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Securing Green Bonds with Carbon Credits

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The government and private entities around the globe have been trying to raise funds for projects protecting the environment as well as projects which take due account of environmental, social, and governance. The Securities and Exchange Board of India has invited many experts through its consultation paper dated August 04, 2022, to discuss the impact of Green and Blue Bonds in the securities market. Green bonds are raised as an alternative means to raise funds. Carbon credits, on the other hand, are credits given for less emission of carbon based gases. India is one of the main recipients of the global carbon trade and has been leading in carbon trading. After the recognition of Carbon credits as commodities on January 4th, 2008, various individuals and entities have been trading futures contracts through carbon credits. This article aims to find the possible importance of Carbon credits and its usage towards Green debt securities.

Keywords: *green bonds, carbon credits, green debt securities.*

INTRODUCTION

The Securities and Exchange Board of India has proposed a consultation paper[1] on August 04, 2022, on green bonds as a mode of sustainable finance. Sustainable Finance is the process of

[1] Securities and Exchange Board of India, 'Consultation Paper onGreen and Blue Bonds as a mode of Sustainable Finance' (*SEBI*, 4 August 2022) <https://www.sebi.gov.in/reports-and-statistics/reports/aug-2022/consultation-paper-on-green-and-blue-bonds-as-a-mode-of-sustainable-finance_61636.html> accessed 12 September 2022

taking due account of environmental, social, and governance(ESG) considerations while making investment decisions in the financial sector, leading to increased longer-term investments into sustainable economic activities and projects[2]

WHAT IS A GREEN BOND?

"Green Bonds are any type of bond instrument where the proceeds or an equivalent amount will be exclusively applied to finance or re-finance, in part or in full, new and/or existing eligible Green Projects and which are aligned with the four core components of the Green Bond Principles (GBP).

Secured Green Bond: a secured bond where the net proceeds will be exclusively applied to finance or refinance either:

i. The Green Project(s) securing the specific bond only (a "Secured Green Collateral Bond"); or

ii. The Green Project(s) of the issuer, originator, or sponsor, where such Green Projects may or may not be securing the specific bond in whole or in part (a "Secured Green Standard Bond"). A Secured Green Standard Bond may be a specific class or tranche of a larger transaction.

This Secured Green Bond category may include, but is not limited to, covered bonds, securitisations, asset-backed commercial paper, secured notes, and other secured structures, where generally, the cash flows of assets are available as a source of repayment or assets serve as security for the bonds in priority to other claims. For each Secured Green Bond, the issuer, originator, or sponsor should clearly specify in its marketing materials, offering documentation or by other means which method defined in (i) or (ii) above is being applied, i.e., Whether it is a Secured Green Collateral Bond or a Secured Green Standard Bond".[3]

NEED FOR GREEN BONDS IN INDIA

Organizations including NBFCs, banks, and financial institutions have traditionally supported infrastructure funding in India. It is widely accepted that financial sources might not be enough to increase capacity, however, given the enormous investment required in structure space. In

[2] The world bank, 'About the World Bank' (*World Bank*) <https://www.worldbank.org/en/topic/financialsector/brief/sustainable-finance> accessed 12 September 2022

[3] International Capital Market Association, 'Green Bond Principles: Voluntary Process Guidelines for Issuing Green Bonds' (*ICMA Group*, June 2021) <https://www.icmagroup.org/assets/documents/Sustainable-finance/2022-updates/Green-Bond-Principles_June-2022-280622.pdf> accessed 12 September 2022

order to influence an investor base that can invest in the infrastructure sector, such as insurance companies, sovereign wealth funds, pension funds, etc., it is necessary to find a variety of alternative means of creative financial instruments and financing.

Markets for corporate bonds have traditionally been regarded as serving as this crucial alternative source of funding. The declared goals for India's contribution to improving the environment and moving forward on a low-carbon path are set forth in the Intended Nationally Determined Contribution (INDC) document. The paper also emphasises the importance of financial requirements for accomplishing the stated targets. According to a preliminary estimate, India's climate change activities between now and 2030 will require at least USD 2.5 trillion (at 2014–15 prices). In this regard, the document discusses the issuance of INR 50 billion (USD 794 million) Tax Free Infrastructure Bonds for the financing of renewable energy projects in the 2015–16 fiscal year. Additionally, India has set an ambitious goal to create 175 gigawatts of renewable energy capacity by 2022, which will cost an estimated $200 billion in funding. Thus, in order to meet the financing needs of the renewable energy sector, new channels need to be investigated. These channels should be able to not only supply the necessary funding but also potentially lower the cost of capital.

