Why has India allowed FIIs to invest in its green bonds? | Explained

What are Sovereign Green Bonds? How will investments by Foreign Institutional Investors in green government securities accelerate India's transition to a green economy?

April 17, 2024 08:30 am | Updated 08:30 am IST

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Solar panels installed next to a wheat field at Vahelal village, about 40 km from Ahmedabad. | Photo Credit: AFP

The story so far: On April 5 the Reserve Bank of India (RBI) green lighted investments in the country's Sovereign Green Bonds (SGrBs) by Foreign Institutional Investors (FIIS) — investors such as insurance companies, pension funds and nation-states' sovereign wealth funds. SGrBs are a kind of government debt that specifically funds projects attempting to accelerate India's transition to a low carbon economy.

How does it help in green transition?

Allowing FIIs to invest in India's green projects widens the pool of capital available to fund the country's ambitious 2070 net zero goals, ensuring 50% of India's energy comes from non-fossil fuel based sources and to reduce the carbon intensity of the nation's economy by 45%, as pledged by Prime Minister Narendra Modi at COP26 in Glasgow 2021.

The RBI had issued SGrBs worth ₹16,000 crore in two tranches in January and February last year with maturities in 2028 and 2033. While in both instances the bonds were oversubscribed, the main participants were domestic financial institutions and banks, narrowing the avenues from where the government could borrow. Moreover, these green Government-Securities (G-Secs) were classified under the Statutory Liquidity Ratio (SLR), a liquidity rate fixed by the RBI that financial institutions must maintain with themselves before they lend to their customers.

SGrBs yield lower interest than conventional G-Secs, and the amount foregone by a bank by investing in them is called a greenium. But central banks and governments the world over are encouraging financial institutions to embrace greeniums to hasten the transition to a greener future. Climate finance experts believe India would gain from allowing FIIs in green G-Secs. They say FIIs are also looking to diversify their pool of green investments, as there is considerable regulatory support particularly in developed countries. And so this is an opportunity for them to invest in India's green g-secs. Ashim Roy, Energy Finance lead at World Resources Institute, India said FIIs might also be looking to gain green credentials when such investments may not be available in their home markets, and because India has successfully addressed greenwashing fears with the Sovereign Green Bonds Framework in late 2022.

What is the green taxonomy gap?

In the 2022-23 Union Budget, Finance Minister Nirmala Sitharaman announced the government's decision to issue SGrBs to accelerate funding government projects such as harnessing offshore wind, grid-scale solar power production, or encouraging the transition to battery operated Electric Vehicles (EVs). But the RBI had not created a green taxonomy, or a way to assess an investment's environmental, or emissions credentials to ensure the project is not an attempt at greenwashing, that is, faking green credentials to secure funding.

To address this gap, the Finance Ministry released India's first SGrB Framework on November 9, 2022 detailing the kind of projects that would receive funding through this class of G-Secs. These included "investments in solar/wind/biomass/hydropower energy projects (under 25 MW) that integrate energy generation and storage; supporting public lighting improvements (e.g. replacement with LEDs); supporting construction of new low-carbon buildings as well as energy-efficiency retrofits to existing buildings; projects to reduce electricity grid losses.” The list goes on to include promoting public transport, subsidies to adopt EVs and building charging infrastructure. The government also sought Norway-based validator Cicero’s opinion comparing India’s SGrB Framework with International Capital Market Association’s (ICMA’s) green principles. Cicero rated India’s framework as “green medium” with a score of “good governance”. WRI’s Ashim Roy said, “it would be crucial to identify new green projects with credible audit trails and high impact to optimally deploy the proceeds, especially ones that has received limited private capital like Distributed Renewable Energy and clean energy transition finance for MSMEs.”