SECURITIES AND EXCHANGE BOARD OF INDIA

Memorandum to the Board

DISCLOSURE REQUIREMENTS FOR ISSUANCE AND LISTING GREEN BONDS

1. Objective

1.1. This Board Memorandum proposes "Disclosure requirements for issuance and listing of Green Bonds" for approval of Board.

2. Background

2.1. India's Intended Nationally Determined Contribution (INDC) document puts forth the stated targets for India's contribution towards climate improvement and following a low carbon path to progress. The document also impresses upon the need of financing needs for achieving the stated goals, where a preliminary estimate suggests that at least USD 2.5 trillion (at 2014-15 prices) will be required for meeting India's climate change actions between now and 2030. In this regard the document talks about the introduction of Tax Free Infrastructure Bonds of INR 50 billion (USD 794 million) for funding of renewable energy projects during the year 2015-16.

2.2. Further, India has embarked upon an ambitious target of building 175 gigawatt of renewable energy capacity by 2022 and this requires a massive estimated funding of USD 200 billion. Thus, the financing needs of renewable energy space require new channels to be explored which can provide not only the requisite financing, but may also help in reducing the cost of the capital. Green bonds as a part of corporate bonds space may be one of the answer to this problem.

2.3. Also, there are specific global pool of capital, which are earmarked towards investment in Green Ventures. This source of capital focuses primarily on environmental, social and governance (ESG) related aspects of the projects in which they intend to invest. Thus, green bonds provide an issuer the access to such investors which they otherwise may not be able to tap with a regular bond.

2.4. Globally, Green Bond is a very new phenomenon, started only in 2007, featured with initial issuances from Supranational organizations such as the European Investment Bank and the World Bank, along with few government agencies mainly. However, lately it has picked up in a big way, where Year 2013 saw the participation from corporate sector, which substantially increased in year 2014. (Global issuance of Green bonds in 2013 and 2014 were USD 11 Bn and USD 36.6 Bn respectively)

3. Issuance requirements of Green Bonds

3.1. A green bond is like any other bond where a debt instrument is issued by an issuer for raising funds from investors. However what differentiates a Green bond from other bonds is that the proceeds of a Green Bond offering are 'ear-marked' for use towards financing ‘green’ projects.

3.2. SEBI (Issue and Listing of Debt Securities) Regulations, 2008 (hereinafter "ILDS Regulations") govern public issue of debt securities and listing of debt securities issued through public issue or on private placement basis, on a recognized stock exchange.

3.3. Thus, an issuance of Green Bonds in India, shall be governed under ILDS Regulations, requiring issuer to make disclosures as required under ILDS Regulations. However, given the nature of such bonds there is a need for defining what all constitutes under Green Bonds and the specific disclosure requirements with regards to management of proceeds, reporting requirements etc.

3.4. While even today Green Bonds can be issued under ILDS Regulations, the proposal under consideration removes uncertainty about what constitutes a green bond and what is the process required to be followed. This is intended to benefit those funds/investors which have a mandate to invest only in green initiatives. These funds/investors will no longer have to need to apply their separate test for eligibility and as such facilitate quicker decision making. This move will also help in uniformity regarding green bonds and remove any future confusion. Besides, if the government or any regulator decides to grant any benefit/forbearance for such bonds, this initiative will come in very handy.

3.5. SEBI in its meeting of Corporate Bond and Securitisation Advisory Committee (CoBoSAC), held on July 29, 2015, took an agenda item on introduction of disclosure and monitoring requirements for Green Bonds In India. The issue was deliberated in the committee meeting and proposal was accepted. Committee, recommended that SEBI may consider to initiate the consultation process for introduction of disclosure requirement and monitoring of Green Bonds, which are in line with the requirements as have been provided in Green Bond Principles as recommended by International Capital Market Association (ICMA)

3.6. Subsequently a proposal for initiating the public consultation process for disclosure requirements for Public Issue and Listing of Green Bonds and listing of privately placed Green Bonds which was taken up and approved by Board in the meeting held on November 30, 2015. Pursuant to that, a concept paper was placed on the SEBI website on December 03, 2015, for seeking public comments. The consultation paper is enclosed at **Annexure-A.**

3.7. SEBI has received comments from (Detail has been excised for reasons of confidentiality) entities including industry bodies, international organizations engaged in the area of determining standards for the climate financing, banks, merchant banks, law firms, individuals, etc.(Summary of the same is placed at **Annexure-B**)

4. Analysis of the Public comments:

4.1. Use of proceeds:

4.1.1. Proposal in discussion paper:

The issuer shall define and disclose in their offer document, the criteria for identification as 'green' i.e. what projects, assets or activities will be considered 'eligible for financing' and quantum of funds to be spent on the projects/assets/activities.

