Exploring environmental, social and governance (ESG) and sustainable finance solutions for African sovereigns

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Acronyms and abbreviations

CBN	Central Bank of Nigeria
CBS	Climate Bonds Standard
DBS	Development Bank of Seychelles
DMO	Debt Management Office
ERGP	Economic Recovery and Growth Plan, Nigeria
ESG	Environmental, Social and Governance
FDI	Foreign Direct Investment
FMEnv	Federal Ministry of Environment, Nigeria
FMF	Federal Ministry of Finance, Nigeria
GBP	Green Bond Principles
GDP	Gross Domestic Product
ICMA	International Capital Market Association
KPI	Key Performance Indicator
NDC	Nationally Determined Contribution
SDG	Sustainable Development Goal
SeyCCAT	Seychelles Conservation and Climate Adaptation Trust

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1 Introduction

The objective of this report is to explore how African countries can use debt instruments with an Environmental, Social and Governance (ESG) focus to meet their financing requirements based on the experience of sovereign issuers in Africa and other emerging markets. We primarily focus on understanding the terms and conditions of the sovereign green bonds, given their relatively advanced development compared with other forms of ESG financing. However, where relevant, other types of ESG-related financing are discussed, such as sustainability linked bonds and debt-for-climate swaps.

African countries face many economic and social challenges in light of the COVID-19 pandemic and the anticipated effects of climate change. The region experienced its first recession in half a century with GDP contracting by 2.1% in 2020 (AfDB, 2021). As a consequence, about 30 million Africans were pushed into extreme poverty in 2020 and another 39 million may fall into extreme poverty in 2021 (AfDB, 2021). African countries are also highly vulnerable to climate shocks. Although accounting for less than 4% of the world's annual greenhouse gas emissions, Africa will be more severely affected by climate change than any other continent, given its geographical position and limited capacity to adapt (Fjelde and von Uexkull, 2012; IPCC, 2018; Ritchie and Roser, 2019). Recognising these climate risks, almost every African sovereign is party to and has ratified the Paris Agreement on climate change and has committed to reducing carbon dioxide emissions through national programmes.

Meeting these challenges as well as other Sustainable Development Goals (SDGs) will require the continent to take advantage of a diverse range of innovative sources of funding. The continent's financial requirements to adapt to climate change are projected to be between US$20 billion and US$30 billion annually until 2030 (Niang et al., 2014). The level of available public finance is inadequate to meet all these investment needs.

On the demand side, huge infrastructure gaps mean there is no shortage of projects or industries in need of green financing across the continent (Benhida and Mounsif, 2019; LSEG Africa Advisory Group, 2018). For example, an estimated 600 million people in Africa have no access to electricity, and Africa is generating about twenty times less renewable electricity per capita than other continents (AfDB, 2017). There are also opportunities in other sectors: transport, the provision of clean water and sanitation, flood protection, irrigation and roads.

On the supply side, there is a growing trend in global finance to not only seek financial turns, but to also contribute to sustainable goals by investing with an ESG focus. Countries that can demonstrate good ESG credentials, via good ESG scores[1] or by demonstrating progress in improving them, should have a better chance of attracting capital for investment (Smith, 2021). The capital could be foreign direct investment (FDI), private equity, or portfolio investment in a country's stock or bond market. There are also opportunities for issuing green and social bonds that target ESG investment directly into projects defined as 'green' or 'social', and for sustainability linked bonds where the cost of borrowing is conditional on a government or company reaching a specified target (for example the percentage of electricity from renewable sources).

Green, social and sustainability linked bonds are seen as one of the most readily accessible and economical options available to nations to facilitate raising large amounts of capital to meet environmental and social targets and the funding of investment projects that underpin them. Although non-frontier market economies and low-income African Development Fund countries have continued to rely on multilateral concessional credit, international capital markets have been a growing source of debt financing for many African countries since the early 2000s. Commercial creditors (bondholders and commercial banks) have more than doubled their share of Africa's external debt in the last two decades from 17% in 2000 to 40% in 2019 (AfDB, 2021). By the end of August 2020, about 21 African countries had issued vanilla Eurobond instruments valued at over $155 billion. Moreover, despite a pause in early 2020 due to the pandemic, 7 sub-Saharan African countries (Cameroon, Côte d'Ivoire, Benin, Gabon, Ghana, Senegal and Kenya) to date issued vanilla Eurobonds in 2020 and in

1 ESG scores aggregate individual data points corresponding to ESG factors into an overall ESG score. The data points may measure a country's strength or vulnerability to a given factor as well as a country's ability to manage that risk.

