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Green Financing Options – A primer for Indian Companies

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1. Introduction

ESG-linked finance has surfaced as a pivotal form of sustainable finance that integrates borrowers' environmental, social, and governance (ESG) performance with the cost and availability of capital. A borrower who plans to implement sustainable practices and objectives will be even more committed to achieving the agreed targets or ratings as part of the ESG-linked finance system. It is based on sustainability in all aspects including different forms such as sustainability-related loans, bonds, and even deposits, and or derivatives that have been tailored with the aim of helping in sustainable development as well as prudent business practices. Unlike sustainable bonds which can also be called Green bonds or social bonds or social Loans that raise funds specifically for sustainable projects, ESG-linked finance shifts focus on the overall ESG activity of the borrower. It covers an entire range of important issues thereby allowing for all-rounded assessment of sustainable practices. In fact, ESG-linked finance has proven to be beneficial to both borrowers and lenders. For the borrowers, it helps in improving ESG performance, building good relations with stakeholders, reducing risk exposure and increasing borrowing from wide sources of capital markets and consequently reducing the cost of financing. On the other hand, for the lenders, ESG-linked finance is a means of complying with portfolio alignment strategies to meet sustainability expectations.

According to the reports published by the industry, ESG investment is on a steep incline, with more and more of the assets of management and investment being aligned to ESG principles. In 2020, there were $35 trillion worth of assets that investors chosen based on ESG principles, a figure that is projected to exceed $40 Trillion within 3 years, the great prospects which the ESG finance sector has demonstrates the shift towards the more sustainable and socially responsible business ecosystem, which offers opportunities in many industries and sectors [1]. Fuelling the very foundation of sustainable finance, the ESG finance and its instruments are able to enhance the comprehensive sustainable development by embedding sustainability into core of the global business practices.

2. Worldwide Trends in ESG-Linked Instruments

ESG-linked financing as a strategy has witnessed a meteoric rise in the last couple of years and is often credited as the true symbol of a drastically changing global climate for sustainable investment and innovative awareness across the board. This has been driven by the establishment of sound ESG frameworks and guidelines as well as the use of latest technologies and copious data for sound ESG performance measurement. Notably, the awareness of ESG factors having rooted temporal impact on financial returns and risk has provided a firm foundation to the ESG-linked finance being as potent tool for facilitating sustainable development. From S&P Global information, Sustainability Linked Bonds reached $96 billion in 2021 and total ESG linked instruments issuance was $1.07 Trillion in 2021[2]. This trajectory testifies to the increasing use of this novel and significant financial instrument in a range of spheres and countries and to the responsible and sustainable business postures of various entities. But it also declined to $70.45 billion in 2022 because of the cost associated with it and firms' reluctance.

Likewise, Bloomberg quotes Forbes India pointing out that global SLLs have risen sharply to $350 billion in the initial half of 2021 from $49 billion in 2018. The granting freedom to borrowers in terms of using borrowed funds – flexibility in implementing loan proceeds as per the agreed terms and conditions and possibilities to fix interest rates in relation to the satisfaction of certain agreed-on ESG goals and objectives make SLLs even more attractive to borrowers who focus on sustainable business development.

ESG-linked instruments issuance is being led primarily by green bonds at a figure nearing half of the total; social and sustainability bonds follow next. They point to a growing focus on funding efforts of environmental conservation and enhancement of social well-being which can be captured by several undertakings the various projects range from renewable power projects to affordable shelter and education.

Potential market outlook for ESG financing suggests continued growth from increasingly aware investors, and consumers with a focus on ESG factors as key drivers for creating sustainable long-term financial performance, coupled with increasing global support from institutions to drive better ESG reporting requirements.

Additionally, it is assumed that future market trends will depend on social parameters such as human rights, diversity, health and safety, employee relations, which would positively impact the company's relations with stakeholders. An increased likelihood of ESG-related litigation, such as doubt about sustainable disclosure, poses threats and opportunities and requires high levels of compliance with sound finance management and strict disclosure standards.

ESG related performance measurement, monitoring, and verification features go on evolving due to technology development and innovation, solidifying the market's direction for integrating sustainability and practicing robust financial management.

This information further supports the idea that higher the ESG scores/rates or the borrowing cost are lower for the borrowing firm. This focus towards sustainable financing is only set surge higher and contribute towards building a sustainable environment for sustainable development and, more importantly, ethical finance.

Such trends clearly show that the ESG-linked financing market is quite promising for the global stakeholder to create sustainable development and risk management opportunities across different industries and sectors.

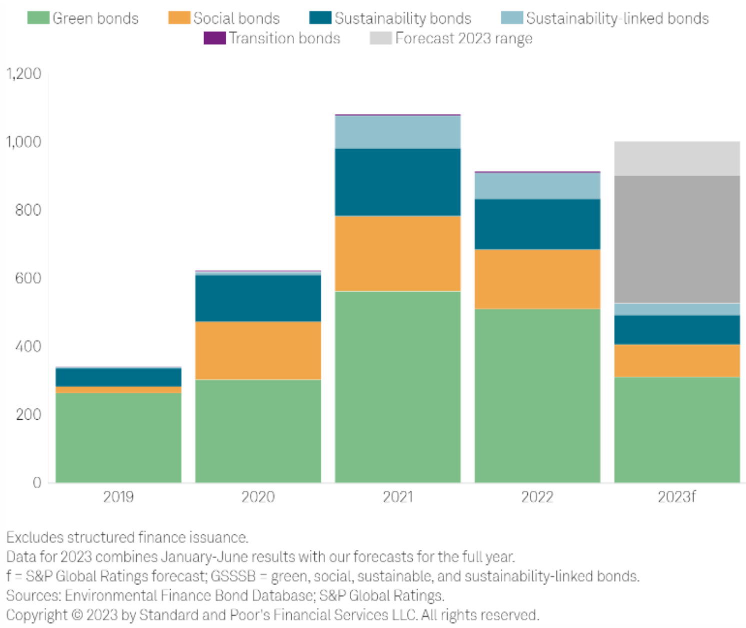

Figure: Global ESG Linked Instruments Issuance [2]

