

Clean Green or a mirage on screen?

Combating greenwashing in IFSC ESG DEBT

23 December 2024

Introduction

In response to the growing concerns related to greenwashing that largely involve misleading claims regarding the environmental benefits of Environment, Social, and Governance (ESG) labelled debt securities, the International Financial Services Centres Authority (IFSCA) has issued a circular on "Principles to mitigate the Risk of Greenwashing in ESG Labelled Debt Securities in the IFSC" on 21 November 2024 (Circular).

What is greenwashing

The term 'greenwashing' in general refers to exercising acts of deception by making unsubstantiated, false, vague, exaggerated or misleading claims regarding the sustainability benefits associated with a product, service, or business operation. The term may also encompass other deceptive practices including concealment, omission, or hiding of relevant information in sustainability claims and usage of words, labels, symbols, and imagery that emphasize the positive environmental aspects while masking or downplaying the harmful and negative attributes.

The practice of greenwashing in the ESG labelled debt securities can lead to misleading the investors by creating a false impression of sustainability and creating an uneven playing field between genuine and non-compliant issuers.

Key highlights of the circular

The Circular offers a comprehensive guidance to address the concerns of "greenwashing" in the issuance of ESG-labelled debt securities. According to Regulation 75 of the International Financial Services Centres Authority (Listing) Regulations, 2024 (IFSCA Listing Regulations), ESG labelled debt securities include "green", "social", "sustainability", "sustainability linked" debt securities or any other ESG labelled debt securities as may be specified by IFSCA, which is listed or proposed to be listed on a recognised stock exchange.

The Circular lays down five key principles that issuers of ESG-labelled debt securities shall adhere to, which are discussed in detail in the subsequent sections.

Recognized Standards

Regulation 76 of the IFSCA Listing Regulations require funds raised by issuing ESG labelled debt securities to be utilized for financing or refinancing projects and/or assets that are aligned with any of the following recognised standards:

1. International Capital Market Association (ICMA) Principles / Guidelines;
2. Climate Bonds Standard;
3. ASEAN Standards;
4. European Union Standards;

5. Any framework or methodology specified by a competent authority or a financial sector regulator in India; or
6. Other international standards as may be permitted by the Authority on case-by-case basis.

The IFSCA Listing Regulations further mandate the appointment of an independent external reviewer to ensure alignment of the ESG labelled debt securities with the afore-mentioned standards.

Principles to be adhered

1. Being True to Label – Avoid misleading labels and terminology

Issuers may utilize the terminology involving “green,” “social,” “sustainability,” “sustainability-linked,” or similar terms, or combinations thereof, only if the issuance and marketing of ESG-labeled debt securities are in line with the above-mentioned recognized frameworks under the IFSCA Listing Regulations. This principle lays down the requirement of providing a clear explanation of the alignment with these frameworks and the specific environmental or social objectives in both the offer documents and marketing materials. Issuers must refrain from using misleading labels, vague claims, or engaging in strategic inconsistencies.

2. Screen the Green – Transparency in methodology for project selection and evaluation

This principle requires issuers of ESG-labeled securities to provide comprehensive disclosures in line with Regulation 77(1) of the IFSCA Listing Regulations. These disclosures must include key details such as the specific ESG objectives of the project, the various tools used for the investment decisions, the proposed use of proceeds from the issuance, and the mechanisms in place to track and monitor the deployment of these proceeds. The offer documents must provide enough information to allow investors to completely and easily comprehend the sustainability-related investment screening criteria of the product, avoiding broad or generic statements.

Clear communication of the sustainability goals associated with the project, including the methodologies and metrics for measuring the progress towards these goals is an essential requirement on part of the Issuers under this principle. In addition, they must outline the processes for identifying and managing risks associated with the project, as well as the decision-making tools and frameworks used to guide the investment process. When setting sustainability targets, issuers must provide a detailed explanation of the target itself, including the specific objectives, the timelines for achieving them, and the underlying assumptions or conditions that informed the target-setting process. This ensures transparency and accountability, enabling investors to assess the credibility and feasibility of the issuer's sustainability claims.

