SEBI's New Framework for Sustainable Finance: A Review Beyond Environmental Sustainability

BACKGROUND

The Securities and Exchange Board of India ("**SEBI**") released a consultation paper ("**SEBI paper**") on August 16, 2024 proposing to expand the scope of the sustainable finance framework in the Indian securities market. The SEBI paper recognized that various jurisdictions will continually require tremendous amounts of financing for the purposes of meeting the 17 Sustainable Developments Goals ("**SDGs**"), as part of the 2030 UN Agenda for Sustainable Development. In fact, a report by S&P Global Ratings estimates that sustainable bond issuances will reach USD 1 trillion by 2024 globally. This highlights the need for India to fill the deficit of required financing to meet its sustainability commitments. Recently, the Indian delegation at the COP29 Ministerial Conference, held in November 2024, also recognized and highlighted the role played by climate finance in implementing climate action in developing economies. In this context, the SEBI recently amended the Securities and Exchange Board of India (Issue and Listing of Non-Convertible Recently Securities) Regulations of 2021 (the, "**NCS Regulations**") by issuing the SEBI (Issue and Listing of Non-Convertible Securities) (Third Amendment) Regulations, 2024 on December 11, 2024 ("**Amendment Regulations**"), to implement the proposals put forth in the SEBI paper.

This note discusses the expansion of asset classes under the Indian sustainable finance framework pursuant to the Amendment Regulations and its impact on listed issuances by Indian corporates to domestic and foreign investors.

INTRODUCING THE CONCEPT OF ESG DEBT SECURITIES

The SEBI introduced a framework for listed issuances of green debt securities in 2017, which was later revised in the year 2023. However, the revision failed to broaden the scope of sustainable finance related security issuances under Indian law beyond environmental sustainability. A close look at the definition of 'green debt securities' under Regulation 2(1)(q) of the NCS Regulations reveals that it covered securities for financing limited types of projects and assets such as renewable and sustainable energy including wind and bioenergy, clean transportation, energy efficiency, making infrastructure more resilient to impacts of climate change, sustainable waste management and land use, pollution prevention and control, issuance of blue bonds for the purpose of financing projects for sustainable water management and a sustainable maritime sector, yellow bond issuances in relation to solar energy generation and transition bonds for transitioning to a more sustainable form of operations etc. The ambit of the definition does not extend to measures for fulfilling social objectives under the SDGs, for example, building sustainable cities and communities and increasing gender diversity. Accordingly, the Amendment Regulations have introduced the concept of 'Environmental, Social and Governance Debt Securities' ("**ESG Debt Securities**") under Regulation 2(1)(oa) of the NCS Regulations, which will include securities such as social bonds, sustainable bonds and sustainability linked bonds, and green debt securities.

UNDERSTANDING THE AMBIT OF THE ESG DEBT SECURITIES

Various international jurisdictions have used the framework of the Bond Principles of the International Capital Markets Association, ("**ICMA Principles**") as a foundation for developing regulatory frameworks for ESG bond issuances. The ICMA Principles emphasize the role that debt markets can play in contributing to ESG goals and broadly distinguish between the asset classes by strictly outlining the purpose of each asset class in the following manner:

1. Social Bonds:[1] The issue proceeds from these bond issuances can be used to raise funds for new and existing projects that have the purpose of generating a positive social outcome. This may include projects relating to: (a) providing affordable basic infrastructure such as sanitation, transport and clean drinking water; (b) providing access to essential services such as healthcare, financial services or education; and (c) implementing food security systems.

2. Sustainable Bonds:[2] These bonds can only be issued with the purpose of financing or re-financing a combination of green and social projects. This bond category recognizes that the green projects and social projects may have overlapping objectives and outcomes. For instance, Alphabet Inc., the parent company of Google, made a landmark issuance of USD 5.75 billion in sustainability bonds in 2020. Alphabet's Sustainability Bond Framework includes eligible projects such as the construction of green buildings and expenditure on clean transportation. Such project categories lead to outcomes that benefit both environmental and social objectives.

[1] Social Bond Principles, ICMA, 2023

[2] Sustainable Bond Principles, ICMA

3. Sustainability Linked Bonds:[3] These instruments are forward looking performance-based instruments which can be used for general purposes by the issuer. Such bonds are issued with a commitment to improving sustainability outcomes in the future and are measured through predefined Key Performance Indicators ("**KPIs**") and assessed against predefined Sustainability Performance Targets. ("**STPs**").

It may be noted that there are two key categories of ESG bond issuances under the ICMA Principles: (i) use of proceeds; and (ii) KPI. While in (i), the proceeds are utilized for a specific project, in (ii), proceeds are utilized to generally meet the overarching goals of sustainability and ESG objectives. The use of proceeds route is more regulated as specific project outcomes are mapped against predefined timelines. For example, the National Highways Authority of India has recently announced a green bond issuance aggregating to INR 10 billion for expenditure on avenue plantation, median plantation, construction of animal underpasses, natural stormwater drainage, streetlight on renewable energy (solar), waste recycling & reuse and rainwater harvesting in relation to the Delhi-Mumbai Expressway project. Contrastingly, KPI issuances could include issuances that are benchmarked against broader sustainability objectives such as reducing CO2 emissions from operations to a certain percentage, reducing emissions from significant suppliers of the entity, increasing green material content in production activities, working towards obtaining green certifications for clean energy, increasing gender diversity in the operations of the organization, and paying a certain percentage of revenues of wages to all employees.

