TOPE ADEBAYO LP

SUSTAINABLE FINANCE, GREEN FINANCE AND GREEN BONDS: A COROLLARY TO ESG.

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INTRODUCTION

One buzzword that has permeated every industry in the last half a decade is clean energy, green bonds, green economy, sustainable finance and ESG.[1] The growing lexicon reflects a collective recognition of the dangers posed by climate change resulting from the emission of greenhouse gases and environmental degradation, which jeopardizes our economy.[2] As a result, governments, investors, businesses, and individuals worldwide are taking the responsibility to address the issue of climate through the development of decarbonization techniques. In 2015, Nigeria signed the Paris Agreement, pledging to reduce its greenhouse gas emissions by 20% by 2030, and in 2017, the nation increased its reduction pledge to 45%.

To achieve the climate targets set in the Paris Agreement, the Federal Government of Nigeria issued the first green bond in Nigeria in December 2017, making Nigeria the first African country and fourth worldwide to issue a green bond.[3] In this article, we delve into the intertwined realms of sustainable finance, green finance, and green bonds, which are pivotal in financing the transition to a low carbon economy and reducing the effect of climate change while entrenching ESG policies on the other hand.

Sustainable Finance and the Green Economy

Finance is an essential aspect of achieving change. Transitioning to a low-carbon or green economy requires substantial investment capital, innovation and research, market initiatives, risk management and policy support. In sustainable finance, financiers make decisions considering ESG factors, promoting long-term investments in sustainable economic activities and projects.

[1] Economic, Social and Corporate Governance
[2] Green & Sustainable Finance https://www.europarl.europa.eu/RegData/etudes/BRIE/2021/679081/EPRS_BRI(2021)679081_EN.pdf (accessed 30th April 2024)
[3] Sustainable Finance in Nigeria: Performance and Outlook (Sustainable-Finance-in-Nigeria-Performance-and-Outlook-.pdf, (accessed 28th February 2024)

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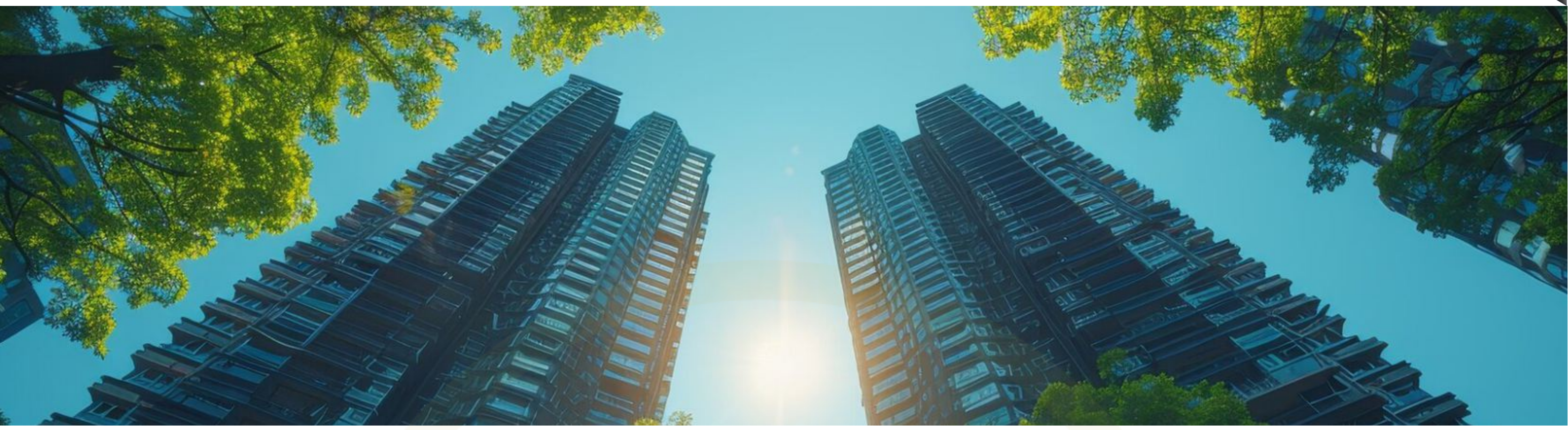

A key financing innovation is green finance, which involves gathering funds or investments specifically to address climate and environmental challenges. Besides addressing these issues, green finance aims to enhance financial risk management related to climate and environmental risks. This includes strategies such as investing in climate-resilient infrastructure or incorporating environmental considerations into financial risk assessments. The transition towards a green economy offers numerous benefits, including sustainable management of natural assets, enhanced resilience against climate change, improved energy security, and increased productivity across sectors like commodities and agriculture.[4]