2021. In total, markets anticipate Eurobond sales of about $15 billion in 2021 (IMF, 2021). Investor appetite for green, social and sustainability linked bonds is expected to grow, and some African countries can potentially benefit from this increasing demand (Amundi and IFC, 2021; Marbuah, 2020; Smith, 2021). For others, it may not be a good fit due to the lack of institutional readiness across key government departments or the lack of an investor base.

The rest of the report is structured as follows: Section 2 provides a brief overview of the ESG market in terms of key definitions, features and size. Section 3 uses actual examples to illustrate the key financial and non-financial terms and conditions of these instruments, drawing comparisons to more conventional debt instruments where possible. Section 4 offers recommendations for public debt managers in Africa seeking to unlock ESG financing opportunities in a sensible and strategic manner. Section 5 concludes.

"Investor appetite for green, social and sustainability linked bonds is expected to grow, and some African countries can potentially benefit from this increasing demand"

2 Overview of sovereign ESG market

2.1 What is ESG financing?

ESG has become an umbrella term to describe investment strategies, instruments or activities that incorporate ESG issues from a variety of perspectives. Some investors are becoming more conscious of the effects of their economic footprint and of the benefits of integrating ESG considerations into investment decisions using ESG scores. Global bond markets have also evolved in response to this changing investor behaviour by creating labelled bonds. Although characterised by all the same features of a traditional bond in terms of structure, risk and expected returns, labelled bonds are distinguishable by the 'use of proceeds'. There are several types:

- **Green bond:** Where the proceeds from the bond are directed to projects or assets with environmental benefits. The global market for green bonds (including non-sovereign bonds) experienced an explosion after 2013, with a more than 300-fold increase in issuance between 2007 and 2019 and a 104% average annual growth rate over the same period (Marbuah, 2020).
- **Social bond:** Where the proceeds of the bond are used for projects and assets with positive social outcomes such as health care and education.
- **Blue bond:** Where proceeds are used for projects and assets related to the marine and coastal industries and ecosystems. A blue bond could be categorised as a green bond if the project brings climate and/or other environmental benefits.
- **Sustainability or SDG bond**: Where proceeds finance a range of both social and environmental projects/ assets. An SDG bond invests in projects and assets that are aligned and contribute to the achievement of the SDGs.
- **Sustainability linked bonds:** Where proceeds are not allocated to specific sustainable projects, but their financial and/or structural characteristics can vary depending on whether a defined ESG objective or key performance indicators (KPIs) are achieved.

Given the importance of the label as a discovery mechanism for investors that allows them to identify specific investments more easily, various global benchmarks and guidelines have emerged. These tend to have explicit criteria relating to the use of proceeds, transparency, disclosure and reporting. Green bonds, for example, can be certified against the Climate Bonds Standard (CBS)[2] as having met the criteria for use of proceeds and disclosure for impact reporting. However, the lack of standardisation of ESG frameworks in terms of sovereign ESG measures and their impact and the lack of a common sustainable finance taxonomy make it difficult for investors to meaningfully evaluate and compare sovereign ESG practices and risks. A true single set of global rules or standards, however, is unlikely to emerge in the near term.

Beyond focusing on labelled instruments, many investors are also integrating ESG factors into their sovereign bond investment decisions using the ESG rating from data providers. Similar to traditional sovereign credit ratings, an ESG data provider develops an analytical framework with which to assess countries' ESG performance (and/or ESG risks). Different providers use different techniques, reflecting different philosophical and methodological choices about the meaning and purpose of sovereign ESG. There is therefore significant variation in sovereign ESG scoring across different providers (Boitreaud et al., 2020). MSCI and Sustainalytics are among the most widely used ESG data providers.