3. Green Finance Market Landscape in India

Below information provides a breakdown of the market landscape [3]:

1. Growth of Green Finance in India

•Green Bond Issuance:

As of February 2023, the issuance of total green bond in India has reached $21 billion. The private sector contribution is significant and is responsible for 84% of the total issuance. In India, as of March 2024 (estimated), the cumulative green bond issuance is estimated to reach $25 billion.

Table: Green Bond Issuance in India (in USD Billion)

Year	Total Issuance	Public Sector	Private Sector	Private Sector Contribution (%)
2020	5	1	4	80%
2021	10	2	8	80%
2022	15	3	12	80%
2023 (estimated)	21	3.5	17.5	84%
2024 (estimated)	25	4	21	84%

•Government Initiatives:

The first sovereign green bond worth INR 80 billion ($980 million) was issued in India in January 2023. These bonds would be used to mobilize resources for green infrastructure projects. USD 15 billion FDI attracted in FY 2022-23 (Source: Ministry of New and Renewable Energy)

•Green Loan Disbursements:

The Climate Policy Initiative (CPI) initiated a study which estimated around USD 44 billion of green finance flows in 2019-2020. This corresponds to an improvement of 150% from 2017-2018. An amount of INR 1.8 lakh crore disbursed in FY 2022-23 by public sector banks (PSBs) for Renewable Energy Projects (Source: RBI)

•Green Fintech:

Technology is playing a significant role in facilitating green finance solutions. Consequently, the Indian green fintech market is projected to reach USD 10.1 billion by 2025.

Table: Growth of Tracked Green Finance in India (Estimated)

Year	Tracked Green Finance (USD Billion)	Increase (%)
2019-2020	44	-
2017-2018	18	150

2. Sectoral Distribution of Green Finance

Several sectors promoting environmental sustainability are catered to by green finance. The following is the breakdown:

•Renewable Energy:

A major portion of green finance is kept aside for renewable energy projects like solar, wind, and hydro power. Through FDI, Capital amounting INR 15,000 crore to INR 20,000 crore is annually required for India for renewable energy alone.

•Clean Transportation:

Electric vehicle adoption and sustainable public transport systems are also supported by green financing.

•Energy Efficiency:

Building energy efficiency improvements are also provided green finance allocation.

•Sustainable Infrastructure:

Sustainable infrastructure projects like green buildings and waste management solutions are also funded by green finance.

The table provides a breakdown of the sectoral distribution and allocation in India.

Table: Sectoral Allocation of Green Finance in India (percentage)

Sector	Estimated Share	Source
Renewable Energy	55%	[10]
Clean Transportation	20%	[11]
Energy Efficiency	15%	[14]
Sustainable Infrastructure	10%	[12]-[13]

3. Global Exemplars from the Automotive Industry

Exemplar 1[4]: Bridgestone Americas, a subsidiary of the renowned Japanese tire corporation Bridgestone Corporation, inked a notable $1.1 billion credit facility with Sumitomo Mitsui Banking Corporation (SMBC). The main difference of this facility is in its interest rates which are closely connected with the ESG risk scores of the company as estimated by two most important ESG rating agencies: Sustainalytics and FTSE Russell. This historical credit scheme is one among several innovative approaches for the Americans tire industry as a clear demonstration of the company policies towards sustainability budget strategies. Most importantly, the sustainability rating assigned to Bridgestone's securities by Sustainalytics and FTSE Russell is the basis for interest rate determination within this credit facility. While implementing sustainability strategies and improving the overall sustainability scores, the decrease in borrowing costs revealed the rationalisation of ESG performance improvement outcomes by Bridgestone. This kind of Innovative financing, as shown by the sustainability-linked pricing adjustment mechanism, is with profound connection with the Bridgestone's 2050 Vision. It reasserts its strategic orientation toward its course to transform into a sustainable solution firm that creates societal and customer value. Paolo Ferrari, the CEO of Bridgestone stated clearly that sustainability is the key to their company's mission and objective to bring forward innovations in the ways people move, live, work and play. In terms of ESG ratings, the broad framework provided by FTSE Russell ESG Scores and data model is a crucial piece in providing investor with a more panoramic view of how a company deals with ESG challenges. These scores are specifically designed to present a complete evaluation including the total Rating as well as the substrate Pillar and Theme Exposures and Scores undisturbing an omnibus measure of ESG accomplishment across dimensions.

