Green Bonds

Why in News

As per a recent study by the **Reserve Bank of India (RBI)**, the **cost of issuing green bonds has generally remained higher than** other bonds **in India**, largely due to asymmetric information.

Key Points

- **Green Bonds (Description):**
    - **About:**
        - A green bond is a **debt instrument** with which **capital is being raised to fund 'green' projects,** which typically include those relating to renewable energy, clean transportation, sustainable water management etc.
            - A bond is a **fixed income instrument** that represents a loan made by an investor to a borrower (typically corporate or governmental).
            - Bonds **traditionally paid a fixed interest rate (coupon)** to investors.
    - **Growth:**
        - In 2007, green bonds were **launched by few development banks** such as the European Investment Bank and the **World Bank**. Subsequently, in 2013, corporates too started participating, which led to its overall growth.
    - **Regulation:**
        - The **Securities and Exchange Board of India (SEBI)** has put in place **disclosure norms** for issuance and listing of green bonds.
    - **Benefits:**
        - **Enhances Reputation:**
            - Green bonds enhance an **issuer's reputation,** as it helps in showcasing their commitment towards **sustainable development**.
        - **Fulfillment of Commitments:**
            - Ability to meet commitments, for signatories to climate agreements and other green commitments.
            - India's Intended Nationally Determined Contribution **(INDC)** document puts forth the stated targets for India's contribution towards climate improvement and following a low carbon path to progress.
        - **Raised at Lower Costs:**
            - Green bonds typically **carry a lower interest rate** than the loans offered by the commercial banks.
            - With an increasing focus of foreign investors towards green investments, it could help in reducing the cost of raising capital.

- **Sunrise Sectors:**
    - These green bonds have been crucial in **increasing financing** to **sunrise sectors** like renewable energy, thus contributing to India's sustainable growth.

- **Details of RBI's Recent Study:**
    - **Current Share:**
        - Green bonds constituted only **0.7%** of all the bonds issued in India **since 2018.**
            - However, **bank lending to the non-conventional energy** (renewable energy) constituted about **7.9%** of outstanding bank credit to the power sector, as of March 2020.
        - Most of the green bonds in India **are issued by the public sector units or corporates** with better financial health.
    - **Challenges:**
        - **High Coupon Rate:**
            - The average coupon rate for green bonds issued since 2015 with maturities between 5 to 10 years have generally **remained higher than the corporate government bonds** with similar tenure.
        - **High Borrowing Cost:**
            - It has been the **most important challenge due to the asymmetric information. High coupon rate is one of the reasons** for high borrowing cost.
            - **Asymmetric information,** also known as "information failure," occurs when one party to an economic transaction possesses greater material knowledge than the other party.
    - **Suggestion:**
        - **Developing a better information management system** in India may help in reducing maturity mismatches, borrowing costs and lead to efficient resource allocation in this segment.
- **Other Challenges:**
    - **Misuse of Funds:**
        - There have been serious debates about whether the projects targeted by green bond issuers are green enough because the proceeds of green bonds are being used to fund projects that harm the environment.
    - **Lack of Credit Ratings:**
        - Lack of credit rating or rating guidelines for green projects and bonds.
    - **Shorter Tenor Period:**
        - Green bonds in India have a shorter tenor period of about 10 years whereas a typical loan would be for a minimum 13 years. Further Green Projects require more time to bring returns.

Way Forward

- One of the foremost requirements is to **harmonise international and domestic guidelines and standards for green bonds** to develop a robust green bond market. Homogeneity is also required in terms of what constitutes green investments, as varied taxonomies would be antithetical to a cross-border green bond market.
- **Appropriate capacity building efforts for issuers** in emerging markets to spread knowledge

on the benefits and related processes and procedures pertaining to green bonds, would help in addressing the institutional barriers to entry into this market.

- In the context of green bonds, **strategic public sector investment could help in attracting private investment** as well as inspire investor confidence in the green bond market overall.