3. Walk the Talk – Managing and tracking use of proceeds

Issuers shall ensure the implementation of clear procedures and internal controls in order to ensure that the allocation of proceeds from the issuance is solely towards the projects specifically outlined in the offer document. These controls should include robust monitoring systems to verify that funds are used according to the specified ESG objectives, ensuring transparency and integrity throughout the issuance process and meeting investors' expectations.

A comprehensive allocation plan setting out the method of utilization of funds towards financing or refinancing eligible ESG projects shall be included in the offer document. This plan should provide a transparent breakdown of the distribution of proceeds across various projects, ensuring alignment with the stated environmental or social goals.

Issuers shall also ensure disclosure of the method of managing unallocated proceeds, including temporary placements such as cash or short-term investments. These placements should be transparently disclosed, along with their environmental impact, and explained in relation to the overall ESG goals.

If there is any misallocation of proceeds, issuers must promptly inform investors, ensuring full transparency. In cases of significant misallocation that affect the project's alignment with ESG objectives, issuers must consult investors about potential remedies, such as offering early exit options. This transparency and accountability builds trust and ensures the continued alignment of the debt issuance with its ESG objectives.

4. Overall Impact – Quantifying Negative Externalities

Issuers must assess and disclose the negative externalities related to the use of proceeds from ESG-labeled debt securities. This includes quantifying any residual environmental impacts or potential environmental risks tied to the financed projects. In order to achieve complete transparency, any limitations or trade-offs associated with the environmental benefits of the projects being financed shall be explicitly set out in the offer document. Environmental data provided must be comprehensive, verifiable, and presented in a clear and accurate manner to prevent misleading impressions of the environmental impact.

Issuers must avoid exaggerating or obscuring any negative environmental consequences. The offer document should present a balanced view of both the positive and negative environmental outcomes, giving investors a realistic understanding of the project's impact. This approach ensures investors are fully informed about the sustainability implications of their investments, building trust and confidence in the integrity of the ESG-labeled debt issuance. Such transparency is crucial for maintaining credibility and aligning with true environmental goals.

5. Be alert - Monitoring and Disclose

Issuers must monitor and disclose the environmental impact of projects financed through their ESG-labeled debt issuance on an ongoing basis. The Issuers should provide clear metrics that demonstrate the reduction of adverse environmental effects, such as carbon emissions, pollution levels, and other relevant environmental factors. Issuers are required to track and report progress towards achieving the sustainability objectives and the methodologies used for measuring the progress towards the sustainability objectives outlined in the offer document. Regular updates should be provided to investors, showcasing how the financed projects contribute to environmental improvements. These disclosures should be accurate, transparent, and verifiable, ensuring that investors are kept informed about the environmental performance of the projects and the alignment with the stated sustainability goals. This ongoing monitoring and reporting will help maintain trust and demonstrate the issuer's commitment to the environmental objectives associated with the debt issuance.

The Circular provides a further guidance that the Issuers should communicate the following:

- (a) List and description of the projects to which the proceeds have been directed along with the qualitative performance indicators and the quantitative performance measures of the ESG impact of the project;
- (b) Information on the proposed process for measuring the progress of the perceived sustainability targets of the project.

Conclusion

The Circular takes into account the best-in-class global practices and contains detailed guidance notes and illustrative examples for a better understanding of the principles explained above. It marks a significant step towards enhancing transparency and integrity in sustainable finance. By establishing clear guidelines for issuers, the IFSCA aims to combat the deceptive practices associated with greenwashing, which have the potential to undermine investor confidence and distort market dynamics. The principles outlined in the Circular emphasize the importance of accurate labeling, transparent methodologies, and accountability in the management of proceeds from ESG investments.

By aligning with recognized international standards, the IFSCA not only seeks to protect investors but also to foster a more credible and sustainable investment environment within the International Financial Services Centre.

In conclusion, the IFSCA's proactive approach in addressing greenwashing is essential for maintaining market integrity and promoting genuine sustainable practices. As adherence to these principles becomes mandatory, it is expected that both issuers and investors will benefit from increased trust and clarity in ESG-labelled debt securities, ultimately contributing to a more sustainable financial ecosystem.

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