Further, for assigning the status of the bonds as Green, the broad categories of areas where such monies may be invested may be one or more of the following:

- Renewable and sustainable energy (wind, solar etc.)
- Clean transportation (mass transportation)
- Sustainable water management (clean and/or drinking water, water recycling etc)
- Climate change adaptation
- Energy efficiency (efficient and green buildings)
- Sustainable waste management (recycling, waste to energy etc.)
- Sustainable land use (including sustainable forestry and agriculture, afforestation etc.)
- Biodiversity conservation

However, it is to be noted that this is an indicative list and may include other categories as specified by Board.

Further, an issuer, if proposes to utilise a proportion of the proceeds of the issue of Green Bonds, towards refinancing of existing green assets, it shall be clearly provided in the offer document and wherever possible, shall also provide the details of the portfolio/assets/projects which are identified for such refinancing.

4.1.2. Comments on consultation paper:

Definition of Green

4.1.2.1. Most of the comments received in this regard suggest that for green bond market to remain a credible financer of projects that have positive environmental impacts, it is essential to adequately define what types of projects are eligible as green, coz. if left to issuers, the definition of 'green' can be interpreted in a wide variety of ways and may cause confusion in the minds of investors. This would also help to prevent the accusations of 'greenwash' i.e. allegations stating that the projects are not 'green'.

4.1.2.2. In this context existing publicly available standards can be leveraged for definition of green bonds so as to align with a globally accepted definition. There are different types of definitions and standards that can be leveraged:

a) Definitions used by large development finance institutions; such as the World Bank, IFC and the European Investment Bank
b) Asset specific standards such as The Forest Stewardship Council (FSC) standard for sustainable forestry and building standards such as Leadership in Energy and Environmental Design (LEED)etc..
c) Definitions and standards developed specifically for the green bond market by Climate Bonds Initiative (Climate Bonds Initiative is an investor-focused not-for-profit organisation working to mobilize bond markets for climate change solutions).

4.1.2.3. Further, harmonisation with international guidelines and standards can help Indian issuers gain improved access to international investors who are comfortable with existing international definitions of what is green.

View on comments and proposal

4.1.2.4. We accept the proposal and accordingly it is proposed that the definition of the "What constitutes Green" will be formalised keeping in view the requirements as proposed in the consultation paper and the "Climate Bond Standard report" by Climate Bonds Initiative.

Minimum eligibility criteria for Issuers of Green Bonds

4.1.2.5. Comments have been received that apart from the general eligibility requirements to be fulfilled by the issuer there should be additional requirements which the issuers should satisfy in case it plans to issue Green Bonds. Some of the conditions which may be considered are

a) Net worth requirements
b) Rating Parameters
c) Track record of the Issuer.

4.1.2.6. Also, given the fact that the Green Bond Market in India is in a nascent stage, the same shall be issued initially by the issuers on a private placement basis with the appointment of merchant Bankers made mandatory. Further, depending on the success of the private placement issuances, the same may be allowed to be issued to public at large.

View on comments and proposal

4.1.2.7. SEBI ILDS Regulations provides the framework for public issue and listing of debt securities and listing of debt securities issued through private placement basis. ILDS regulations require the issuers of such debt securities to make comprehensive disclosures including financials, rating, default if any etc. Thus, an issuer of corporate bonds can come out with an issuance subject to making disclosures as required under ILD Regulations. Therefore, restricting an issuer from making issue of Green Bonds on basis of certain criteria as mentioned at point 4.1.2.5 above and requiring them to compulsorily make a private placement of such bonds may not accepted.

4.2. <u>Project evaluation and selection:</u>

4.2.1. Proposal in discussion paper:

The issuer of a Green Bond shall provide the details of decision-making process, it will/has followed for determining the eligibility of projects for using Green Bond proceeds. An indicative guideline of the details to be provided is as under:

- process followed/ to be followed for determining how the project(s) fit within the eligible Green Projects categories;
- the criteria, making the projects eligible for using the Green Bond proceeds; and
- environmental sustainability objectives.

4.2.2. Comments on consultation paper:

Certification requirement for the process

4.2.2.1. Comments received on the criteria for project evaluation and selection, delves upon the need of a certification process, from independent third party certifiers or validators, so as to ensure integrity and to avoid dilution of the seriousness of the issuance of Green bonds It is been said that there is a growing trend in international Green Bond market towards receiving a pre-issuance independent review.

