

Consultation paper on proposed IFSCA Guidance framework on Sustainable and Sustainability linked lending by financial institutions.

Introduction and Scope of the Guidance framework.

Policymakers around the world are scaling up efforts to tackle the urgent threat and growing impact of climate change. The Paris Agreement and the Sustainable Development Goals (SDGs) are important outcomes of these recent efforts. Meeting the ambitious goals of these multilateral commitments will require an unprecedented mobilization of both public and private sources of finance for green and sustainable lending and investments.

2. Banks and Finance Companies/Units are critical supporting pillars for achieving a low carbon, sustainable future provided they establish a robust framework for putting in place financing solutions, to help clients transition to a low carbon and green economy. Such financing can be in the form of a Loan facility which is essentially a credit line made available to borrowers to finance projects and assets which meet the indicative sector eligibility criteria prescribed in Appendix I of this document. Loans can be unsecured (with general recourse to the obligors) or secured (non-recourse or limited recourse to the borrowers), short term or loan term facilitates. These include bilateral loans, syndicated/Club loans, revolving credit facilities, export credit facilities among others. A green, social or sustainable loan may also take the form of one or more tranches of a loan facility. In such cases the tranches must be clearly designed.

3. The framework intends to provide guidance to the IFSC Banking Units (IBU) and Finance Companies/Finance Units (FC/FUs) to internally develop a comprehensive Board approved policy on green/social/sustainable/sustainability-linked lending. The framework is divided in the four broad areas:

Part A General guidance on green/social/sustainable lending¹.

Part B Guidance on sustainability linked lending.

Part C Guidance on short term financing/working capital finance (green / social / sustainable).

Part D Reporting framework.

4. IFSCA directs the registered IBUs and FC/FUs (undertaking lending activities from IFSCs) to develop a Board approved policy on sustainable lending within a time period of 9 months from the date of issuance of the final framework. Further, IBUs and FC/FUs shall have at least 10 per cent of their loan assets in the form of lending to

¹ The terms green/social/sustainable are used interchangeably in the framework, IBUs and FC/FUs are required to develop the internal policy based on the differentiation as existing in the standards and frameworks referred to in this circular.

green/social/sustainable/sustainability-linked sectors/facilities, from the financial year beginning April 2023 /calendar year beginning January 2023. In case, if the IBU or FC/FU is unable to meet the above targets it shall report to the Authority explaining reasons for non-compliance of the same.

Part A General Guidance on Green/Social/Sustainable lending

5. While developing the internal Board approved policy, the lending institution shall duly factor in the principles laid down in the international standards listed below. The internationally accepted standards are recommended as they are aimed at providing a consistent methodology for use across the loan market, whilst allowing the loan product to retain its flexibility and preserving the integrity of the green/social/sustainable market while it develops. These standards broadly aim at recommending the structuring features, disclosure and reporting associated with lending or issuance of financial product. The frameworks that can act as a guiding tool are:

- (i) Green Loans Principles developed by Loan Market Association (LMA)
- (ii) Social Loan Principals developed by Loan Market Association (LMA)
- (iii) Bond Principles developed by International Capital Markets Association (ICMA);
- (iv) Climate Bond Standards by Climate Bonds Initiative;
- (v) Any other globally recognized standards or any framework or methodology specified by a competent Authority in India.

6. The core components of such policy on lending shall cover aspects such as:

- (i) Borrower assessment process,
- (ii) Assessing the use of proceeds and appropriately describing it in the legal documentation of the loan facility,
- (iii) Process to be adopted for project evaluation and selection, management of proceeds,
- (iv) Reporting mechanism,
- (v) Monitoring either internally or through external reviewer, and;
- (vi) De-classification of lending facilities.

7. The IBUs and FC/FUs may establish an in-house process to assess the borrower and the eligibility of loan facility (project/trade/ working capital finance facilities, etc.) in meeting the identified Environmental/Social/Sustainable objectives. Individual facilities may be assessed on a case-to-case basis for whether the level of 'green' is sufficient, whether the borrower and the lenders have mutually agreed to classify such facilities as 'green', 'social' or 'sustainable' and to put measures in place to avoid greenwashing and similar instances.

