CIRCULAR

F. No. IFSCA-DSF/6/2024-Capital Markets **November 21, 2024**

To,

Recognised stock exchanges in the International Financial Services Centres (IFSCs)

Issuers who have listed/propose to list ESG labelled debt securities in the IFSCs

Dear Sir/Madam,

Subject: Principles to mitigate the Risk of Greenwashing in ESG labelled debt securities in the IFSC

1. International Financial Services Centres Authority (IFSCA) recognizes the pivotal role of ESG labelled debt securities (Green Bonds, Social Bonds, Sustainability Bonds, Sustainability-linked Bonds and other labelled bonds as may be specified) in financing sustainable development and transition to a low-carbon economy. However, there is a growing concern globally among stakeholders, including investors, regarding the accuracy and reliability of claims made by issuers about the sustainability benefits of the projects or assets they invest in. While there is no universally accepted definition/taxonomy of greenwashing, the term "*Greenwashing*" generally refers to the deceptive practice of making unsubstantiated, false, vague, exaggerated or misleading claims regarding the sustainability benefits of a product, service, or business operation. It also includes practices such as concealing, omitting, or hiding relevant information in sustainability claims and use of words, labels, symbols, and imagery placing emphasis on positive environmental aspects while downplaying or concealing harmful attributes.

2. In the context of ESG labelled debt securities such claims may exaggerate, misrepresent, or omit information about the projects or assets where the proceeds of issuance are utilised to create a false impression of sustainability, thereby misleading investors. Greenwashing undermines investor confidence and market integrity. This can

also result in an uneven playing field between issuers engaging in greenwashing and those who have genuinely *"greened"* operations.

3. The announcement of the Hon'ble Finance Minister in the Budget speech of 2024-25 towards developing a taxonomy for climate finance for enhancing the availability of capital for climate adaptation and mitigation will support in addressing issues related to greenwashing across various sectors in India.

4. The International Financial Services Centres Authority (Listing) Regulations, 2024 ("Listing Regulations") requires one of the following international standards/principles to be adhered to in order to label the debt securities as "green", "social", "sustainability" and "sustainability-linked" bond:

    i. International Capital Market Association (ICMA) Principles/Guidelines;
    ii. Climate Bonds standard;
    iii. ASEAN Standards;
    iv. European Union Standards;
    v. Any framework or methodology specified by a competent authority or a financial sector regulator in India.

5. Further, the Listing Regulations, in addition to mandating certain initial and annual post issuance disclosures, mandate the appointment of an independent external reviewer to ascertain that the ESG labelled debt securities are in alignment with any of the recognised standards mentioned above.

6. International Organization of Securities Commissions (IOSCO) in November 2022 published the paper[1] on "IOSCO Good Sustainable Finance Practices". The good practices identified by IOSCO focus on product-level disclosures concerning naming, labelling and classification of sustainability-related products, investment objectives and strategies disclosure, monitoring of compliance and sustainability-related performance of products.

[1] https://www.iosco.org/library/pubdocs/pdf/IOSCOPD717.pdf

7. ICMA[2] also published a report on "Market integrity and greenwashing risks in sustainable finance" in October 2023 and identified four areas of concern of greenwashing with respect to sustainable bonds viz. lack of ambition, strategic inconsistency, mismanagement of wider sustainability risks and actual deception.

8. In line with the above, practices prevalent in other jurisdictions and in order to further promote transparency, accountability and adequacy of disclosures to investors, the IFSCA hereby issues the following principles which issuers of ESG labelled debt securities in IFSC should adhere to:

Principles

A. *Being True to Label* - Avoid misleading labels and terminology

An issuer of debt security in IFSC shall not use the name "Green", "Social", "Sustainability", "Sustainability-linked" or similar terms or a combination of these terms in the issuance of ESG labelled debt securities or its marketing, unless the securities are aligned with any of the frameworks recognised by IFSCA. Additionally, the offer document and marketing materials, if any must clearly explain how the issue including use of proceeds aligns with the chosen framework and the specific environmental or social objectives it aims to achieve.

Further Guidance: An issuer should refrain from labelling or representing projects/activities as environment friendly with vague green claims when the projects/activities are only partially green, or when the green attributes are not a significant part of its overall environmental impact. Further, there should not be any strategic inconsistencies, to illustrate, where there is a lack of a broader sustainability/environmental strategy accompanying a green bond especially where there is a clear inconsistency between the green label and what the issuer does beyond the label. In case of sustainability linked bonds, issuer on a voluntary basis may consider taking an external review on adequacy of ambition.

[2] https://www.icmagroup.org/assets/documents/Sustainable-finance/Market-integrity-and-greenwashing-risks-in-sustainable-finance-October-2023.pdf

Example of misleading labels:

1. *A bond is being marketed as a Green Bond; however, the issuance is not aligned with any of the recognised frameworks as referred in sub-regulation (1) or (2) of regulation 76 of the Listing Regulations.*

2. *A bond is issued as a sustainability-linked bond; however, the sustainability performance targets (SPTs) are too low or their tracking/reporting is misrepresented, or data is being selectively picked from research while ignoring other data which is unfavourable to issuer.*

B. *Screen the Green* - Transparency in methodology for project selection and evaluation

The issuer shall disclose in the offer document a statement on ESG objectives, details of process followed for evaluating and selecting the project(s) and/or asset(s), proposed use of the proceeds and details of the systems and procedures for tracking the deployment of the proceeds as per the regulation 77 (1) of the Listing Regulations, for the issue of securities. The issuer shall avoid the use of broad or generic statements to describe investment screening criteria. Further, disclosures should enable investors to fully understand the product's sustainability-related investment screening criteria.

