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GREEN BONDS: HELPING TO DRIVE CLIMATE CHANGE MITIGATION AND SUSTAINABLE INVESTMENTS IN NIGERIA

1. Introduction

The global financial landscape is undergoing a transformative transition towards climate change mitigation and sustainable investment practices. This transition is prominently marked by the emergence and increasing adoption of sustainable financial instruments, which are proving to be a catalyst for driving sustainable investments globally, including Nigeria. One of such sustainable financial instruments is the Green Bond which can be issued by governments and corporate bodies. The issuance of Green Bonds has gained prominence in financial markets worldwide and Nigeria is not an exception. You may ask the question: What is a Green Bond? The Nigerian Exchange Limited ("NGX") defines Green Bonds, in its Rules for Issuing and Listing Green Bonds on the Exchange ("NGX Rules"), as "*debt instruments (Fixed Income) whose proceeds are used to finance climate change and environmental sustainability projects.*"[1]

Unlike plain vanilla bonds, which are typically issued to raise capital for the financing requirements of an issuer, Green Bonds are specifically earmarked to fund environmentally friendly and climate change mitigation projects. These projects range from renewable energy ventures and energy-efficient infrastructure to afforestation initiatives, climate change adaptation and sustainable water and wastewater management systems. The essential feature of a Green Bond is the use of its proceeds to fund projects that contribute positively to environmental sustainability and climate change mitigation. Investors who invest in these bonds align their investment objectives to seek financial returns accompanied by environmental benefits.

2. The Green Bond Principles

The Green Bond Principles[2] are voluntary process guidelines developed by the International Capital Markets Association ("ICMA") for the issuance of Green Bonds that aim to promote integrity in the green capital markets through transparency in disclosure and reporting. The following are the four primary principles:

- **Use of Proceeds**: The purpose for which the returns of a Green Bond issuance will be utilised should be properly described in the legal documentation for the transaction. All designated projects should provide clear environmental benefits, which will be assessed and quantified by the issuer.

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1 The Process for Issuing and Listing Green Bonds on the Exchange
2 Green Bond Principles - ICMA

- **Process for Project Evaluation and Selection**: An issuer is required to clearly communicate the environmental sustainability objectives, the process to determine the eligible projects and the related eligibility criteria to potential investors.

- **Management of Proceeds**: The net proceeds from the issuance are required to be credited to a sub-account, moved to a sub-portfolio, or otherwise tracked by the issuer in an appropriate manner and attested to by the issuer in a formal internal process.

- **Reporting**: An Issuer is required to make readily available up-to-date information to the investors on the use of proceeds. This shall be renewed annually until full allocation and as may be necessary thereafter in the event of material developments. The report should include a list of the projects to which the proceeds have been allocated and a brief description of projects, amounts allocated, and expected impact.

3. Advantages and Systemic Impact

The key benefits for issuers of Green Bonds include the enhancement of reputation and brand value, an increase in investor demand, the diversification of the bond issuer's investor base and contribution to climate change mitigation practices. This diversification would potentially reduce exposure to bond demand fluctuations and help to foster an improved relationship with debt providers. For investors, the advantages of investing in Green Bond instruments comprise meeting Environmental, Social, and Governance ("ESG") requirements, fulfilling green investment mandates, and engaging in sustainable products and initiatives without incurring additional risk. Furthermore, the systemic benefits of Green Bonds encompass fostering green innovation, stimulating positive reactions in the securities market, and facilitating the implementation of climate-friendly policies.

Furthermore, the Climate Change Fund, established under the Climate Act of 2021, offers several advantages to Green Bond issuers. This fund is designed to support various initiatives, including innovative projects aimed at mitigating and adapting to climate change, subject to approval by the National Council on Climate Change. Additionally, the fund can be used to provide incentives to both private and public entities for their efforts to transition to clean energy and maintain reductions in greenhouse gas emissions.[3]

[3] Section 15(2) Climate Change Act 2021

4. Introduction of Green Bonds in Nigeria

Nigeria took a significant step towards combating climate change and fostering sustainable development by signing the Paris Agreement in September 2016 and the subsequent enactment of the Climate Change Act in 2021. You can view our earlier article on the Climate Change Act here.[4] This step aligned the nation with a global coalition dedicated to mitigating the adverse impacts of climate change on the environment. Under the Paris Agreement, Nigeria's Nationally Determined Contribution ("NDC") is to reduce carbon emissions by 20% unconditionally and 45% with international support by 2030.