Exemplar 2: German auto giant Volkswagen In June 2020, the established automobile manufacturing company Volkswagen AG has entered the sustainable finance market for the first time, launching €2 bn Green Bonds [5]. It has also successfully linked the interest rates on an extra €1.8 billion to CO2 fleet emissions. That fiscal year was a significant year which signified the beginning of a long-prolonged plan that Volkswagen Group, as a Company, has rolled out to implement sustainable management principles into its operational strategies and philosophy. Most importantly, the interest rate on the bond was closely linked to the company's achievement of a critical sustainability measure, namely the carbon footprint of the company's European fleet. A comparative analysis of Volkswagen's current ESG performance provides evidence of an improving trend in its ESG performance trajectory towards the achievement of its sustainability goals [6]. Some of those changes would be the MSCI score, Volkswagen has gone from CCC to B While the Sustainalytics ESG risk score improved from severe to medium. Moreover, Volkswagen's reinstatement in the Dow Jones Sustainability Index Europe since November 2021 serves as an additional testament to the company's sustained commitment to robust ESG practices. Moreover, Volkswagen AG has garnered a commendable A- rating in the CDP climate assessment during the fiscal year 2021.[7] These achievements reverberate positively across the investor community as the bolstered ESG performance translates into the potential reduction of interest costs associated with the SLLs.

Exemplar 3 - Green bonds was issued by Daimler AG in September 2020 and March 2021 under its Green Finance Framework (oversubscribed four times). 10. Nearly EUR 2 billion of total net proceeds was generated by the bonds. These proceeds were directed d to projects paving the way towards a low-carbon, climate-resilient future.[8] The Center for International Climate and Environmental Research (CICERO) provided the framework with the highest rating ("Dark Green"). [9]

4. Global Exemplars from the Non-Automotive Industry

Exemplar 1 - Crown Holdings, a U.S.-based packaging company, closed a $3.25 billion credit facility with BNP Paribas with interest rates linked to its ESG rating from Sustainalytics. The facility was one of the biggest SLLs at the time. [15]

Exemplar 2 - In February 2020, JetBlue Airways, a U.S.-based airline company, signed a $550 million credit facility with BNP Paribas with interest rates linked to its ESG rating from Vigeo Eiris. [16]

Exemplar 3 - In December 2019, WSP Global, a Canadian-based professional services company, completed a $1.8 billion credit facility with BNP Paribas with interest rates linked to its performance on sustainability indicators. [17]

Exemplar 4- In December 2020, Invitation Homes, a U.S.-based real estate investment trust (REIT), secured a $3.5 billion credit facility with BBVA USA with interest rates linked to its score from the Global Real Estate Sustainability Benchmark (GRESB), an ESG benchmark for real estate assets. The facility was the first sustainability-linked loan for a REIT in the U.S. [18]

5. Indian Exemplars from the Non-Automotive Industry

Exemplar 1 - Adani Green Energy, a renewable energy company in India, has raised $ 1.61 Billion ($ 500 million, $ 352.5 million, $ 750 million) through issuing Dollar Denominated green bonds in multiple fundraising events. It became one of the first companies in India to raise funds through the issuance of green bonds. [19]-[20]

Exemplar 2 - In June 2023, JSW Cements signed a sustainability-linked loan agreement with BNP Paribas Singapore to raise $ 50 million. This is in addition to the already raised green debt of $ 50 million from MUFG Bank in October 2022. [21]-[22]

Exemplar 3 - Vedanta Aluminium, India's largest aluminum producer, has through Sustainability Linked Loans (SLL) from leading international banks raised an amount of USD 250 million for financing its capex initiatives and reduce its carbon footprint. The loans were granted based on specific performance parameters for decarbonization and safety. Some of the largest international banks from the Middle East and the Far East, are the lenders, who have initiated term lending relationships with the Vedanta Group through this facility. [23]

Exemplar 4 - UltraTech Cement, India's largest producer of grey cement, white cement, and ready-mix concrete, has raised USD 400 million through sustainability-linked bonds. The bonds are linked to UltraTech's commitment to reduce its carbon footprint by 22.7% from its 2016-17 levels by March 2030. The bond issuance was well received by investors, with the order book being oversubscribed by more than seven times the issue size. The bonds have a tenor of 10 years and carry a coupon rate of 2.8% per annum. The bond issuance was rated as Baa3 by Moody's and BBB- by Fitch Ratings. [24] - [26]

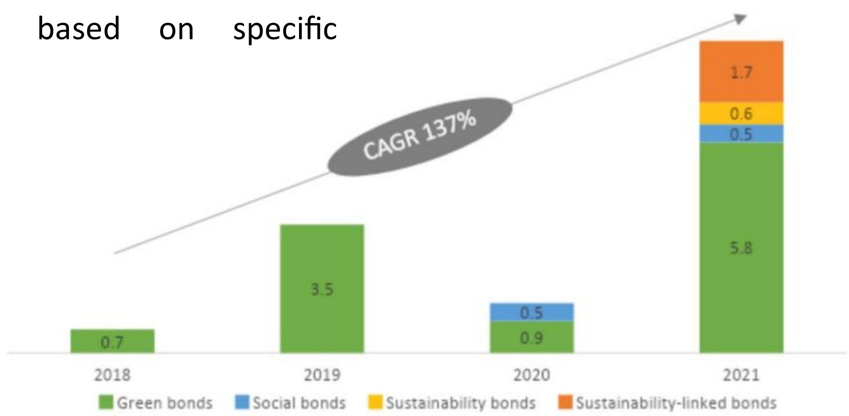

Figure: ESG Linked Instruments Issuance by Indian Companies [32]