2.2 The African experience with ESG financing

The sovereign ESG bonds market has witnessed significant growth globally since the first sovereign issuance by Poland in 2016, driven primarily by high investor appetite for environmental and climate-aligned investment vehicles. As of November 2020, 22 national governments had issued sovereign ESG bonds totalling US$96 billion (CBI, 2021).

However, the nascent market for the African region is relatively underdeveloped compared with other emerging markets as well as African vanilla sovereign bond issuances. Only 3 of the 22 sovereign ESG bond issuers are in Africa:

2 For further details, see https://www.climatebonds.net/standard.

Nigeria's 2 issuances in 2017 and 2019, Seychelles in 2018 and Egypt in 2020 (see Box 1 for further details). Other African sovereigns such as Kenya, Ghana and Cote d'Ivoire have publicly indicated their intention to issue a green sovereign debt issue in the near future (CBI, 2021; LSEG Africa Advisory Group, 2018). In comparison, 20 African countries have outstanding vanilla sovereign Eurobonds of $135 billion (face value) with several being repeat issuers since the first issuance by South Africa in 1995.

Although there have been limited sovereign ESG bond issuances in Africa to date, South Africa, Morocco, Namibia and Kenya have welcomed ESG bond issuances by other entities such as development finance institutions, municipals and corporates. Financial institutions accounted for 60% of the sub-Saharan African cumulative green bond issuance by volume in 2020 compared to 50% in emerging markets and 19% in developed markets (Amundi and IFC, 2021). Kenya and South Africa have also made a concerted effort to establish standards, harmonise the public and private sector efforts, and build capacity within the green economy. Corporates in South Africa have also made use of instruments such as green loans, while the region of Lagos in Nigeria signed a sustainability linked loan in 2018. Although these developments are positive, the challenge for the region to tap into new private sector funding sources remains high.

Box 1: Snapshot of the three ESG sovereign issuances in Africa

Country	Amount	Tenor	Coupon rate
Nigeria	N10.6 billion	5 years	13.48%
	N15 billion	7 years	14.5%
Seychelles	US$15 million	10 years	2.8%*
Egypt	US$750 million	5 years	5.25%

*Note: * Credit enhancement measures reduced the coupon rate from 6.5%*

- **Nigeria** issued Africa's first green bond in 2017, which was also the first sovereign green bond certified under the CBS, globally. Issued in local currency, the **N10.69 billion (approximately US$30 million) issuance has a 5-year tenor and 13.48% fixed coupon rate**. This was followed by a second issuance in 2019 for **N15 billion (approximately US$41 million) with a tenor of 7 years and a higher coupon rate of 14.5%**. Both bonds are listed on the Nigerian stock exchange and accounted for 0.16% of Nigeria's federal government domestic debt stock as at March 2021 (Government of Nigeria, 2021). Both green bond issuances are part of the government's larger green finance agenda to ensure regular funding for projects, aligned with Nigeria's Nationally Determined Contribution (NDC) and Economic Recovery and Growth Plan (ERGP), and are a drop in the ocean in its planned NGN 150 billion (US$420 million) green bond programme (LSEG Africa Advisory Group, 2018).
- **Seychelles** issued the world's first sovereign blue bond of **US$15 million in 2018**. Though it has a coupon of 6.5%, the coupon payable by the Government of the Seychelles is reduced to **2.8%** through credit enhancement means (such as partial credit guarantee from the International Bank for Reconstruction and Development). The **10-year blue bond** will be redeemed in three equal instalments of $5 million in 2026, 2027 and 2028. Since the total amount of the blue bond is of relatively low volume in market terms, it was **privately placed** with three socially responsible impact investors, namely Calvert Impact Capital, Nuveen and Prudential, all US-based and the reason why the bond was issued in US dollars. Bond proceeds will be used for the management of sustainable-use marine protected areas and priority fisheries, and to expand seafood value chains to maintain sector growth while fish stocks are rebuilding.
- **Egypt** issued the first US dollar sovereign green bond for Africa in 2020 with an issue size of **US$750 million, tenor of 5 years and coupon of 5.25%** (close to where a standard Egypt USD with similar duration trades). Moreover, it had a credit rating of B(S&P)/B+ (Fitch). The order attracted a strong book, prompting the government to increase its offering from $500 million to $750 million. The bond was **oversubscribed 5x** and will contribute to the financing of $1.95 billion of public investment projects tagged as green by the government. These projects are split across six eligible categories, each aligned to one or more of the United Nations' SDGs.