8. Declassification mechanism shall be pre-agreed upon between the lender and the borrower so as to maintain integrity and compliance of the facility as per the initial classification either as green/social/sustainable. Declassification of a facility shall result in an immediate discontinuation on the publicity of the facility as green/social/sustainable in any manner. The Board approved policy shall have a strategy towards meeting the asset-liability mismatch which may arise due to such declassification. However, at any point in time such lending shall be in compliance with the standards adopted by the IBU or FC/FU.

Part B Guidance on Sustainability linked lending

9. Sustainability linked lending incentivises the borrowers' sustainability performance by linking the interest margin to the improvement of the companies' ESG score or to the improvement on tailored sustainability Key Performance Indicators (KPI) or Sustainability Performance Targets (SPTs). The sustainability linked policy so developed shall be adopted on a case specific transaction based on underlying characteristics of the transaction. The loan facility may be labelled as sustainability linked provided that it factors in the principles laid down in the international standards listed below:

- (i) Sustainability Linked Bond principles developed by ICMA, or,
- (ii) Sustainability Linked Loan Principles jointly developed by Asia Pacific Loan Market Association, LMA and LSTA, or,
- (iii) Any other globally recognised standards

10. Broadly, the lending policy on sustainability linked lending may cover aspects such as:

- (i) Borrower assessment,
- (ii) Manner of selection of Key Performance Indicators (KPI),
- (iii) Calibration of Sustainability Performance Targets (SPT) with mutual process between lender and borrower,
- (iv) Financial and/or structural characteristics to incentivize the achievement of the SPTs and /or involve a penalty if the SPTs are not met,
- (v) Suitable provisions for reporting and
- (vi) Mechanism for verification of performance.

It may be noted that the penal mechanisms may be as mutually agreed between the lender and the borrower while finalizing the terms of loan agreement.

11. Indicative examples of common categories of KPIs and SPTs include setting a target around reduced greenhouse gas emissions, reduced water consumption and the amount of renewable energy generated or used. An ESG rating can also be used as a SPT. The table below highlights some considerations that a borrower/lender may have

when choosing to use an ESG rating and/or a target SPT in a transaction

	SPTs (e.g. GHG reduction)
Possible alignment	<ul style="list-style-type: none"> • Alignment and contribution to company Sustainability strategy as well as internal and public targets • Reduction in GHGs in relation to the business being carried out by the borrower • A focus on outcomes is also more easily aligned with SDGs • Public disclosure at least annually on delivery of the SPTs aligned with its sustainability reporting • Improvements in the borrowers ESG rating and/or achievement of a recognized ESG certification
Precautions	<ul style="list-style-type: none"> • Risk management and reporting frameworks need to be established and functioning • Nascent market, therefore, hiring a verifier to limit the risk of green- washing accusations

Part C Guidance on short term financing/working capital finance (green / social / sustainable).

12. There has been an increase in the instances of classifying or labelling trade finance transactions as sustainable as well a shift in the thought process on sustainable trade finance across the globe. This is also evident from the positioning paper on the subject rolled out by International Chamber of Commerce. Considering the shift towards the labeling and classification of short term finances into green/social/sustainable it may be prudent that the Board approved framework on sustainable lending also enables such classification wherever possible. While drafting internal policies, reference can also be drawn for evidencing the greenness of the associated projects or activities by associating to the Industry Green Standards wherever applicable. An illustrative list of such standards is provided in Appendix II of this guideline.

13. The borrower may report to the lender such information (including relevant certifications) which ascertains that the proceeds of the facility availed by the borrower (as part of sustainable trade finance, working capital finance etc.) are used for financing green/social/sustainable projects/activities. This information may also include the positive environmental/social impact resulting from such projects/activities. The manner and frequency of such reporting by the borrower may be provided by the lender in their Board approved policy.