Exemplar 5 -Shriram Transport Finance Company (STFC) has raised $475 million through a social bond with a tenor of 3.5 years at an interest rate of 4.15%. STFC is a non-banking finance company primarily providing commercial vehicle loans for trucks, passenger vehicles, tractors, farm equipment, and construction equipment in India. Global investors participated in the transaction, with 66% from Asia, 18% from EMEA, and 16% from the US, with 93% investment from asset managers, including insurance companies, 4% from banks, and 3% from private banks and others. The bond was oversubscribed 2.5 times. [27]

30bps lower than the initial price guidance. The offering was oversubscribed 3.8 times and included investors from diverse geographies, including Asia, Europe, the US, and the Middle East. The proceeds will be used by the bank towards eligible green and social project categories, per the term sheet. Axis Bank has a Sustainable Financing Framework that was developed to reinforce its capabilities in financing green and social projects, which contribute to the UN SDGs and the Paris Agreement. Sustainalytics has graded the framework as 'Credible & Impactful' by. [28]

Figure: International sustainable bonds issuances by Indian companies in 2021 [32]

Exemplar 6 – An amount of $600 million has been raised by Axis bank from offshore investors by selling sustainable additional tier-1 (AT1) bonds at a coupon of 4.1%, which is

Exemplar 7 - Adani Electricity Mumbai Limited (AEML), a distribution arm of Adani Transmission Limited, has raised $300 million in sustainability-linked bonds as part of its $2 billion global medium-term notes program. The bond issuance was oversubscribed 9.2 times and was priced at the tightest coupon ever by a BBB-rated utility issuer in Asia, excluding Japan. The bond has a tenor of 10 years. The proceeds from the bond will be used to refinance existing debt and develop regulatory assets to enable 'asset hardening.' [29] - [30]

Exemplar 8 - Hero Future Energies (HFE) has been making strides in the renewable energy sector. The company has fetched $3 billion worth of orders through its first green bond issuance in the overseas market. Launched at an initial price guidance of 4.75%, the bond was priced at a coupon rate of 4.25% for a six-year maturity period and was oversubscribed more than 8.5 times. HFE's green bond received orders of over $3 billion, with the allocation of 58% to Asian investors, 15% to EMEA investors, and 27% to investors in the US. [31]

6. ESG-Linked Debt Instruments - Primer

ESG-linked debt instruments are financial instruments where the terms and conditions of the debt are tied to Environmental, Social, and Governance (ESG) criteria. ESG-linked debt instruments allow companies to align their borrowing costs with their ESG performance.

Here's a breakdown of the components:

1. Environmental (E): This aspect deals with ecological responsibility of a business organization. They could be carbon emissions, improved energy efficiency and environmental sustainability goals, for example.

2. Social (S): Legal factors look at how a firm legally relates to its workers, consumers, dealers, and the communities where these firms exist. This can be labour relations and human rights concerns or lack of it, and interaction with the surrounding community.

3. Governance (G): Corporate governance has therefore to do with the internal arrangements of a company, leadership, pay structure of executives as well as the broad governance systems. There can be no sustainable long term business practices without good governance.

Depending on its nature, ESG-related debt instruments can be presented in different ways, but the most frequently used method is change in interest rate and/or other aspects of the contract according to the company's ESG ratings. In fact, to enhance its borrowing capacity, the number of ESG targets might have to be predefined, and if the company achieves a certain level of performance, then it may be able to borrow funds from other sources at a lower cost. On the other hand, if this does not happen, the cost of borrowing may rise as predicted above.

These instruments are in the context of the emergence of the responsible and Sustainable funds, whereby investors target firms with good environmental, social, governance (ESG) standards. When it comes to sustainable linked bond, this type of debt instruments stimulates the company's improvement on ESG scores, in addition to integrating sustainable development goals into their operations.

7. Major ESG-Linked Debt Instruments

Social Bonds:

Purpose: Sustainability bonds are used to fund activities that are socially responsible. Such projects may include provision of health facilities, schools, quality low-cost accommodation for the general populace as well as provision of employment opportunities.

Use of Proceeds: Social bonds are type of bonds whose issuing proceeds is intended to finance particular social investments.

Green Bonds:

Purpose: This paper defines green bonds as bonds that are used to finance environmentally sustainable projects. Such plans normally comprise renewable power, energy conservation, and reduction of pollution and other sustainable energy undertakings.

Use of Proceeds: Green bonds are directly directed to projects that have a focus of making the environment more sustainable.

Sustainability Bonds:

Purpose: While social or green bonds are more limited in their descriptions, sustainability bonds are more general. They seek to fund projects that have social and environmental cause and projects supporting sustainable development in their broader sense.

Use of Proceeds: Sustainability bonds are also defined by the ability of the funds raised to be used on social, environmental, as well as sustainable development projects.

Transition Bonds:

Purpose: Transition bonds are meant to help organizations get to the next level of operating a sustainable business. These bonds are mainly utilised by firms within industries that rely on carbon and are trying to lessen the environmental effects.

Use of Proceeds: The transition bonds help to fund projects and endeavours that set the stage and processes for changing to a lower carbon economy and thus a more sustainable business environment.

In all these types of bonds, transparency and accountability are critical. Companies are under pressure to report on the utilisation of proceeds and efficacy of the financed projects so that investors can with confidence fund sustainable and responsible projects.