In regard to the 'S' and 'G' in ESG financing, African governments do not currently issue other types of social, governance or sustainability sovereign bonds. However, since the onset of COVID-19, there has been greater focus on the 'S' strand of ESG, with some emerging market sovereigns, such as Ecuador and Guatemala, issuing social bonds (Fatin, 2021). Ghana also recently announced its plan to raise as much as $1 billion through a sale of sustainable bonds by July 2021 (Dzawu, 2021). This is likely to be a mix of green and social bonds. The proceeds would help refinance domestic debt used for social and environmental projects, including loans taken to pay for the government's free senior secondary school policy.

Sustainability linked instruments (KPI linked) are increasingly being marketed by investment banks, although no sovereign has issued this type of instrument to date globally. Despite the absence of strict criteria for use of proceeds, there are notable shortcomings relating to the selection of suitable KPIs, the fact that these instruments would not be attractive to labelled bond dedicated funds and generally the non-binding nature of the pricing structure.

Multilateral and regional development banks are also important players in the ESG bond market in Africa. First, they have issued green bonds themselves and used the proceeds to finance climate-friendly projects and other projects with positive environmental and social impacts. The African Development Bank (AfDB) has been particularly active, establishing green and social bond programmes in 2013 and 2017, respectively, and developing the Green and Social Bond Frameworks in line with International Capital Market Association (ICMA) principles. Within these frameworks, the proceeds of the Bank's green and social bonds are used to finance specific eligible green and social projects that have been carefully selected and evaluated. Second, multilateral development banks have also supported issuers from Africa to issue bonds and assisted with capacity building. The World Bank, for example, provided a partial guarantee of US$5 million to the Government of the Seychelles to secure more attractive terms for the government's 'blue bond'. The International Finance Corporation (IFC) has also been actively involved in capacity building with regulators, central banks and stock exchanges (through the Sustainable Banking Network).

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3 Key terms, conditions and outcomes of sovereign green bonds

This section compares the terms, conditions and outcomes of green sovereign bond issuances to their vanilla equivalents in the domestic and international debt markets, where applicable.

3.1 Cost of financing – No conclusive empirical evidence of price premium/ greenium at issuance

One of the first objectives of a public debt manager is to raise the cheapest source of financing with a prudent degree of risk. The prospect of a greenium may therefore make ESG bonds attractive. A greenium refers to the idea that issuers are able to obtain a cheaper cost of funding by issuing debt with a specified 'use of proceeds' that has positive environmental and/or social impacts as compared to traditional bonds due to a supply/demand imbalance and diversified investor base. If true, green/ESG-linked bonds would be issued with a higher price and lower yield compared to existing debt from the same issuer and would price inside its existing yield curve.

However, there is no conclusive empirical data to confirm this assertion. A recent survey of 23 individual sovereign ESG bonds in developed and emerging markets found that the cost of funding these bonds was similar to or less than vanilla equivalents (CBI, 2021). Moreover, although evidence of a greenium became more pervasive in the latter half of 2020, it cannot be guaranteed for every ESG bond.