Part D Reporting to the Authority (quarterly basis)

Classification	Previous Quarter				Cumulative in FY (USD mn)
	Long term (USD mn)	Short term (USD mn)			
		Trade Finance	Working Capital / Supply Chain Finance	Others	
Green					
Social					
Sustainable					
Sustainability-linked					
Total Amount					
Total as a percentage of Loan assets					

Table 1: Reporting on overall sustainable financing

Sector (list is indicative)	Amount (USD mn)	Type of Financing	Total No. of transactions
Renewable Energy			
Energy Efficiency			
Pollution Prevention and Control			
Sustainable Water and Wastewater Management			
Clean Transportation			
Climate Change Adaptation			
Green Buildings			
Affordable Basic Infrastructure			
Affordable Housing			
Food Security and Sustainable Food Systems			
Any others (please specify)			
Total			

Table 2: Sector-wise classification of ESG Financing

14. **Public Comments:** The comments / suggestions are invited from general public and stakeholders on the draft framework, so as to reach us on or before March 22, 2022 (i.e. within 21 days from the date of press release). Comments may be sent by email to Ms. Riddhi Bhandari, Deputy General Manager, IFSCA at riddhi.bhandari@ifsc.gov.in with a copy to lobhas.khairnar@ifsc.gov.in. The comments should be in the following

format (MS Word or MS Excel format only):

Name and Details of the Person / Entity (Organisation name (If applicable), Contact No and Email address)			
Sr. No.	Point No.	Comments/Suggestions	Detailed rationale

Appendix I

List of Eligible Green and Social categories²

Table 1: List of eligible green categories:

No.	Eligible Green Categories	Illustrative Eligible Green Projects ³
1.	Renewable Energy	<ul style="list-style-type: none"> • Generation of electricity from Renewable Energy (RE) sources such as wind (onshore & offshore), solar, hydropower <25 MW or >25MW which have either a lifecycle carbon intensity of $\leq 100\text{gCO}_2/\text{kWh}$ or power density $\geq 5\text{W}/\text{m}^2$ ⁽⁴⁾, waste to energy, geothermal energy or production of biofuels from waste sources. • Development and/or manufacture of renewable energy technologies, including equipment for renewable energy generation and energy storage. • Construction/ maintenance/ expansion of RE-associated distribution networks.
2.	Energy Efficiency	<ul style="list-style-type: none"> • Promotion of energy efficiency in industrial and commercial sectors through development, manufacture and/or installation of technologies for increasing operational energy efficiency of utilities and reducing GHG emissions. • Retrofit of renewable energy power plants. • Energy efficiency in municipal projects – Street Lighting projects. • Energy efficiency in residential building, agricultural equipment and transportation.
3.	Pollution Prevention and Control	Projects addressing reduction of pollution and waste (e.g. air emissions, greenhouse gas control, soil remediation, waste prevention, waste reduction, waste recycling and energy/ emission-efficient, waste to energy etc.)

² The projects are only for indicative purposes, they may depend upon the country targets and classification that may evolve over the course of time.

³ In case of companies having diversified business, products and services, a qualifying criteria need to be set by lenders to identify the projects as eligible based on their Board approved policy.

⁴ Climate Bonds Initiative - Hydropower sector guide (<https://www.climatebonds.net>)

4.	Sustainable Water and Wastewater Management	<ul style="list-style-type: none"> • Activities that provide access to adequate sanitation facilities. • Activities that improve water quality (e.g. water treatment facilities and upgrades to waste water treatment plants to remove excess nutrients). • Activities that increase water-use efficiency (e.g. water recycling and reuse, water saving systems, technologies and water metering). • Water management/ treatment projects, distribution, desalination and other projects that ensure accessibility, drinkability and security of water • Sanitation infrastructure projects • Projects, products and services to provide basic sanitation and safe drinking water to society.
5.	Environmentally Sustainable Management of Living Natural Resources and Land Use	<ul style="list-style-type: none"> • Programs encouraging sustainable land use and sustainable agriculture, including climate-smart agriculture which take into account climate mitigation and adaptation measures. • Projects that promote a low carbon economy around sustainable agriculture and food security; • Rehabilitation of sensitive and degraded ecosystems through sound management practices and land use planning. • Projects that promote climate smart animal husbandry, sustainable aquaculture and fisheries, sustainable management of natural resources and land use - products, services and technologies.
6.	Terrestrial and Aquatic Biodiversity Conservation	<ul style="list-style-type: none"> • Conservation and enrichment of carbon pools in natural ecosystems. • Programs that encourage environmental conservation and sustainable use of natural resources.
7.	Clean Transportation	<ul style="list-style-type: none"> • Technology to replace or reduce the direct use of fossil fuels, which generate GHG. • Development of an effective, efficient, integrated affordable and eco-friendly public transportation system. • Programs encouraging land use planning which allows movement by cycling, walking and public transport. • R&D programs focusing on higher fuel efficiency and alternative fuel. • Incorporating green technology in transportation infrastructure.
8.	Climate Change Adaptation	<ul style="list-style-type: none"> • Activities that increase resilience of ecosystems such as integrated watershed management. • Climate change adaptation infrastructure such as flood defense systems.