4.2.2.2. A pre-issuance review process includes review of project evaluation and selection criteria including project categories eligible for Green Bond financing. This gives investors a confidence that robust processes and policies are in place for the issuer to allocate proceeds to eligible green projects. Further, a detailed guidance on what this review consist of could also be provided. Issuers can have the option of having either a second opinion type of review or an independent third party verification of its processes.

View on comments and proposal

4.2.2.3. An independent third party reviewer/certifier/validator, for reviewing the reviewing/certifying the pre-issuance process including project evaluation and selection criteria including project categories eligible for Green Bond financing, will lend credibility to the issuance of Green Bonds. Thus, we accept the proposal, however given the fact that the availability of such third party reviewer/certifier/validator in India is not adequate and globally such review is not mandatory, we may keep it optional. Further any issuer of Green Bonds, if opts for appointment of such reviewer/certifier/validator same shall be disclosed in the offer document.

Detailed Environmental Sustainable Objectives

4.2.2.4. It is also suggested that the 'environmental sustainable objectives' of the green financing shall also be outlined clearly, providing for the measurable benefits of the proposed Green Investment – e.g. Green House Gas reduction, reduction of water use, reduction of harmful emissions and so on. Further, wherever feasible or relevant, the methodologies developed by United Nations Framework Convention on Climate Change (UNFCCC) may be used to define such impact and the outlined benefits may be subject to validation by the certifier or validator.

View on comments and proposal

4.2.2.5. We may accept the suggestion, as this shall provide the investors with the information regarding the benefits/impact of the funds raised through issuance of Green Bonds. Further, wherever feasible the issuer may disclose such environmental objectives in accordance with the methodologies developed by UNFCC, in the offered document.

4.3. **<u>Management of proceeds:</u>**

4.3.1. **Proposal in discussion paper:**

The proceeds of Green Bonds shall be credited to an escrow account, and shall be utilised only for the stated purpose, as in the offer document. The use of proceeds shall be tracked as per an approved internal policy of issuer and such policy shall be disclosed in the offer document/placement memorandum.

The utilisation of the proceeds may also be verified/supplemented by the report of an external auditor, or other third party, to verify the internal tracking method and the allocation of funds towards the projects, from the Green Bond proceeds.

4.3.2. **Comments on consultation paper:**

Requirement of Escrow Account

4.3.2.1. The requirement of crediting the proceeds of an Green Bond issuance in an Escrow account may likely discourage issuers, as issuers find it difficult to hold separate cash account. Therefore, instead of mandating requirements for a specific escrow account, stress should be given to providing assurance and transparency around the tracking of proceeds.

4.3.2.2. For operationalising the same the issuer can provide assurance that the proceeds are fully invested and/or are earmarked for eligible projects and the same can be verified by the external auditors. However, where issuer's themselves choose the escrow route, it should be allowed.

4.3.2.3. Thus, it would be better to allow to track the projects and cash by use of a sub-portfolio within the main portfolio and track the funds via a formalized internal process.

View on comments and proposal

4.3.2.4. We accept the suggestion for not mandating the requirement of escrow account for tracking the proceeds of Green Bond Issuance. However, the issuer shall provide the details of the system/procedures to be employed for tracking the proceeds of the issue including the investments made and/or investments earmarked for eligible projects and the same shall be verified by the external auditors.

Disclosure requirement for eligible investment other then the specified projects

4.3.2.5. It is suggested that for transparency purposes the issuer shall disclose to investors what types of eligible investments the funds will be held in prior to disbursement or allocation to the projects. These investments may include money market instruments, bank deposits or other liquid assets etc.

4.3.2.6. Further, reporting on the following issues shall be mandatory, once the proceeds are utilized:

a) Extent of proceeds utilized in defined green investments.
b) Use of unutilized proceeds (this shall be limited to the instruments as mentioned at point 4.3.2.4 above)

View on comments and proposal

4.3.2.7. Issuer post raising of funds through Green Bonds, may keep/invest the proceeds/funds pending investments in the cash or cash equivalents (money market instruments, liquid mutual funds, bank deposits etc.

Requirement of second opinion/independent verification

4.3.2.8. Comments received, advocate that to promote transparency the green bond market is increasingly moving towards obtaining a second opinion or an independent verification of the issuer's green assets/ framework. Both processes effectively provide a certain degree of comfort to investors and stakeholders at large that the framework is robust and the proceeds are being directed towards the desired assets.