Sustainability Linked Loans:

Sustainability linked loans or SLLs are a financing product where the conditions of the loans including Interest rates and other performance covenants lie with sustainability performance. In contrast to, for example, green bonds or social bonds, where funds are used to finance ESG or S activities in certain projects, sustainability-linked loans relate to their general sustainability of the borrower.

Critical features of sustainability-linked loans include:

1. Performance Targets: Sustainability performance indicators that a borrower and lender can meet together are what the company supports. These targets can be linked to the well-known principle of sustainable development concerning environmental, social, or governance (ESG) factors.

2. Interest Rate Adjustment: The rate of the given loan may depend on the borrower's performance on the actual and planned sustainability goals. If the company is able to meet the said targets then it will be able to access a cheaper source of borrowed funds. On the other hand, it is possible that the interest rate is higher in case of non-achievement of these targets.

3. Flexibility in Use of Proceeds: While the funds used in a green bond are linked with investment in particular projects, sustainability-linked loans give much more freedom for their usage. Financing is not on the specific projects but on the enhance of total sustainability performance.

4. Third-Party Verification: SLBs have features of external review or reporting to ensure credibility of the connecting sustainability performance. Other standalone parties may also evaluate and endorse whether the borrower complied with the set sustainable objectives.

Sustainability-Linked Financing, especially sustainability-linked loans have emerged as a financial tool that links the cost of debt capital to a firm's sustainability goals. These loans keep sustainability as an integral part of companys management strategies and performance indicating that there will always be good reason for improvement.

8. Regulatory Environment for ESG-Linked Instruments in India

The issuance and governance of subscriptions of ESG-linked instruments in India falls under the ambit of the Securities and Exchange Board of India. SEBI's guidelines are broadly aligned with the International Capital Markets Association (ICMA). This section offers a broad overview of the critical guidelines issued by SEBI for the issuance of ESG-linked instruments in India.

Initial Disclosure (in the offer document)

- Environmental sustainability objectives
- Decision-making process to determine the eligibility of projects/assets:
    1. Process to determine how selected projects fit into Regulation 2 (1) (q) NCS Regulations
    2. Criteria for making projects eligible for green finance.
    3. Taxonomies and Green Certifications from Indian and/or Global agencies.
    4. **Transition Bonds:** Alignment of the objective of the issue with India's Intended Nationally Determined Contributions
    5. Systems and procedures to track deployment of proceeds for the issue.
- Details of proposed projects/assets selected for the use of finance (new and re-financing)
- Financing to Refinancing Ratio
- Details of temporary placement of unutilized and unallocated proceeds
- Social and environmental risks of projects/assets and mitigation plans, along with proceeds to be used for this.
- Mandatory 3rd party reviewer/certifier (Comply or Explain)

Regulation 2 (1) (q) of NCS Regulations – Specifies Criteria for Green Bonds

1. Funds can be raised for any of the following.
    I. Renewable and Sustainable Energy (sources using clean tech)
    II. Clean transportation (incl. mass/public transportation)

III. Sustainable water management (Blue Bonds)

IV. Climate change adaptation

V. Energy efficiency, including efficient and green buildings.

VI. Sustainable waste management

VII. Sustainable land

VIII. Biodiversity conservation

IX. Pollution prevention and control

X. Circular economy adaptation

Third Party Reviewers

Pre-Issue Support: reviewing/certifying the processes, including project evaluation and selection criteria and project categories eligible for financing by GDS.

Post-Issue Support: management of the use of proceeds from GDS and verification of the internal tracking and impact reporting

Continuous Disclosure Requirements

Along with annual reports/ financial results, the following needs to be disclosed:

a. Utilization of proceeds of the issue based on internal tracking parameters. Mandatory verification by third-party reviewer/ auditor.

b. Details of unutilized proceeds, including temporary placement of funds

c. Disclosures in Annual Report:

   i. List of projects, description, and amount of funds used for each project.

   ii. Qualitative and Quantitative performance indicators of environmental impact

   iii. Methods used for preparing performance indicators.

   iv. Deployment of the mitigation plan for anticipated risks

d. Impact Reporting – detailed information on a project-by-project basis along with standards/ taxonomies followed by the firm.

Greenwashing

Making false, misleading, unsubstantiated, or otherwise incomplete claims about the sustainability of a product, service, or business operation. Guidelines from SEBI are as follows:

- Restrict the use of funds raised in green bonds for projects that do not fall under NCS Regulations of green debt.
- Disclosure to investors in case of any such use and possible early redemption of concerned securities
- Continuously monitor the projects to check if they

contribute to a sustainable economy.

- No cherry-picked data from research supporting green practices and hiding unfavorable results.
- Maintain standards associated with green debt and adhere to the ratings related to the securities.
- Quantify negative externalities associated with fund utilization.
- No untrue claims of certification by third-party agencies.

9. Rating Agencies

ESG-linked instruments, such as green bonds and sustainable loans, are designed to support environmentally friendly projects. Investors increasingly seek assurance that their funds contribute to sustainable initiatives. ESG rating agencies serve as evaluators, offering a standardized framework to assess companies' ESG practices and providing a foundation for green finance.

