Building Bonds: The Mechanics of India's Debut Sovereign Green Issuance

INTRODUCTION

Last year, in India's Union Budget for the present fiscal, the country's finance minister had announced[1] that the Reserve Bank of India ("**RBI**") would issue 'sovereign green bonds' ("**SGrBs**") for the purpose of mobilizing resources for green infrastructure, and the proceeds from such bond issuance would be deployed in public sector projects to reduce the carbon intensity of the economy. Accordingly, the framework (the "**SGrB Framework**")[2] and indicative issuance calendar[3] with regard to the SGrBs were released on November 9, 2022 and January 6, 2023, respectively. Consistent with global practice, India's SGrB Framework is based on the green bond principles ("**GBPs**") of the International Capital Market Association ("**ICMA**"), as updated through June 2022.[4]

The Significance of Green Bonds

Green bonds are a type of thematic bonds – a category which includes blue, social, gender, sustainability, and sustainability-linked bonds as well. Designed to provide borrowers with alternative financial solutions for accessing private sector financing in order to address specific challenges, thematic bonds are fixed-income securities to raise financing for projects and activities related to a specific theme – such as climate change, education, housing, ocean and marine conservation, or the Sustainable Development Goals adopted by the United Nations (SDGs).[5] Green, social, and sustainability bonds are usually referred to as use-of-proceeds bonds, given that

[1] See here.

[2] Available here.

[3] See here.

[4] See here.

[5] See here.

resources raised through these securities are earmarked for specific projects designed to generate intended impacts. Standard green use-of-proceeds bonds involve an unsecured debt obligation with full recourse to the issuer alone.

Green bonds have emerged as the preferred option when it comes to thematic bonds, representing almost two-thirds of the aggregate outstanding amount. Further, according to a 2020 report published by the International Finance Corporation (IFC),[6] green bond issuances were projected to reach USD 100 billion annually by 2023 in emerging markets alone (the estimate was revised upwards by a whopping USD 50 billion in just two years)[7] – although such markets currently constitute only 15% of the total. Furthermore, while sovereigns represent less than a tenth of the aggregate thematic bond market, interest in sovereign instruments has grown significantly in recent times. In fact, an increasing number of emerging market sovereigns have started issuing thematic bonds in local currency,[8] moving away from past practice where such issuances were denominated in currencies such as USD, Euro, and the Japanese yen.

Since investors, shareholders, and regulators are increasingly clamoring for concrete action to address the potentially cataclysmic consequences of climate change, the global demand for thematic bonds is poised to continue its current trajectory of rapid growth. Further, as policymakers around the world continue to enact new rules and regulations on sector-specific reporting and risk management obligations for climate-related issues, financial institutions will likely continue to robustly engage with such thematic instruments. In addition, since shareholders today demand that corresponding investees transition to 'net-zero' status and focus on sustainability, such financial institutions will remain under pressure to seek thematic assets. This present momentum offers a significant opportunity for issuers in emerging markets – such as India and Indian corporates. A strong demand for India's SGrBs can diversify the country's investor base, signal commitment to local sustainability goals, and achieve better pricing in the future.

According to some commentators,[9] sovereign green bond issuances may lead to an overall improvement in the quality and frequency of offering, as well as in marketability, of similar instruments across such sovereign's wider economy. Thus, the SGrBs might provide a welcome template for Indian companies to follow and aspire to, including in

[6] Available here.

[7] See here.

[8] Ibid.

[9] See here.

respect of enjoying the benefits of enhanced credibility to counter potential allegations of greenwashing.[10]

The Significance of the GBPs

The GBPs, under the auspices of ICMA, provide voluntary process guidelines for the issuance of green bonds. They outline best practices that promote transparency and disclosure, thereby underpinning the integrity of global debt markets towards financing environmental and social sustainability.

Pursuant to ICMA's vision, the four main components of the GBPs have been reflected in the SGrB Framework, including in respect of the following: (i) use of proceeds, (ii) project evaluation and selection, (iii) management of proceeds, and (iv) reporting. Indeed, the content, format, and procedural blueprint (including with regard to external review) of the SGrB Framework – along with its stated mission – all follow international precedent, such as the frameworks designed by Italy,[11] Poland,[12] Ireland,[13] etc. for their respective sovereign green bond issuances in the past.