More importantly, in the context of Africa, **the size of greenium tends to be miniscule compared to the spreads for vanilla African Eurobonds**. On average, greeniums calculated from mainly developed market bonds tend to be in the region of 2 to 5 basis points. This differential matters for bonds with very low yields, such as those issued by European sovereigns, but is less impressive when compared to African bonds with much larger yields. With the spread on 10-year Eurobonds (over US treasuries) at roughly 290 basis points in South Africa and 630 in Ghana, the magnitude of benefits from the greenium for African countries appears small. There are also still too few other pioneers to judge where an African green or social bond should trade relative to a country's standard debt. However, the signs so far from Africa's debut sovereign issuance are positive. In the case of Egypt, which issued Africa's first hard currency sovereign green bond in 2020, there is evidence of a greenium with the $750 million green bond priced at a spread (to US treasuries) that was 50 basis points lower than the curve for Egypt's vanilla USD Eurobonds, as shown in Figure 1 (Smith, 2020). A similar comparison is not valid for the Seychelles blue bond because of its small size at $15 million and seldom is traded.

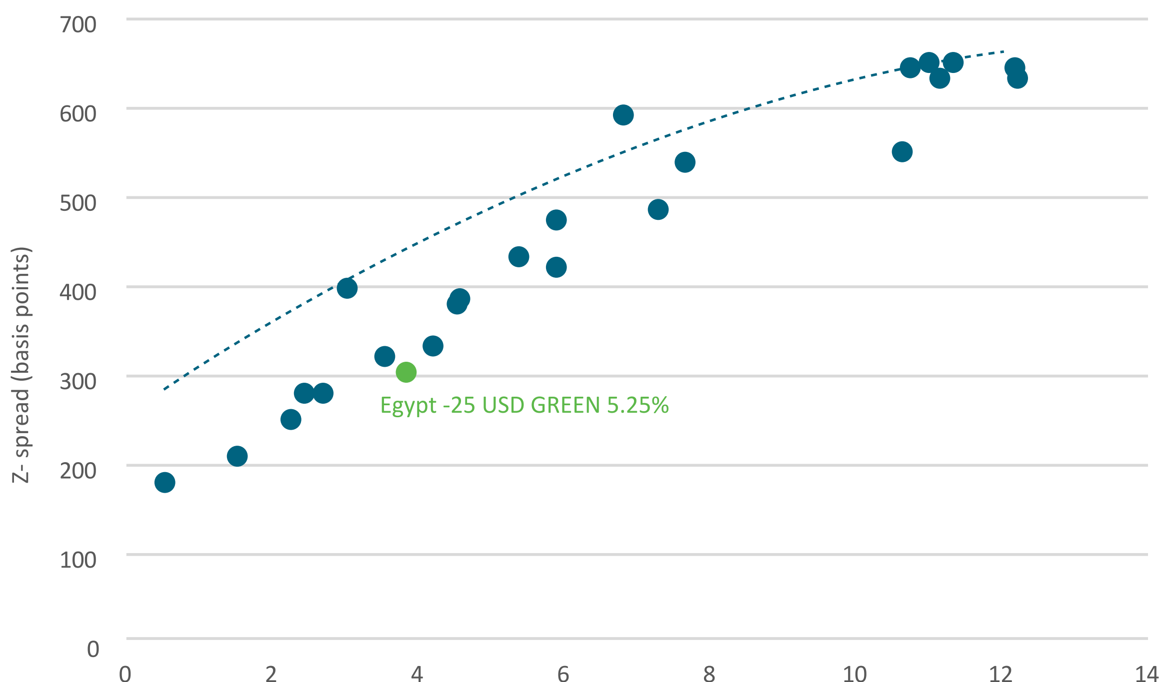
In conclusion, **if a country's motivation is to only issue a green bond to access cheaper financing compared to a vanilla issuance, then caution should be exercised as the benefits might be small**. However, the issuance could be part of a strategy where sovereigns build a positive brand around their ESG credentials, which in turn could attract more and calmer capital (Smith, 2021). Key pricing determinants include the probability of default, illiquidity, volatility and uncertainty. So, while the direct greenium might be small, there could be benefits from sovereigns and investors engaging more closely with one another on ESG issues, as this might improve investors' understanding of the country and reduce the premium in the price of African bonds linked to uncertainty. A positive ESG brand could help African sovereigns attract all types of capital, not only from debt instruments but also FDI and private equity.