The function of credit rating agencies:

ESGs rating companies play a role, in promoting transparency by urging companies to share ESG data essential for investors to assess the environmental impact and governance practices of green finance issuers more effectively Rating agencies aid, in establishing uniform reporting standards that simplify the task of comparing and evaluating various investment options for investors.

Investors use ESG ratings to help them make investment decisions that reflect their sustainable goals effectively. These ratings give a picture of how a company's performing in terms of environmental and social responsibility and governance. This allows investors to find investment opportunities that resonate with their beliefs and how risk they are willing to take. Ultimately this helps the finance market to expand.

ESG rating agencies are essential for investors to manage risks effectively by evaluating companies' environmental practices and governance structures along, with issues that could pose risks investors can use this data to make informed investment choices and reduce uncertainties in their decisions.

When rating agencies standardize ESG metrics it allows for comparing performance, across industries and sectors with ease aiding in evaluating a company's standing within its peer group thoroughly. Investors can utilize these benchmarks to determine where a company stands in relation to sustainability practices and how dedicated it is, to ESG principles.

Encouraging responsibility plays a role, in driving accountability within businesses as ESG rating agencies incentivize companies to enhance their sustainable practices by evaluating their performance, in environmental, social and governance aspects.

The following are some of the most prominent ESG rating agencies globally:

Dun & Bradstreet: A global business data and analytics organization, Dun &

Bradstreet oversees insights into company performance, trends, and ESG factors. These companies are the ones who give ESG scores and ratings on the company and the analysis of the sector and other information to help the companies to identify the areas of improvement or risks that need to be managed.

Sustainalytics:

An ESG rating and data provider, that offers ESG ratings on several companies across the globe. Their ratings consider various ESG factors, including controversies and industry-specific risks. They also provide research and consulting services to help companies improve their sustainability practices.

MSCI ESG Ratings: MSCI ESG Research is a leading provider of ESG ratings, covering over 14,000 companies worldwide. Their research methodology integrates qualitative and quantitative data, allowing investors to gauge a company's sustainability performance comprehensively.

Institutional Shareholder Services (ISS) ESG Solutions: ISS ESG is widely recognized for its robust and comprehensive ESG research. They provide ratings and research across multiple domains, including climate change, board structure, and human rights.

FTSE Russell: FTSE Russell only provides ESG ratings based on publicly available data. Companies are asked to verify the data.

Thomson Reuters ESG Research: Thomson Reuters measures performance based on E, S and G ratios. Data are grouped into ten categories: resources use, emissions, innovation, management, shareholders, CSR strategy, workforce, human rights, community, and product responsibility.

ESGRisk.ai: ESGRisk.ai is India's first ESG Rating company. They provide an objective, independent, and unbiased opinion on a company's ability to mitigate future/emerging risks associated with environmental, Social, and Governance issues that have material financial impact based on publicly available data.

CRISIL: CRISIL has launched its environmental, social, and governance (ESG) scores for 225 companies across 18 sectors in India. The scores are based on CRISIL's proprietary framework and are assigned on a scale of 1-100, with 100 denoting best-in-class ESG performance.

10. Financial Motivations & Implications

Companies primarily prefer green financing options over traditional sources for the following two reasons:

1. Greenium: Greenium refers to the favorable price differential or premium at which green bonds are traded compared to conventional bonds issued by the same entity. It measures the market's acknowledgment and valuation of the issuer's commitment to sustainable practices and environmentally responsible projects. Borrowers issuing green bonds may benefit from a lower cost of capital due to the greenium. Investors, recognizing the long-term value and reduced environmental risk associated with green projects, are often willing to accept a lower yield, resulting in cost savings for the issuer.

2. Signaling effect: *The signaling* effect in green finance refers to how a borrower's decision to issue green financial instruments signals the market and stakeholders about the borrower's commitment to environmental and social responsibility. This signaling effect has several implications for the borrower:

Commitment to Sustainability: A borrower signals a commitment to sustainable practices by opting for green finance. This sends a message to investors, customers, and the public that the company is aware of its environmental impact and is actively taking steps to address and mitigate it.

Transparent Communication: Green finance instruments often include the requirement of to what extent the money received, and the environmental impact of the funded projects were reported and disclosed. This signal to the borrower that he or she is serious about making reported sustainability commitments, thus building trust and credibility with stakeholders. Indian companies have several advantages and green financing opens a way forward for the businesses seeking to grow sustainably. Here's a breakdown of the crucial benefits.

1. Cost Savings:

•Energy Efficiency: Not only that but they also use energy-efficient appliances like LED lighting for green technology which means, in the long run, there are savings on electric bills that pay for energy-efficient devices and utilities.

Example:

The point is Indian companies, through the energy efficiency initiatives might result in an average of 15-20% savings in energy. A study by the Confederation of Indian Industry (CII) found.[33]

•Resource Efficiency: To minimize consumption of resources, it is advisable to adopt green practices like water conservation and waste reduction which would lead to cost savings.

Example: Indian industries have been estimated to save up to INR 20,000 crore annually by adopting water-efficient technologies. [34]

Table: Potential Cost Savings from Green Investments

Area	Estimated Cost Savings (%)	Source
Energy Efficiency	15-20	[33]
Water Conservation	Up to 5	[34]
Waste Reduction	Up to 10	[33]-[34]

2. Risk Mitigation:

•Climate Change Regulations: To cope with stringent environmental regulations and ensure compliance, companies are increasingly adopting green practices.