The Amendment Regulations do not provide clarity on the adoption of the ICMA Principles explicitly but state that the ESG Debt Securities shall be issued in accordance with such international frameworks as adapted or adjusted to suit Indian requirements that are specified by the SEBI from time to time. Further, new Regulation 12A of the Amendment Regulations states that an issuer desirous of issuing and listing ESG Debt Securities shall comply with such conditions as may be prescribed by SEBI; however, the SEBI is yet to issue any directions or notifications pursuant to Regulation 12A. Once the SEBI comes out with further directions and notifications, there will be clarity on the extent to which the Indian framework adopts the ICMA Principles.

REGULATORY FRAMEWORK FOR ISSUE AND LISTING OF ESG DEBT SECURITIES

The existing disclosure framework under the NCS Regulations generally covers certain disclosures in the offer document for all kinds of non-convertible securities as defined under Regulation 2(1)(w) of the NCS Regulations. Schedule I of the NCS Regulations provides the initial disclosures to be made in the offer document for public issuances and private placements of non-convertible securities. Further, the SEBI (Listing Obligations

[3] Sustainability-Linked Bond Principles, ICMA, 2024

and Disclosure Requirements) Regulations of 2015 provide certain additional disclosures to be made by the issuer company on an ongoing basis.

Given the nature and purpose of green debt securities, prior to the Amendment Regulations, Regulation 26 of the NCS Regulations read with Chapter IX, Chapter IX-A and Chapter IX-B of the Master Circular for issue and listing of Non-convertible Securities, Securitised Debt Instruments, Security Receipts, Municipal Debt Securities and Commercial Paper dated May 22, 2024 ("**Master Circular**") provided additional disclosure requirements applicable to issuers of green debt securities to protect investors against the risks of greenwashing. Such requirements included: (i) additional initial disclosures to be made in the offer document such as a statement on the environmental sustainability objectives of the issue, details of the decision-making process for determining the eligibility of green projects and details of procedures followed for tracking the deployment of funds received etc; (ii) continuous disclosures in the annual report and financial statements of the issuer company and the Business Responsibility and Sustainability Report ("**BRSR**"), where applicable. Disclosure through the BRSR is a mandatory requirement under Indian law for the top 1000 listed entities; (based on their market capitalization) and (iii) appointment of a third-party reviewer or certifier in relation to the issued green debt securities for post issue management of the proceeds received and verification of the tracking of funds and impact reporting to be carried out by the issuer company.

The SEBI has now omitted Regulation 26 pursuant to the Amendment Regulations. The relevant chapters of the Master Circular have also been omitted as they had been adopted under Regulation 26 of the NCS Regulations. Accordingly, there is currently a regulatory gap in relation to the disclosure framework for all ESG Debt Securities, including green debt securities. It is only when the SEBI adopts a revised comprehensive framework for issuance and listing of ESG Debt Securities under Regulation 12A of the NCS Regulations, that there will be clarity on the legal framework for these issuances.

FOREIGN INVESTMENT IN ESG DEBT SECURITIES

The objective of expanding the scope of the categories of bonds under the umbrella of ESG securities, which can be issued and listed by Indian companies, was to enhance the availability of capital by widening the investor base. This is aligned with India's commitment towards a green transition for meeting the country's climate goals. However, potential investment by foreign investors may be limited under the present Indian regulatory framework governed by the Foreign Exchange Management Act of 1999. Expanding the investor base to foreign investors may require special consideration by the regulators.

CONCLUDING REMARKS

The SEBI's review of India's bond issuance framework in regard to ESG objectives is aligned with India's commitment to reducing its Intended Nationally Determined Contributions in its infrastructure and development activities. As a developing nation, India is highly reliant on the debt market for financing its sustainability activities. Data from the SEBI shows that 20 Indian entities have undertaken an issuance of green debt securities between 2017-2024, raising a total amount of INR 61.28 billion. Indian entities operating in the ESG space will now have access to additional capital through ESG Debt Securities from interested investors. This expansion will play a significant role in attracting greater investment to meet India's SDG goals. The Indian government has already been implementing various Production Linked Incentive ("**PLI**") schemes aimed at meeting sustainability objectives. As an example, the PLI scheme for high efficiency solar PV modules provides incentives over a period of five years to selected solar manufacturers. Projects developed under such PLI schemes will now be able to issue ESG Debt Securities based on their commercial requirements.

The Amendment Regulations also align the domestic Indian framework with Chapter X of the International Financial Services Centres Authority (Listing) Regulations, 2024, which already regulate the listing procedure for green, social, sustainability, sustain ability linked or any other ESG labeled debt securities on the India International Exchange in the International Financial Services Centre (the, "**IFSC**") in GIFT City, which is a special economic zone in India.

The revised framework presents India as a potential jurisdiction for ESG bond investors that have invested in other jurisdictions that follow international standards in regard to their sustainable finance framework. However, further notifications from the SEBI are awaited to clarify the legal framework within which Indian entities can issue and list the ESG Debt Securities.

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