Institutions like banks, NBFCs, and financial institutions have historically supported infrastructure finance in India. However, it is generally acknowledged that present project funding sources may not be adequate for capacity increase given the enormous investment required in the infrastructure domain. A wider range of investors, including pension funds, sovereign wealth funds, insurance firms, etc., who can invest in the infrastructure sector, must thus be leveraged by the introduction of new financing methods and innovative financial instruments. Corporate bond markets have long been thought of as a possible alternative source of funding that is sorely needed.

The declared goals for India's contribution to improving the environment and moving forward on a low-carbon path are set forth in the Intended Nationally Determined Contribution (INDC) document. The paper also emphasises the importance of financial requirements for accomplishing the stated targets. According to a preliminary estimate, India's climate change activities between now and 2030 will require at least USD 2.5 trillion (at 2014–15 prices). In this

regard, the document discusses the issuance of INR 50 billion (USD 794 million) Tax Free Infrastructure Bonds for the financing of renewable energy projects in the 2015–16 fiscal year. Furthermore, India has set an ambitious goal to create 175 gigawatts of renewable energy capacity by 2022, which will require enormous money, according to estimates. As a result, the financing requirements of the renewable energy sector need the exploration of new channels that can not only supply the necessary funding but also potentially lower the cost of capital.

INDIAN REGULATORY AUTHORITY FOR GREEN BONDS

The Securities and Exchange Board of India (SEBI) is the sole authority for regulating aspects of securities with respect to the issue, listing, and raising of funds through stock exchanges in India. Green bonds have been defined as green debt security in Regulation 2(1)(q) of SEBI(Issue and Listing of non-convertible securities)

"Green debt security means debt security issued for raising funds that are to be utilised for project(s) and/or asset(s) falling under any of the following categories, subject to the conditions as may be specified by the Board from time to time:

(i) Renewable and sustainable energy including wind, solar, bioenergy, and other sources of energy that use clean technology,

(ii) Clean transportation including mass/public transportation,

(iii) Sustainable water management including clean and/or drinking water, water recycling,

(iv) Climate change adaptation,

(v) Energy efficiency including efficient and green buildings,

(vi) Sustainable waste management including recycling, waste to energy, and efficient disposal of wastage,

(vii) Sustainable land use including sustainable forestry and agriculture, afforestation,

(viii) Biodiversity conservation, or

(ix) a category as may be specified by the Board, from time to time."[4]

Companies may issue green debt securities in India in both listed and unlisted formats. While there are no additional restrictions beyond the normal requirements for debt securities issuance for unlisted green debt instruments, listed green debt securities must adhere to the following regulations in order to be issued:

i. The SEBI (Issue and Listing of Non-Convertible Securities) Regulations, 2021[5] (**NCS Regulations**);

ii. Chapter IX of the SEBI Operational Circular for Issue and Listing of Non-convertible Securities (**SEBI Operational Circular**)[6],

iii. The SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (**LODR Regulations**)[7]; and

All the above regulations are collectively called as "**Green Debt Securities Regulations**".

EVOLUTION FOR CARBON CREDITS IN INDIA

Indian businesses were able to profit from the rapid surge in the carbon market, making it a popular destination for those looking to purchase carbon credits. Over time, it is anticipated that India will benefit from carbon trading to the tune of at least $5 billion to $10 billion (about Rs 22,500 crore to Rs 45,000 crore). Additionally, through the Clean Development Mechanism, India is one of the main recipients of the global carbon trade, accounting for around 31% of the total (CDM). One of the fastest-growing carbon markets in the world, India has already generated close to 30 million carbon credits, the second-highest number of sales globally. India's carbon trading market is expanding more quickly than the country's biotechnology, computer technology, and BPO industries combined. There are over 850 projects in the works, totaling Rs.

[4] Securities and Exchange Board of India, 'Issue And Listing Of Non-Convertible Securities Regulations 2021' (SEBI, 9 August 2021) https://www.sebi.gov.in/legal/regulations/aug-2021/securities-and-exchange-board-of-india-issue-and-listing-of-non-convertible-securities-regulations-2021_51764.html> accessed 12 September 2022

[5] SEBI (Issue and Listing of Non-Convertible Securities) Regulations 2021

[6] SEBI Operational Circular for Issue and Listing of Non-convertible Securities 2021

[7] SEBI (Listing Obligations and Disclosure Requirements) Regulations 2015

650,000,000,000. Carbon is now traded on India's Multi Commodity Exchange. India is the first country in Asia to trade carbon credits.