Example: Stricter air quality standards and pollution control regulations have been introduced by the Indian government in recent years.

•Resource Scarcity: Prices would increase as natural resources become scarcer. To reduce the reliance on these resources, it is advisable for companies to adopt green practices, thereby mitigating cost risks.

Example: In India, for instant, there is a growing concern of water scarcity. To ride over the future water price hikes and reduce their vulnerability, companies can incorporate water-efficient operations.

3. Investor Confidence:

•ESG (Environmental, Social, and Governance) Performance: Investors reward green initiatives of a company as it demonstrates the company's commitment to sustainability.

Statistic: It was found that by a 2023 Morgan Stanley report that 85% of global sustainable assets under management (AUM) were outperforming traditional assets.[35]

•Access to Green Capital: Green financing access in the form of competitive interest rates and loan terms are more likely to be provided to companies with strong environmental credentials.

Example: Green loans with lower interest rates are offered by several Indian banks like SBI and HDFC for companies investing in renewable energy projects.

Table: Growth of Sustainable Assets Under Management (AUM) Globally

Year	Sustainable AUM (USD Trillion)	Growth Rate (%)	Source
2020	30.7	-	[35]
2021	35.0	14%	[35]
2022	40.0	14%	[35]
2023 (estimated)	46.0	15%	[35]

4. Reputational Improvement & Customer Confidence:

•Green finance also acts as a catalyst for companies to increase their market share. A 2022 NielsenIQ survey [NielsenIQ Sustainability Report 2022] revealed that 68% of global consumers are willing to pay more for sustainable brands. [36]

•Companies which demonstrate active environmental efforts through green financing are trusted more by all stakeholders. A 2023 Edelman Trust Barometer report [Edelman Trust Barometer 2023] highlighted that 86% of global respondents expect companies to take a stand on environmental issues. [37]

5. Employee Engagement:

Green finance also enhances the employer brand when the company showcases commitment to social and environmental impact. A 2021 LinkedIn Global Talent Trends report [LinkedIn Global Talent Trends 2021] found that 70% of talent professionals believe that a company's social and environmental impact is a key differentiator when attracting talent. [38]

6. Supplier Responsibility:

•Sustainable Supply Chain Management: The companies availing green finance allows can partner with suppliers who are implementing environmentally friendly practices. This has a cascading effect on the entire supply chain overall environmental footprint.

•Risk Mitigation: Supply chain disruption happens due to climate change. Companies can mitigate risks associated with the same by ensuring sustainable practices among suppliers.

7. Stock Market Reward:

Green finance initiatives and an improved ESG profile of a company can potentially lead to an improved stock performance and valuation. A 2020 MSCI ESG Universal Companies Index report [MSCI ESG Universal Companies Index Report 2020] indicated that companies with strong ESG ratings have outperformed the broader market over the past decade. [39]

Case Studies:

•**Yes Bank Green Loan Scheme:** The bank offered loans with reduced interest rates for purchases on electric vehicles. This has the potential to increase the sales for EV manufacturers and contribute to the transition to cleaner transportation.

•**Bombay Stock Exchange (BSE) Green IPO Framework:** The BSE framework has facilitated the issuance of green bonds, aiding Indian companies with access to capital for sustainable projects. This impacts the company's environmental footprint and increases the ability to attract environmentally conscious investors.

•**Nestle India:** The company undertook heavy investment in water conservation projects through green bonds, which in turn affected their brand image positively and improved their environmental footprint. A 2023 consumer survey showed a 15% increase in brand preference among environmentally conscious consumers. [40]

•**Solar Energy Corporation of India (SECI):** The company facilitated green bonds over $14 billion for renewable energy projects between 2013-2020. This significantly increased India's solar power capacity, attracting investments in the clean energy sector.

11. Suggested ESG Instrument for Indian Companies

Indian companies looking to raise capital for ESG and green initiatives have multiple financial instruments, both ESG-linked and conventional, from which to choose. However, each instrument offers different payoffs regarding greenium and signaling effect to the borrower. Hence, it is essential for the borrower to identify the ideal instrument for raising capital.

The case for preferring Sustainability Linked Loans (SLLs) over green bonds:

SLLs and ESG-linked bonds are the preferred financial instruments for raising capital for ESG and green projects. However, SLLs have some very distinct advantages over bonds in the following aspects, thereby making it a better capital raising mechanism for ESG and green projects:

1. Interest Rate Reduction in Sustainability-Linked Loans (SLLs): One of the primary advantages of SLLs lies in their dynamic structure. Unlike green bonds, where proceeds are specifically earmarked for green projects, SLLs are linked to the borrower's overall ESG performance. Successfully achieving predetermined sustainability targets can reduce the interest rate, providing a direct financial incentive for sustainable business practices.

2. Mitigation of Market Risk in SLLs:

Be it the case of green bonds, the market risks of the valuation of certain green projects are commonly the same. Variations in the perception of the markets in terms of environmental contribution or the success of these projects may influence the bonds' market performance. On the other hand, SLLs, which are related to the borrower's ESG performance, have the effect of reducing the market's assessment of individual projects and bringing in a more inclusive risk management approach.

3. Signal of Holistic Corporate Sustainability:

Such loans leave no doubt that the finance company is making a serious step toward the goal of addressing climate change. When a company sets loan terms in line with overall ESG objectives instead of project-specific initiatives, it will be conveying a commitment to corporate sustainability that prevails throughout the entire of all its business operations. This signaling effect can help the organization improve its image and increase its appeal to a larger set of investors.