THE ERA OF GREEN BONDS AND PRINCIPLES GOVERNING GREEN BONDS

Green bonds serve as financial instruments dedicated to supporting environmentally and climate-focused initiatives, such as renewable energy, energy efficiency, pollution prevention and control, biodiversity conservation, sustainable transportation, sustainable water management, climate change adaptation, and the development of eco-efficient products and technologies.[5] Since the issuance of a Climate Awareness Bond in 2007 and the first green bond by the World Bank in 2008, the green bond market has grown astronomically. In 2023, new records were set when sales of green bonds from corporates and government increased to $575 billion, a step up from 2022 toppling the 2021"s $573billion figure.[6] The US, China and France are the top three green bond issuers,[7] these bonds provide investors with a dual incentive, combining financial returns with tangible environmental impact. This uniqueness not only attracts capital

[4]Benefits of a Green Economy Transformation in Sub-Saharan Africa https://www.greenpolicyplatform.org/ (accessed 30th April 2024)
[5]Overview of Sustainable Finance https://finance.ec.europa.eu/sustainable-finance/overview-sustainable-finance_en (accessed 30th May 2024)
[6]Green bonds reached new heights in 2023 https://www.bloomberg.com/professional/insights/trading/green-bonds-reached-new-heights-in-2023/ (accessed 30th April 2024)
[7] https://www.weforum.org/agenda/2020/11/what-is-green-finance/

but also accelerates the shift towards a low-carbon economy, aligning financial interests with environmentally sustainable goals.

To encourage transparency, disclosure, and promote integrity in the development of the green bond market, the International Capital Markets Association (ICMA) set out voluntary guidelines -the Green Bond Principles ("GBP"). GBPs are intended for broad use by the market, providing issuers with guidance in launching a credible green bond, aiding investors in providing information necessary to evaluate the environmental impact of their investments and assisting underwriters by moving the market towards disclosures that facilitate transactions.

THE FOUR (4) PILLARS OF THE GBP:

a. Use of Proceeds: Green bond proceeds must be earmarked for environmentally beneficial projects. Issuers must clearly articulate this commitment in the bond documentation to ensure transparency and foster investor trust and accountability.

b. Project Evaluation and Selection: Issuers of green bonds are expected to provide investors with comprehensive information regarding the environmental sustainability objectives. This includes detailing the process used by the issuer to assess how the projects align with eligible green project categories, along with the associated eligibility criteria. Additionally, issuers should outline any processes implemented to identify and mitigate potential environmental and social risks linked to the projects. Issuers are encouraged to contextualise this information within the issuer's overarching standards referenced in project selection, enhancing transparency and ensuring alignment with sustainability goals.

c. Management of Proceeds: The net proceeds of the green bonds, or an amount equal to these net proceeds, should be credited to a sub-account, moved to a sub-portfolio or otherwise appropriately tracked by the issuer, and attested to by the issuer in a formal internal process linked to the issuer's lending and investment operations for green projects. The balance of the tracked net proceeds should be periodically adjusted to match allocations to eligible green projects.

d. Reporting: Issuers should annually provide up-to-date information on the use of proceeds until full allocation, and on a timely basis in case of material developments. The annual report should include a list of the projects funded by the green bond proceeds, brief description of the projects, amounts allocated, and their expected impact.

EXPLORING THE ROLE OF ENVIRONMENTAL, SOCIAL AND GOVERNANCE (ESG)

Beyond moral imperatives, ESG considerations have evolved into regulatory imperatives across various sectors. Companies increasingly recognise the dual benefits of ESG integration: improving corporate sustainability and attracting investors while accessing financing. This underscores the relationship between financial performance and environmental stewardship, driving a paradigm shift towards more responsible and resilient business practices.

In Nigeria for example, initiatives such as the Nigerian Sustainable Finance Principles (NSFP) and Guidelines on Sustainable Principles for the Capital Market demonstrate the government's commitment to sustainable financing. Regulatory bodies like the Securities and Exchange Commission (SEC) promote compliance with sustainability disclosure guidelines, thereby promoting transparency and accountability for the players.[8] The Nigerian Exchange Group (NGX) encourages issuers to disclose sustainability information in their annual reports or separate sustainability reports, which should align with financial reporting periods and be independently verified to international standards for credibility.

CONCLUSION

Transitioning to a low-carbon, green economy necessitates significant investment from both public and private sectors. Green bonds and other forms of sustainable financing are pivotal in mitigating the detrimental effects of climate change while driving overall development. Embracing transparency standards, regulatory frameworks, and ESG principles is crucial for the successful adoption of sustainable financing and green bond initiatives. Green bonds, guided by ESG principles, play a vital role in directing investments towards environmentally beneficial projects, thereby mitigating climate risks and fostering sustainable development.

[8] Sustainable Finance in Nigeria: Performance and Outlook, N.13--14

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