9.	Eco-efficient and/or circular economy adapted products, production technologies and processes	<ul style="list-style-type: none"> • Projects which focus on development of environmentally sustainable products, with an eco- label or environmental certification and/or resource-efficient packaging and distribution. • Production technologies and processes may relate to design and introduction of reusable, recyclable and refurbished materials, components, circular tools and services.
10.	Green Buildings	<ul style="list-style-type: none"> • Construction of green buildings or retrofit of existing buildings which meet regional, national or internationally recognized standards or certifications (e.g. EDGE, BREEAM, LEED, Green Mark, GRIHA). • Lease Rental Discounting facility for a Green Building that meets the criteria.

Table 2: List of eligible social categories:

No.	<u>Eligible Social Categories</u>	<u>Illustrative Eligible Social Projects</u>
1.	Employment generation, and programs designed to prevent and/or alleviate Unemployment stemming from socio-economic crises, including through the potential effect of SME financing and Microfinance	<ul style="list-style-type: none"> • Financing microfinance institutions and financing of SMEs that are often unable to gain access to financial products and services, e.g.: <ul style="list-style-type: none"> • Rural populations focusing on agricultural production and agricultural value chains. • Small businesses that demonstrate gender equality at the board and/or ownership level. • Provision of financing to businesses run by economically excluded individuals. • Financial inclusion through ease of access to financial services and promoting financial literacy • Commercial Vehicle Lending (for livelihood purpose only)
2.	Affordable Basic Infrastructure	<ul style="list-style-type: none"> • Clean drinking water, sanitation, transport and energy (e.g. projects under the National Energy Policy addressing access to electricity for all households, including in rural areas). <ul style="list-style-type: none"> • Construction, maintenance and equipment for water supply infrastructure. • Development of roads (including road infrastructure with a goal to improve rural/ remote connectivity).

3.	Access to Essential Services	<ul style="list-style-type: none"> • Access to health, education, vocational training, healthcare, financing and financial services (e.g. ramping up of health and wellness centers in rural and urban areas) • Infrastructure for the provision of emergency medical response and disease control services. • Supporting health-care related products and services such as provision/ distribution of healthcare equipment and R&D and manufacturing for equipment for the provision of emergency medical response and disease control services. • Construction of public schools • Training for educational professionals that is accessible to the public/ low-income individuals.
4.	Affordable Housing	<ul style="list-style-type: none"> • Access to adequate, safe and affordable housing for excluded and/or marginalized populations.
5.	Food Security and Sustainable Food Systems	<ul style="list-style-type: none"> • Physical social and economic access to safe, nutritious and sufficient food, that meets the dietary needs and requirements; • Resilient agricultural practices • Reduction of food loss and waste • Improved productivity of small scale producers

Appendix II

Indicative list of Industry Green Standards

For business activities or product categories associated with material ESG issues or increased controversies, any industry-wide green standards and eco labels, certifications, or indexes, if available, should be considered as reference points to evidence the “greenness” of associated projects or activities, for example:

- BREEAM: sustainability assessment method for master planning projects, infrastructure, and buildings
- LEED: independent verification of resource-efficient, high-performing, healthy, cost-effective buildings
- Roundtable on Sustainable Palm Oil (RSPO): certificate of global standards for sustainable palm oil production
- Forest Stewardship Council (FSC): forest certification and license for forest products
- Green Building Rating Systems by Indian Green Building Council or alternatively EDGE or GRIHA

In addition to these examples, other sustainability standards can be found from the ISEAL Alliance, which sets standards of good practice for certification schemes and requires its members to commit to meet them or the list provided in the Standards Map by International Trade Council⁵.

⁵ <https://www.standardsmap.org/en/identify>