EXAMPLES OF CARBON TRADING IN INDIA

(i) Jindal Vijaynagar Steel

According to Jindal Vijaynagar Steel, the amount of carbon that the industry would save will be worth $225 million within the next ten years. Due to the steel plant's use of Corex furnace technology, which prevents the release of 15 million tonnes of carbon dioxide into the atmosphere, this was made feasible.

(ii) Powerguda in Andhra Pradesh

The Andhra Pradesh hamlet was trading in credits for 147 tonnes equivalent of carbon dioxide saved. The business claims to have prevented the emission of 147 MT of CO2. The 4500 Pongamia trees in their hamlet were used to extract biodiesel for this purpose.

(iii) Handia Forest in Madhya Pradesh

By recovering 10,000 hectares of damaged community forests in Madhya Pradesh, it is predicted that 95 extremely poor rural villages will collectively receive at least US$300,000 every year from carbon payments.

CURRENT POSITION OF CARBON CREDITS

Both governmental and private markets are available for trading carbon credits. International credit transfers are permitted under current commercial regulations. The price of credit is mostly determined by the amounts of supply and demand in the markets. Despite the fact that carbon credits are good for society, it might be difficult for the typical investor to begin using them as investment vehicles. The only item that can be utilised as an investment in credits is certified emissions reductions (CERS). However, specialised carbon funds established by major financial institutions sell CERS. Small investors have the chance to enter the market through carbon funds. The European Climate Market, the NASDAQ OMX Commodities Europe exchange, and the European Energy Exchange are a few examples of specific exchanges that focus on trading credits.

After the Government of India recognised carbon credits as commodities on January 4th, 2008, the Multi Commodity Exchange began futures trading. The National Commodity and Derivative Exchange announced the creation of Carbon Credit Future Contact with the required approval from the Forward Market Commission (FMC) in an effort to improve market transparency and help farmers get paid for environmental projects. In India, only future contracts for carbon credits are traded on NCDEX. A futures contract is a common agreement between two parties to purchase or sell an item of a certain type and quantity at a predetermined future date for a price fixed today (the futures price).

HOW CARBON CREDITS ARE CLASSIFIED

(i) Accounting treatment

Carbon Emission Reduction (CER) is an 'intangible asset'. It is a non-financial asset without a physical manifestation that is anticipated to produce future financial gains. They aren't kept for administrative or rental purposes, nor are they used in the creation or provision of goods and services. Instead, the generating company produces CER and stores it for sale. The normal course of business accounting for Self-Generated CER is not covered by AS 26. In light of this, they must be recorded in accordance with Accounting Standard (AS) 2 "*Valuation of Inventories*".

(ii) Judicial view

My Home Power Ltd. v DCIT Hyderabad[8] has been excerpted below:

"Carbon credit is not an offshoot of business but an offshoot of environmental concerns. No asset is generated in the course of business but it is generated due to environmental concerns. Credit for reducing carbon emission or greenhouse effect can be transferred to another party in need of reduction of carbon emission. It does not increase profit in any manner and does not need any expenses. It is a nature of entitlement to reduce carbon emissions, however, there is no cost of acquisition or cost of production to get this entitlement. A carbon credit is not in the nature of profit or in the nature of income."

[8] *My Home Power Ltd v DCIT Hyderabad* (2014) 365 ITR 0082 (AP)

HOW SECURING BONDS THROUGH CARBON CREDITS WOULD BE BENEFICIAL

Carbon credits in various instances are treated as an asset and for taxation purposes treated as capital receipts. Thus, there exists tax liability only when such credits are either sold or transferred as per Section 115BBG of the Income Tax Act, 1961.[9] Thus, using such carbon credits as collateral does not invite tax liability. In ***Regulation 2(1)(q) of SEBI (Issue and Listing of non-convertible securities)***[10] green debt securities can be issued for energy efficiency including efficient and green building, Carbon credits are assets that are a result of energy conservation, the carbon credits are non-monetary assets which are created for primarily for reducing the emission of carbon gases. When such assets as carbon credits provide collateral for the issue of such bonds, the credibility of the issuer can also be seen as the procurement of carbon credits is through the result of such reduction of carbon gases.

CONCLUSION

Green bonds and Carbon credits are a new concept that encourages various organisations to indulge in activities protecting the environment. Carbon credits encourage less emission of Carbon gases thereby protecting the environment. Thus, the usage of carbon credits to secure green bonds would encourage energy conservation organisations that have carbon credits to raise funds for further preserving of environment and also increase in green buildings around the country.

[9] Income Tax Act 1961, s 115BBG

[10] SEBI (Issue and Listing of Non-Convertible Securities) Regulations 2021, reg 2(1)(q)