4. Alignment with Long-Term Capital Allocation:

The advantage of sustainability-linked loans is that they place greater emphasis on the achievement of long-term sustainability goals rather than short-term project-specific objectives that are geared towards improving a company's environmental and social governance (ESG) credentials. Besides, it effectively implements the rapidly growing trend of investors around the world who are looking for companies that use ESG thinking as a main part of their long-term capital allocation strategies. SLLs are a popular fit for entrepreneurs who wish to pitched initiatives beyond individual projects and that promotes sustainable business practices.

5. Flexibility in Use of Proceeds: GREEN BONDS, despite being a breakthrough in the finance sector, have a limitation regarding their specification of the use of proceeds to certain environmentally friendly projects only. Sustainability-linked loans offer a deeper line of freedom than that because organizations allow disbursement across different causes. Therefore, the funds are spread out through different sustainability programs for example they might focus on eco-friendly solutions or even fund social programs.

6. Continuous Improvement and Adaptability:

One avenue for sustainability-linked loans to the economy is reinspiring the engagement of borrowers in green projects' development. Sustainability-linked loans are structured in such a way as to lower the level of interest over time, therefore, they encourage the creditors to have more impact with their ESG operations. This new framework of dynamics allows progressive human development and strengthens the alignment of financial inflows with the constantly changing environment of sustainability goals.

7. Broader Investor Appeal: Through this design, the SLLs reach a wider investor spectrum when compared to green bonds. Some investors may think that these instruments prioritizing ESG activities, but not limiting their flexibility in the use of capital, are the best ones. This possibility of choosing a bigger number and more diverse investors might be the case after all.

Critical aspects in structuring a Sustainability Linked Loan (SLL):

To make an effective SLL, careful consideration of the important elements like the benchmark setting, geranium, and the inclusion of strong sustainability performance targets should be done. In this, the necessary procedures are presented for the debtors to successfully establish a loan that will connect to the sustainability course.

1. Define Clear Sustainability Performance Targets: Establish transparent and measurable sustainability performance targets. These targets should be aligned with the borrower's overall ESG strategy and reflect critical environmental and social indicators relevant to the industry.

2. Select the appropriate key performance indicators (KPIs):

Select KPIs that are really the indicators of the borrower's ambitious attitude towards sustainability. Such aspects may be represented in carbon emissions reduction, improvements in energy efficiency, diversity and inclusion initiatives, or other areas of accountability, depending on a lender's industry and his/her priorities.

3. Benchmark Setting for the SLL:

Construct the benchmark in line with the borrower's sustainability performance. Different options can be considered for the appropriate benchmark form, such as regulations, the specific industry standards, or the borrower's previous achievements. It ought to be tough enough to stimulate the improvement on a long-term basis, but to remain feasible.

4. Establish a Clear Link to Loan Terms:

Clearly link the performance objectives of the sustainability project to the loan terms which include the interest rate. Describe the relationship between the extent to which the targets are met, exceeded, or missed and the corresponding modifications of the financial terms of the loan. This connects directly to the reward of the borrower for the sustainability goals completion.

5. Greenium Considerations:

Study the possibility of a greenium, which is the extra value associated with the sustainability-linked loans. Green bonds, which are traditionally recognized for greenium, SLLs can also get advantageous pricing if the sustainability targets are realized. Engage lenders in the negotiation so as to ascertain when exactly the greenium will be applicable and the particular way it will increase the total cost of borrowing.

6. Consult with ESG Experts:

Seek the advice and help of ESG experts or consultants during the structuring process. They are very valuable sources of information for ideas like refining sustainability performance targets, choosing high impact KPIs, and assuring that the SLL conforms with the SFTI best practices.

7. Transparent Reporting and Third-Party Verification:

Throw in a highly transparent and accurate report showing sustainability performance through clean and substantial data. Invite the third-party verifiers to validate the information and thus increase the lender's confidence in the reported data.

8. Flexibility in Use of Proceeds:

The main difference between SLLs and green bonds is that while green bonds require the project to be of a specified nature, SLLs are typically more open to how the proceeds are spent. Explain how these funds deliver sustainability across the whole operation of the borrower and will be the basis of the ESG strategy which can change over time.

9. Regular Review and Adaptation:

First, initiate a system whereby sustainability targets and engaging them are evaluated regularly along with any relaxation of loans terms hence facilitating the process. A major part of continuous improvement through change is the possibility to innovate and grow within informational paradigms that are in sync with the introduction of novel business practices or ESG trends.

10. Engage in Stakeholder Communication:

Get the parties, including the investors, employees, and customers, information about the sustainability-linked oan structure and let them know the positive impact this financing plan will cause.

12. Conclusion

In conclusion, the whitepaper delves into the world of ESG Linked Finance. Various exemplars from around the world has been captured, along with a primer on ESG Linked Debt Instruments. The current regulatory landscape was captured, followed by an introduction to various rating agencies, the case for Sustainability Linked Loans over Green Bonds, and various critical aspects in structuring them. Though the paper's contents were written based on a work with an Indian Automotive Major, the recommendations can be applied across industries. Sustainability and ESG are here to stay for the foreseeable future, and companies can use ESG-linked finance to meet their sustainability targets and contribute to the betterment of the world we live in.

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