In a bid to achieve its NDCs under the Paris Agreement, the Federal Government of Nigeria ("FGN") issued a sovereign green bond in December 2017. This made Nigeria to become the first African nation and the fourth country globally to issue a sovereign green bond. The Series 1 issuance thereunder was for over N10.69 billion, and the proceeds of the bonds were utilised to fund energy-related projects. These projects included the renewable energy micro-utilities programme, re-energising education programme, afforestation programme, 10MW Katsina wind farm power, and the purchase of solar-powered tricycles for use across the country. Notably, the Nigerian sovereign green bond was the first sovereign bond to be certified by the Climate Bond Initiative.

5. Legal Framework for Green Bond Issuances in Nigeria

5.1 SEC Green Bond Rules 2018

In 2018, the Securities and Exchange Commission ("SEC") amended its existing rules and regulations to provide for the issuance of Green Bonds in Nigeria. In this regard, the SEC defines a Green Bond as "*any type of debt instrument, the proceeds of which would be exclusively applied to finance or refinance in part or in full new and/or existing projects that have [a] positive environmental impact*"[5].

To qualify to be classified as a Green Bond in Nigeria, the proceeds of the bonds must be invested in specific listed projects such as renewable and sustainable energy, clean transportation, sustainable water management, climate change adaptation, energy efficiency and any other categories as may be approved by the SEC from time to time.

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[4] CLIMATE CHANGE AND FINANCING TRANSACTIONS IN NIGERIA: ANY IMPACT OF THE CLIMATE CHANGE ACT?

[5] SEC Green Bond Rules 2018

In addition to complying with the SEC's existing requirements for registration and clearance of bonds, a Green Bond issuer is required to file the following documents with the SEC:

- **Commitment Letter:** A pledge from the issuer to invest all the proceeds of the bond in projects that qualify as green project(s) or assets.
- **Feasibility Study:** A comprehensive report highlighting the benefits of the proposed green project(s) and its positive effect on the environment/climate.
- **Prospectus:** An information memorandum showing project categories, project selection criteria, decision-making procedures, environmental benefits, use and management of the proceeds, etc.
- **Independent Assessment:** A certification issued by a professional certification authority approved or recognised by the SEC.
- **Additional Requirements**: Any other additional documents that may be required by the SEC.

In addition to the above conditions, the issuer is required to provide the SEC and NGX with an annual Green Bond report containing a list of the projects and assets to which proceeds have been allocated and the effect these projects have had (or are having) on the environment. This reporting obligation extends throughout the bond's tenure.

5.2 The NGX Rules for Green Bond Listings

In addition to fulfilling all the existing requirements for listing bonds, an issuer must meet the under-listed requirements to list a Green Bond on the Exchange. These requirements, as contained in the NGX's Process for Issuing and Listing Green Bonds on the Exchange, are:

- **Clear Declaration of Bond Type**: An issuer shall clearly state in the prospectus that the bond is a Green Bond.
- **Compliance with Bond Listing Criteria**: An issuer must comply with the NGX Rules, existing requirements for listing and issuance of bonds, and the SEC's rules and regulations on Green Bond issuance.

- **Use of Proceeds**: The prospectus and other documents should clearly describe the project to be undertaken with the proceeds of the Green Bond.

- **Process for Evaluation and Selection**: An issuer is required to identify the process for project evaluation, demonstrate the green eligibility of the project, outline the process for managing applicable environmental and social risks, and also identify their environmental sustainability criteria.

- **Reporting**: An issuer shall make up-to-date information on the use of proceeds readily available on an annual basis. The information shall include a list of all projects being financed with the proceeds and their potential impact on the environment.

- **Independent Assessment Report**: An issuer shall appoint an independent external reviewer to issue an annual assessment report to be published and retained on the issuer's website throughout the tenor of the green bond.

- **Independent External Review**: The company (appointed as an external reviewer) shall exist and operate independently of the issuer and not be a subsidiary, possess a relevant track record, and be specialised in assessing bonds' framework.

- **Continuous Obligation on Compliance**: The issuer shall continuously file a report of its compliance with the Green Bond Principles to the NGX. The report shall include a list of all projects and their environmental impact. The first report shall be due twelve (12) months from the issue date.

It is important to note that a failure to abide by the NGX's Rules could result in the NGX publicly declaring the bond as non-compliant, and investors will be warned to trade in such bond with caution.

