to promote transparency and disclosure in, and to facilitate development of the green bond market which was furthered under the ICMA Green Bond Principles (2021) (Green Bond Principles). One of the primary objectives of the Green Bond Principles is to lay down a clear process and disclosure by the issuer to enable the subscribers to understand the characteristics of the green bond. The Green Bond Principles are essentially voluntary process guidelines, which set out: (a) four core principles, being: (i) use of proceeds i.e. permitted (and prohibited) end use restrictions from the proceeds raised through such bonds, (ii) process for project evaluation and selection, (iii) management of proceeds, and (iv) reporting; and (b) two key recommendations for 'green bond frameworks' and 'external reviews'.

The Framework has been designed in alignment with these four key components and key recommendations of the Green Bond Principles. The Framework applies to all sovereign green bonds issued by the government and sets forth the obligations of the government as a sovereign bond issuer (Issuer). We have analysed the components of Framework based on the Green Bond Principles below.

1. Use of Proceeds

The proceeds raised from the issue of the sovereign green bonds (Issue Proceeds) shall be used by the Government to finance or refinance expenditures made by it on eligible green projects (Green Expenditure). Eligible green projects, based on their objectives, have been broadly categorised into the following: (i) renewable energy (e.g. solar projects); (ii) energy efficiency (e.g. installation of energy efficient infrastructure); (iii)

clean transportation (e.g. electrification of public transport) (iv) climate change adaptation (e.g. development of early warning systems); (v) sustainable water and waste management (e.g. building wastewater management infrastructure); (vi) pollution prevention and control (e.g. projects targeting reduction of air emissions); (vii) green buildings (e.g. projects to meet various standards of environmental performance); (viii) sustainable management of living natural resources and land use (e.g. research on living resources and biodiversity protections); and (ix) terrestrial and biodiversity conservation (e.g. projects relating to coastal and marine environment).

Green Expenditure includes an array of expenditures undertaken by the government to meet its sustainable development goals such as investments in hydropower energy projects, clean fuel, waste water and greenhouse gas control. The Ministry of Finance (Finance Ministry) has also constituted a Green Finance Working Committee which will evaluate green projects in alignment with the national environmental policies, the UN SDGs, the Green Bond Principles, the respective state's environmental and social objectives as well as the minimum social safeguards under Indian law. It is pertinent to note that all fossil fuel related projects and biomass-based renewable energy projects that rely on feedstock from protected areas have been expressly kept outside the scope of the Framework.

Under the Framework, the Issue Proceeds cannot be used towards expenditures that occurred prior to more than 12 (twelve) months of the issuance. Furthermore, the Issue Proceeds should be allocated to projects within 24 (twenty four) months of the issuance. In order to avoid double counting, all the expenditures that are already financed/refinanced by any other Government Agency shall be excluded.

2. Management of Proceeds

In accordance with the standard treasury policy, the Issue Proceeds of an issuance will be deposited to the Consolidated Fund of India (CFI), and thereafter the funds from the CFI will be allocated to eligible green projects. Constituted under Article 266(1) of the Constitution of India, CFI is the account of the revenue that the Government of India receives and the expenses it makes, excluding exceptional items. For transparency in allocation and accounting of Issue Proceeds, the Finance Ministry shall create and maintain a separate account for the Issue Proceeds. The Public Debt Management Cell has been accorded the duty to keep a track of Issue Proceeds within the existing guidelines and monitor the allocation of funds towards eligible green expenditures. The Issuer shall be responsible under the framework for allocation of the Issue Proceeds. In case there is any unallocated Issue Proceeds, it will be carried forward to successive years for investment in eligible green projects.

The Reserve Bank of India in coordination with the Finance Ministry will keep track of eligible green expenditures for which Issue Proceeds can be utilised in a year and any green expenditures that can be potentially financed in the subsequent year through another issuance.

3. Green Register

A dedicated information system will be set up by the Finance Ministry with the objective to maintain a comprehensive 'Green Register'. The 'Green Register' will have the details of the green bond issuance, proceeds generated, allocations made to eligible projects including information about the eligible projects.

4. Reporting

The Framework recommends that the Issuer is required to prepare an allocation report which will be updated on an annual basis until the full allocation of Issue Proceeds of the outstanding green bonds. Such annual report, as prepared and issued by the Issuer, shall

consist of: (i) information about the issuance; (ii) list of allocated Issue Proceeds to eligible projects and type of expenditure; (iii) project description and status; (iv) sum of allocated and unallocated Issue Proceeds; (v) quantitative indicators for expected impact of projects; (vi) alignment of eligible procedures and stated objectives and (vii) assumptions, if any. This report aims to provide transparent reporting on the allocation of proceeds, especially through disclosure of expected impact of projects in quantitative indicators, indicating reduction in carbon intensity and other environmental and social benefits.

Comment

The Framework comes in as a step by the government as a commitment towards achieving its sustainable development goals and promoting green financing. In contrast to the existing green debt framework under the Securities and Exchange Board of India (Issue and Listing of Non-Convertible Securities) Regulations, 2021, the Framework stipulates that the redemption of the principal amount and payment of interests are not conditional on the performance of the eligible project which would provide comfort to an investor against any project related risks, thereby incentivizing investor participation in such bonds.

However, there are certain grey areas in the Framework which demand legislative intervention. The Framework does not specify quantitative thresholds for the various project categories. For instance, no benchmark or minimum certification has been provided for construction of low-carbon buildings. Similarly, there is no reference to any recognized sustainability standard and / or certification for evaluation and selection of green projects eligible for Green Expenditure. Given that investors are continually dealing with information asymmetry and lack of any universally accepted ESG reporting framework or standard, policy makers should include benchmarking systems within the Framework which enable measurement of data sets, science-based targets and commitments to enhance credibility in outcomes and end reporting.

That said, the Government's approval of the Framework is certainly a step towards furthering India's 'Nationally Determined Contribution' targets adopted under the Paris Agreement and shall boost India's efforts towards energy transition and sustainability. The Framework shall play a crucial role in attracting both domestic as well as global investments in eligible green projects in India.

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