Further Guidance:

I. The issuer of the security should clearly communicate:

- ✓ the projects' sustainability objectives and the methodology used to measure the projects' sustainability objectives.
- ✓ information on processes by which the issuer identifies and manages perceived social and environmental risks associated with the relevant project(s).
- ✓ various tools deployed for investment decisions.

II. If the issuer has set a certain sustainability target as in the case of sustainability-linked bonds, the issuer should clearly explain:

- ✓ what the target is
- ✓ how and when the issuer is expected to meet the target
- ✓ any assumptions the issuer has relied on when setting that target

C. *Walk the talk* - Managing and tracking use of proceeds

The issuer shall outline procedures for ensuring funds are directed solely towards projects or activities as defined in the offer document and also disclose the internal control for managing and tracking the use of proceeds. Details of the systems and procedures to be employed for tracking the deployment of the proceeds of the issue must be disclosed by the issuer in the offer document.

Guidance: A detailed allocation plan outlining how the proceeds will be used to finance or refinance projects or activities shall be stated in the offer document. The issuer shall disclose to investors the details of investment and instruments towards temporary placement for unallocated net proceeds along with the environmental impact of such investments. In case of any inadvertent misallocation of green bond proceeds, issuers must promptly disclose this to investors. In extreme cases, it is advisable to consult the investors for early exit opportunity.

Example: *Suppose an issuer intends to use the funds to finance the construction of wind farms. However, due to unforeseen delays in obtaining approval for one of the wind farm sites, the issuer decides to use a portion of the green bond proceeds to invest in a temporary bridge loan for another renewable energy project. While the temporary bridge loan supports one of the objectives such as energy efficient projects/pollution control projects, it wasn't part of the original green bond project plan and might be significantly less environmentally impactful as compared to the wind farm project.*

D. *Overall Impact* - Quantification of Negative Externalities

The issuer shall quantify the negative externalities associated with ESG debt utilization. This could include metrics for residual environmental impacts or potential environmental risks associated with the financed projects.

Further Guidance: The issuer in the offer document shall acknowledge limitations or trade-offs, if any, associated with the environmental benefits of the financed projects. Environmental data used in disclosures should be comprehensive, verifiable and the issuer must avoid selectively presenting data to create a misleading picture of the overall environmental impact.

Example: *A manufacturer of consumer packaging, uses the proceeds from the issue of bonds for developing a new line of packaging materials under the brand name "EcoSmart" with the claim that it reduces carbon emissions by 50% compared to standard plastic. However, they provide little detailed information on how this reduction is calculated. Additionally, the company only discloses the carbon footprint of the packaging material in isolation, neglecting the full lifecycle impact such as production, transportation, and disposal. This partial approach may give a misleading impression of overall environmental benefits.*

E. *Be alert* - Monitoring and Disclose

Issuers of green debt securities shall continuously monitor and disclose the environmental impact of their projects financed by the issuance. This includes metrics demonstrating a reduction in adverse environmental impacts (e.g., carbon emissions, pollution levels) and progress towards a sustainable economy, as outlined in the offer document.

Further Guidance:

I. The issuer of the security should clearly communicate:

   a) List of projects to which proceeds have been allocated as well as a brief description of the projects, amounts allocated, and their expected impact. Qualitative performance indicators and where feasible, quantitative performance measures of the expected/achieved ESG impact of the project(s) shall be disclosed.

   b) Information on processes through which the issuer would measure the progress of the perceived sustainability target associated with the relevant projects/activities.

Explanations

i. If the quantitative benefits/impact cannot be ascertained, then the said fact may be appropriately disclosed along with the reasons thereof.

ii. The methods and the key underlying assumptions used in the preparation of the performance indicators and metrics shall be disclosed.

Example

An issuer disclosing environmental impact of their investments, be it qualitative or quantitative, without consistently using the same metrics or without disclosing the change in the metrics in the case of quantitative improvements could be considered as a case of greenwashing.

9. While the above principles may not be exhaustive, the issuer may choose to adopt such other methods, disclosures and processes that would assure investors as measures against greenwashing.

10. Stock exchanges in IFSC where the ESG labelled debt securities are listed / intended to be listed shall monitor the initial and ongoing disclosures and where warranted, seek necessary clarifications from issuers. Any case of potential or actual greenwashing shall be analysed and shall be brought to the attention of IFSCA with comments.

11. In case of any incidence of Greenwashing in the IFSC, the Authority shall undertake suitable action under the provisions of the IFSCA Act, 2019 and the Listing Regulations.

12. The circular is issued in exercise of the powers conferred by Section 12 and 13 of the International Financial Services Centres Authority Act, 2019, read with the regulation 130 of the Listing Regulations.

A copy of this Circular is available on the website of International Financial Services Centres Authority (IFSCA) at www.ifsca.gov.in.

Yours faithfully,

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