According to insights based on World Bank surveys of public debt management offices and international investors in respect of sovereign thematic bonds,[14] investors remain concerned about the issuance framework itself, as well as about second-party opinion confirming alignment with ICMA's vision. Purportedly, investors also focus on governance, eligibility evaluation processes, and robust standards of transparency in respect of annual allocations and impact reports. Significantly, each investor may have its own ESG integration criteria, where they could screen out certain sovereign issuers, such as those which have exposure to certain blacklisted industries or those that receive negative media attention.

While the alignment of India's sovereign issuance with the core components of ICMA's recommendations are well-explained in the SGrB Framework itself, the GBPs do not mandate legal documentation – as long as the underlying issue details are made available in an easy-to-access format. Nevertheless, the GBPs neither constitute specific advice nor create any rights or liabilities themselves. Thus, issuers – including sovereigns – implement the GBPs independently and remain responsible for their own

[10] 'Greenwashing' refers to a misleading or false set of claims or action by an organization about the positive impact that its actions or services has on the environment.

[11] Available here.

[12] See here.

[13] Available here.

[14] Available here.

decision to issue green bonds. If a conflict arises between an applicable law and the GBPs, the relevant local statutes and regulations will prevail.

INDIA'S SGRB ISSUANCE

India's debut sovereign issuance in green bonds involve INR 160 billion (USD 1.9 billion), offered in two tranches of INR 80 billion each – in five and ten-year tenors – through auctions scheduled for January 25 and February 9, 2023, respectively. The issuance has been categorized under the so-called 'Fully Accessible Route' ("**FAR**") for the benefit of foreign investors.

FAR

The FAR was introduced with effect from April 1, 2020 as a separate channel for non-resident investment in 'dated' securities issued by the Indian government (*i.e.*, carrying a fixed or floating interest rate, paid on the face value on a half-yearly basis, with a tenor of at least 5 years) – where eligible investors can participate without any investment ceilings. Accordingly, certain specified categories of government securities can be made fully accessible for non-resident investors, *i.e.*, without any restrictions, apart from being available to domestic investors as well. Such specified securities, once so designated, remain eligible for investment under the FAR until maturity.

The Auction

The SGrB auction will be conducted on the basis of yield for new security and on the basis of price for securities which are re-issued.[15] In the event of re-issuance made on the basis of price, the coupon will be pre-determined. Accordingly, bidders will need to quote the price (per INR 10,000)[16] at which they wish to purchase the SGrBs. Alternatively, when the issuance is made on the basis of yield, the coupon of the SGrBs will be decided in an auction conducted by the RBI. The SGrBs will carry the same coupon rate until maturity.

An applicant may submit multiple bids at the same or different rates of yield or price, pursuant to separate applications for each bid. The aggregate amount of bids submitted by a person for an individual bond should not exceed the aggregate amount of the SGrBs offered for sale, plus any additional amount that may be retained under the 'green shoe' option, if any, that the Indian government chooses to exercise. This means that the RBI may accept excess subscriptions up to a specified extent – as prescribed in the specific notification related to the SGrB issuance – and make

[15] See here.

[16] Stocks will be issued for a minimum amount of INR 10,000 (nominal) and in multiples of INR 10,000 thereafter.

allotments accordingly. Ultimately, albeit in consultation with the Indian government, it is the RBI that will have the ultimate discretion to accept or reject any or all applications, either wholly or in part, without assigning any reason.

On the basis of bids received, the RBI, in consultation with the Indian government, will determine the maximum rate of yield or the minimum price offered – as applicable – at which offers for the purchase of the SGrBS will be accepted. In the absence of a price-based auction, the maximum rate of yield, as determined, will be the coupon rate per annum in respect of the SGrBs sold at such auction.

Uniform Price

The SGrBs will be issued to eligible investors through a 'uniform price' auction. Under this method, competitive bids offered with rates up to and including the maximum rate of yield, or the prices up to and including the minimum offer price, as determined by the RBI, will be accepted at the maximum rate of yield or at the minimum offer price so determined. Bids which are quoted higher than the maximum rate of yield or lower than the minimum price (as determined by the RBI in consultation with the Indian government) will be rejected.