3.2 Tenor of sovereign green bonds tends to be less than vanilla bonds

The tenor of African sovereign Eurobonds has increased since 2017. Prior to 2017 most Eurobonds in Africa were issued with maturities of around 10 years, with a few exceptions from sovereigns that had longer issuance track records, such as South Africa. But since Nigeria's successful issuance of 30-year bonds in November 2017, Ivory Coast, Ghana, Kenya, Angola, Egypt and Senegal have all come to market with 30-year paper and, in a few cases, 40-year paper. The median maturity of outstanding African sovereign Eurobonds is currently 15 years.

In contrast, the average maturities of green bonds tend to be much shorter than that of vanilla Eurobonds. Emerging market green bonds have typically been medium-term instruments, with most issuances having a 3- to 5-year tenor. In 2020, however, issues were longer-dated, as 33% of issuances were in the range of 5 to 10 years and another

Figure 1: Egypt's maiden green bond was issued tight to the Eurobond curve



Source: Bloomberg, 25 June 2021

32% of issuances were over 10 years (Amundi and IFC, 2021). Issuers tend to provide longer tenors to attract insurance companies and particularly pension funds seeking to match long-dated liability cashflows.

In the case of Africa's three sovereign green bond issuers, the tenor of green bonds currently ranges from 5 to 10 years. Egypt's maiden sovereign green bond has a tenor of 5 years while its most recent vanilla Eurobond issuance prior to that in May 2020 included 4-, 12- and 30-year bonds, and its 2021 issuance included a 40-year bond. Nigeria first and second issuances of local currency green bonds have a tenor of 5 and 7 years respectively, which is similar to that of its other government domestic bonds, which range from 3 to 10 years. Seychelles' 10-year blue bond likely benefited from a longer maturity compared to Egypt and Nigeria due to its small size, as they could approach several large impact investors, as well as the credit enhancement measures provided by the World Bank (2017).

3.3 Green bonds can attract a new class of investors

Attracting a new class of investors – domestically or internationally – is often a stated objective of green bond issuances. This in turn can create a long-term investor base aligned to the maturity of the project's life and reduce exposure to bond demand fluctuations since it is assumed that these investors are not inclined to sell their green bonds.

In the case of Egypt's sovereign green bond, 16 investors that had never made orders in previous Egyptian issuances in the international capital markets participated in the transaction (GoE, 2020). Almost half of the US$750 million issuance was allocated to investors with an ESG mandate (slightly above the 44% average of the ESG bond deals of 15 sovereign issuers), suggesting that there is growing appetite within the ESG investment community for non-investment grade issuers (CBI, 2021). This is consistent with the results of the Climate Bonds Green Bond European Investor Survey. Respondents to that survey indicated that they would like to increase their holdings in emerging market sovereign green bonds (CBI, 2019a). Seychelles' blue bond was completely allocated to ESG investors. The issuance of Nigeria's green bond was also highly supported by the Nigerian investment community, with a wide range of investors from commercial banks, asset management firms and pension groups investing in the green bond.

Although sovereign issuers may actively want to give preference to investors describing themselves as green or socially responsible, this is complicated by the absence of a clear definition of a green investor. However, some attempts at standardisation are currently under way. From 1 January 2022, European investment firms describing their products as green or socially responsible will be required to disclose the percentage of their investments in compliance with the European Union taxonomy – that is, consistent with a net zero economy by 2050. This will give green bond issuers a clear benchmark to measure the relevant credentials of bidders.

3.4 Stricter requirements for the use and management of green bond proceeds

A major difference between a green bond and a vanilla bond relates to the use and management of proceeds. Although vanilla bond prospectuses typically have a section on 'use of proceeds' which explains how the government intends to use the funds borrowed, it tends to be broadly framed as general budget support, financing fiscal deficits or refinancing. In contrast, the use of proceeds of green bonds are generally much more detailed because ESG investors are primarily concerned with the intended use of proceeds.