5.3 FMDQ Green Exchange

A notable addition to Nigeria's sustainable financial landscape is the FMDQ Green Exchange which was launched in November 2021. This innovative platform is dedicated to promoting transparency, good governance, and the advancement of green and sustainable finance within the Nigerian financial markets. The platform serves as a showcase for sustainability-linked capital-raising activities and aligns with global best practices on ESG[6].

[6] Green-Bond-Impact-report-2018-2021.pdf

6. Promoting Green Bond Issuances in Nigeria

Global and national awareness and participation in the trend of issuing Green Bonds is increasing on a daily basis. Corporate bodies are becoming aware of the pertinent role that Green Bonds play in highlighting their environmental and ecological footprint, in addition to enhancing their financial performance. An exemplar of this trend is Access Bank PLC which achieved a historical milestone by issuing the first certified corporate Green Bond in Africa in 2019[7]. In 2021, OneWattSolar announced the issuance of the first series of its NGN10 billion Green Bond Issuance Programme. According to the company, the proceeds of the issuance will be used to purchase renewable energy assets required to implement its pipeline of off-grid energy access projects in Nigeria.[8]

Notwithstanding the above, there are several existing challenges to the growth of the Green Bond market in Nigeria. These challenges include poor and ineffective execution of the highlighted projects stated to be performed under some Green Bond issuances[9], corruption and lack of transparency[10], perceived insufficient financial and economic benefits of Green Bond issuances, burden of reporting requirements on the issuers, which affect enthusiasm for Green Bond issuances, inadequate green contractual protection for investors and greenwashing. Greenwashing refers to the deceptive promotion of the perception that an organisation's products, aims or policies are environmentally friendly[11].

In order to combat some of the above challenges, we recommend that certain mitigation actions should be taken by participants in the Green Bonds space. First, public awareness initiatives should be executed so that prospective corporate and governmental issuers can be informed of the untapped potentials and opportunities that are available in Green Bond issuances. These prospective issuers will be able to raise capital which can be used for the financing of environmentally friendly projects that will boost their societal reputation, social impact and lead to an increase in revenue. Furthermore, corporate issuers who issue Green Bonds will have access to a new crop of investors who are interested in sustainable financing and investments.

[7] Access Bank issues First Certified Corporate Green Bond
[8] https://www.environewsnigeria.com/nigerian-firm-issues-africas-first-green-bond-for-renewable-energy-project/#:~:text=The%20firm%20of%20OneWattSolar%20(OWS,seven%2Dyear%20Green%20Sukuk%20Issue.
[9] https://www.premiumtimesng.com/news/top-news/492711-four-years-after-nigerias-green-bond-projects-fall-below-expectations.html?tztc=1
[10] https://www.premiumtimesng.com/news/headlines/556973-investigation-how-nigerias-n400-million-green-bond-financed-afforestation-projects-failed.html?tztc=1
[11] https://www.bakermckenzie.com/-/media/files/insight/publications/2019/09/iflr--green-bonds-%28002%29.pdf

In addition, to enhance disclosure and transparency, issuers should provide clear and comprehensive information about the use of proceeds, project selection criteria, and regularly report on the environmental impact of projects. This will deepen the acceptance of Green Bonds and also help in avoiding greenwashing.

Green Bonds also have the potential to attract new investments at cheaper costs as a result of the increasing demand for climate-friendly projects. There are also ample opportunities for green financing in several sectors of the Nigerian economy ranging from power and energy to agriculture, housing, and transportation.

7. Conclusion

Investors' demand for Green Bonds is getting stronger due to increasing evidence that "green" factors have a positive impact on long-term financial returns while helping to mitigate the negative impact of climate change. By promoting sustainable infrastructure, renewable energy, and environmentally friendly practices, Green Bonds issuance offers a pathway to economic growth that is aligned with environmental responsibility and making positive social impact.

As Nigeria navigates its way toward a more sustainable future, collaboration between the government, financial institutions, corporate bodies and key market players will pave the way for a vibrant green bond market and demonstrate the country's commitment to addressing climate change and ensuring the well-being of its citizens for generations to come. The government and corporates will derive greater benefits and help improve the environment through the issuance of Green Bonds and utilising the proceeds to finance environmentally sustainable projects and assets across the country. Corporate green bond issuers will also derive the benefits under the Climate Change Act.

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