Who can Invest in the SGrBs?

Investments in the SGrBs may be made by: (i) any person resident in India – including firms, companies, corporate bodies, institutions, state governments, provident funds and trusts, non-resident Indians ("**NRIs**"), overseas citizens of India ("**OCIs**"), foreign portfolio investors ("**FPIs**") registered with the Securities and Exchange Board of India ("**SEBI**") and approved by the RBI; as well as (ii) any other person not resident in India, as specified by the RBI with the prior approval of the Indian government in this regard.

Foreign Central Banks ("**FCBs**") will also be eligible to invest in the SGrBs subject to certain terms and conditions, as stipulated by the RBI in consultation with the Indian government. Nevertheless, an investment made by a person resident outside India or by a company which is incorporated outside India (or by a branch of such a company) will remain subject to the provisions of the Foreign Exchange Management Act, 1999, as amended from time to time ("**FEMA**"), along with applicable regulations framed under FEMA – in addition to other provisions of law which are generally applicable to Indian government securities.

What about Retail Investors?

Under Indian law, for the purpose of encouraging wider participation, a non-competitive bidding facility has been made available for retail investors in select auctions of government securities.[17] Accordingly, 5% of the aggregate nominal amount of the SGrB issuance will be reserved for retail investors – which category may include any individual, firm, company, corporate body, institution, provident fund, trust, or any other person/entity prescribed by the RBI. Nevertheless, to qualify as an eligible participant in the auctions on a non-competitive basis, a retail investor needs to satisfy certain stipulated requirements.[18]

How does one Apply for the SGrBs?

Both competitive and non-competitive bids for the auctions related to the SGrB issuance need to be submitted in electronic format on the RBI's 'Core Banking Solution' (E-Kuber) system on the day of the auction, until the closing time of such auctions, as prescribed by the RBI. Bids in physical form will not be accepted except in extraordinary circumstances, such as network/system failure.[19] FPIs and NRIs, however, are required to submit their applications through bank branches of designated authorized dealers (ADs).[20]

SALIENT FEATURES OF THE SGRBS

The SGrBs will be considered as eligible investments for the purpose of Statutory Liquidity Ratio (SLR) obligations and repurchase transactions ("**Repo**") in banks.

Repo

Indeed, all regulated entities, listed corporates, unlisted companies which have been issued special securities by the Indian government using only such special securities as collateral, all-India financial institutions (FIs) constituted through parliamentary legislation (such as Exim Bank, the National Bank for Agriculture and Rural Development (NABARD), National Housing Bank (NHB), and the Small Industries Development Bank of India (SIDBI)), as well as any other entity approved by the RBI, will be eligible to participate in Repo transactions involving the SGrBs. While such Repo transactions must be undertaken for at least a day's period and at most a year's,[21] they will be tradeable on any recognized stock exchange or RBI-authorized electronic trading platform – or even in the over-the-counter (OTC) market – albeit with

[17] See here.

[18] See here.

[19] Such physical bids should be submitted to the Public Debt Office, Mumbai in the prescribed form, which can be obtained from the RBI website, before the auction ends.

[20] See sub-paragraph (i) of paragraph 2.3 ("Procedure for Application") of the General Notification F.No.4(2)-W&M/2018 on 'Sale of Government of India Securities' dated March 27, 2018, available here.

[21] See here.

prior RBI approval in each case. Further, such transactions can employ any trading process, as long as such process has been mutually agreed upon.

Underwriting

Primary dealers ("**PDs**") – including scheduled commercial banks that undertake PD business departmentally – may engage in underwriting with regard to the SGrB auction. The RBI stipulates (i) a minimum underwriting commitment ("**MUC**") for each PD, and (ii) the amount for which an additional competitive underwriting ("**ACU**") auction will be held. At present, the minimum bidding requirement for each PD in the ACU auction is equal to the amount of the MUC.[22]

The MUC of each PD will be computed to ensure that at least 50% of each issue is mandatorily covered by the aggregate of all MUCs. The MUC must be uniform for all PDs, irrespective of their capital or balance sheet. For the SGrB auction, a PD should bid for an amount which is equal to, or more than, the successful amount in the ACU and MUC.