4.3.2.9. Investors have also clearly expressed to the market that they have a preference for Green Bonds that have the review and this is particularly true for corporate issuers vs multilateral development banks or supranationals.

4.3.2.10. Thus, the disclosure requirements for the Green Bonds may reflect upon the requirement of such opinions/verifications. However, keeping in line with the global norms such requirement shall be kept optional at the part of the issuer..

View on comments and proposal

4.3.2.11. The requirement for taking a second opinion or appointing an independent verifier for reviewing/verifying the issuer's green assets/ framework has been stressed upon in the consultation paper. Further, comments received have also opined for the same, as it lends credibility to the issuer and instils confidence in the investors. However, given the fact that globally such review is not mandatory, we may keep it optional. Further any issuer of Green Bonds, if opts for such review same shall be disclosed in the offer document.

4.4. <u>Reporting:</u>

4.4.1. Proposal in discussion paper:

In addition to reporting on the use of proceeds issuers shall also provide, at least on an annual basis, a list of projects to which Green Bond proceeds have been allocated. This may also include the details of the expected environmental impact of such projects.

The environmental impact report may provide for qualitative performance indicators and, where possible, quantitative performance measures of the expected environmental sustainability impact of the specific project. However, where confidentiality agreements or competition issues limit the amount of detail that can be made available, information can be presented in generic terms.

4.4.2. Comments on consultation paper:

Continuous disclosure requirements

4.4.2.1. To enhance the longevity and credibility of the green bonds market, it is desirable that investors are made aware of the status of the projects at a regular interval. Thus, the regular disclosures to be made by the issuers, shall be made atleast on a half yearly basis and shall contain the disclosures in relation to utilization of proceeds towards green projects. Further, it shall also contain the details of the key factors capturing the environmental impact of such investments.

View on comments and proposal

4.4.2.2. We accept the recommendation on requiring the disclosure requirement, for the green investments, on a continuous basis and the same shall be disclosed in the annual report or periodical filings to be made to the Stock Exchanges.

5. Regulatory Impact of the proposed regulations

5.1. These are enabling guidelines proposing to introduce a framework for disclosure and listing requirement for green bonds and will therefore will be beneficial to the issuers of such bonds and investors and the cost for the same and the benefits accrued cannot be quantified. However, the major cost implications and the benefits accrued are as under:

5.2. **Benefits**

5.2.1. Positive public Relations

Green bonds can help in enhancing an issuer's reputation, as this is an effective way for an issuer to demonstrate its green credentials. It displays the issuers commitment towards the development and sustainability of the environment. Further, this may also generate some positive publicity for the issuer.

5.2.2. Investor Diversification

There are specific global pool of capital, which are earmarked towards investment in Green Ventures. This source of capital focuses primarily on environmental, social and governance (ESG) related aspects of the projects in which they intend to invest. Thus, green bonds provide an issuer the access to such investors which they otherwise may not be able to tap with a regular bond.

5.2.3. Potential for pricing advantage

The green bond issuance attracts wider investor base and this may in turn benefit the issuers in terms of better pricing of their bonds vis-a-vis a regular bond. Further, with increasing focus of the global investor community towards green investments, it is expected that new set of investors will enter into this space leading to lowering the cost of funding for green projects.

Costs

5.2.4. Appointment of external certifiers/validators/auditor

Issuer of such bonds may have to appoint the independent third party certifiers/validators/auditor for verifying/certifying the various processes including criteria for project evaluation and selection, verification of assets etc. However, such appointment is optional as the requirement of external certifiers/validators/auditor is optional at the part of the issuer.

5.2.5. Setting up procedures for tracking the proceeds of Green Bonds

Issuer will have to put in place systems/procedures to track the usage of the green bond proceeds and the same shall have to be verified by external auditors.

6. <u>Proposal</u>

6.1. The Board is requested to consider and approve the recommendations mentioned under paragraphs 4.1, 4.2, 4.3 and 4.4 above.

6.2. SEBI proposes to issue circular/guidelines on the basis of the consultation paper, recommendations received and SEBIs comments thereof.

6.3. The Board is also requested to authorize the Chairman to make consequential and incidental changes to give effect to the decision of the Board.

ANNEXURE A

Concept paper for issuance of Green Bonds issued on December 03, 2015 is available on SEBI website.

ANNEXURE B

The details have been excised for reasons of confidentiality.