WI Trading

While the SGrBs will be eligible for trading in the secondary market – since July 2018, the eligible participant base and the entity-wise limits in respect of transactions in the 'when, as and if issued' ("**When Issued**," or "**WI**") market in government securities have been liberalized and relaxed, respectively. Of particular interest is the fact that the SGrBs will be eligible for WI trading.

A WI security is one which has been authorized for issuance but has not yet been issued. Thus, WI trading occurs between: (i) the time a government security is announced for issuance, and (ii) the time such security is finally issued. Predictably, all WI transactions are on an 'if' basis, *i.e.*, they are settled if and when the security is subsequently issued.

Generally speaking, all entities which are eligible to participate in the primary auction of central government securities may undertake both net long and short positions in the WI market. This applies for new securities as well as for reissuances. Although such eligibility conditions will extend to the SGrB issuance as well, resident individuals, Hindu Undivided Families (HUFs), NRIs, and OCIs will be permitted to take only long positions. Further, entities other than scheduled commercial banks and PDs will be required to close their short positions, as applicable, by the close of trading on the date of auction. All WI transactions for all trade dates are required to be contracted for

[22] See here.

settlement on the date of issue. Finally, if the auction is cancelled for any reason, all WI trades will be deemed null and void.

Requirements in the event of re-issuance, default settlement mechanisms under the Clearing Corporation of India Limited (CCIL), open position limits, trading venues, and miscellaneous reporting obligations have also been prescribed in directions issued by the RBI.[23]

Transferability

The SGrBs can be renewed, sub-divided, consolidated, converted, and transferred in accordance with, and subject to the restrictions stipulated under, applicable law.[24] Transfers by NRIs, FPIs and FCBs will be subject to regulations framed under FEMA and guidelines issued by the RBI. In addition, transfer of the SGrBs by FPIs will be subject to applicable SEBI regulations in respect of FPIs, as modified from time to time.

Tax and Dispute Settlement

Existing Indian tax laws will apply for the purpose of determining the liability of investors/holders in respect of the SGrBs. Any dispute relating to the SGrBs will be subject to the jurisdiction of Indian courts.

CONCLUSION

The SGrB issuance comes at a time of increased ESG adoption in the country, especially given certain important developments in this regard, such as the RBI's discussion paper on climate risk and sustainable finance.[25] In addition, pressure exerted by sectoral regulators on institutional investors – such as on the Life Insurance Corporation of India (LIC) and the Employees' Provident Fund Organisation (EPFO) – to incorporate ESG considerations in their respective portfolios may further drive up domestic demand for the SGrBs,[26] including on account of SEBI's guidance on disclosures with regard to ESG practices under its business responsibility and sustainability reporting framework.[27]

Nevertheless, with regard to retail investors in the domestic market, the absence of tax concessions might dampen demand. Moreover, as the RBI Deputy Governor lamented

[23] See here.

[24] See here.

[25] See here.

[26] See here.

[27] See here.

last month, India still lacks a green taxonomy[28] – *i.e.,* a classification system establishing a list of green economic activities – which, in effect, provides companies, investors, and policymakers with an appropriate definition for what constitutes 'green'.[29] Even though a list of permissible activities has been laid down in the SGrB Framework, the process for evaluating environmental impact and its appurtenant risks remains unclear – according to the 'CICERO Shades of Green' second party opinion (the "**Second Opinion**").[30] The Second Opinion further claims that: (i) the principles for selecting green projects remain (too) general in the SGrB Framework; and (ii) the broadly defined project categories – on account of the absence of quantified thresholds – create uncertainty about which type of expenditure might be financed.

Such important caveats notwithstanding, prior global experience suggests that sovereign green bonds contribute towards creating a conducive ecosystem, which, in turn, fosters greater capital inflow into the green sector. Further, the SGrB issuance may represent an excellent opportunity for India to develop skills in measurement, assurance, and ratings in respect of a green taxonomy.

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[28] See here.

[29] For example, see here.

[30] See here.