Most sovereign issuers must therefore first adopt or adapt an existing green taxonomy to identify eligible sectors and activities to be funded by the proceeds from a green bond. This is usually done through a national framework aligned to national priorities that sets the parameters for ESG bond issuance, such as the eligible categories of projects being financed or refinanced and an exclusion list of expenditures (i.e. projects prohibited from being financed with the proceeds). The management of bond proceeds is also another important part of the framework. This may involve the issuer setting up internal tracking and reporting systems to ensure that the bond proceeds are utilised exclusively for the projects identified (for example earmarking or ringfencing). An annual report on allocation and use of proceeds is normally part of the process. Reporting will generally entail a mix of quantitative and qualitative indicators, which investors can use to assess the impact of their investment. The debt office works with relevant ministries and departments to develop a 'framework' that discloses all the above: use and management of proceeds, reporting and disclosure.

In the case of Nigeria, both green bond issuances are part of the government's larger green finance agenda to ensure regular funding for projects, aligned with Nigeria's NDC and the Federal Government's national development plan, the ERGP. Proceeds from the green bonds provide new financing for renewable energy, afforestation and transportation projects that qualify under the Green Bond Framework developed by the Federal Ministry of Environment (FMEnv) in conjunction with the Federal Ministry of Finance (FMF). A Green Bond Program Technical Advisory Team and an Inter-Ministerial Committee on Climate Change also reviewed projects included in the approved budget for their green credentials. In terms of the management of proceeds, proceeds were credited to the Green Bond Proceeds Account at the Central Bank of Nigeria (CBN) and amounts were transferred to project-specific sub-accounts. The FMEnv, supported by the FMF, reports bi-annually on their website. The CBN also provides periodic reports on the green bond account and the use of proceeds.

In preparing for its blue bond issuance, the Government of Seychelles created a Blue Economy Roadmap which included an analysis of the country's portfolio pipeline as one of the major tasks. The blue bond proceeds were allocated to eligible activities related to sustainable fisheries and marine projects, including the expansion of marine-protected areas, improved governance of priority fisheries and development of the Seychelle's blue economy by sustainably expanding the seafood value chains. In terms of the management of proceeds, the Ministry of Finance transferred the proceeds to two organisations: the Seychelles Conservation and Climate Adaptation Trust (SeyCCAT)[3] to establish a Blue Grants Fund, and the Development Bank of Seychelles (DBS)[4] for the establishment and management of a Blue Investment Fund. A project implementation unit (PIU) embedded in the finance ministry collects and presents data and reports for six-monthly reviews by the National Steering Committee in conjunction with World Bank implementation support missions.

The Government of Egypt has also developed a green financing framework with US$750 million directly contributing to the financing of $1.95 billion of public investment projects tagged as green by the government. These projects are split across six eligible categories aligned to one or more of the United Nations' SDGs: renewable energy, energy efficiency, clean transportation, pollution prevention and control, climate adaptation, and sustainable water and wastewater management. Although the net proceeds will enter the general treasury account rather than a separate account, the funds will be tracked internally. An external reviewer will also assess the green investment on an annual basis, with reporting made public.

3.5 Independent review and verification

To enhance the legitimacy and credibility of a green bond among investors, a good market practice requires the sovereign issuer to obtain an independent review and verification. The verification process is typically performed by an external reviewer, who assesses the list of projects using the CBS for certification or the Green Bond Principles (GBP)[5] in the case of a Second Party Opinion. External reviewers are generally engaged while or soon after

3 SeyCCAT is an independent, nationally based, public–private trust fund established in 2015 to manage the funds generated by a debt restructuring intended to provide a sustainable flow of funds to support the long-term management and expansion of the Seychelles' system of protected areas and other activities that contribute substantially to the conservation, protection and maintenance of biodiversity.

4 DBS is a national development financing institution with a specific mandate to assist in the economic development of the Seychelles.

5 The GBP are a set of underlying global principles for the green bond issuance and disclosure process. They are an industry-led initiative convened by ICMA, promoting the use of proceeds for green projects. The GBP were launched in 2014 and are revised on a yearly basis.

the issuer has set up a Green Bond Framework and the review is normally made public before the roadshow. In addition, for certified bonds, the issuer must issue a post-issuance report signed off by an independent verifier. The post-issuance report is a one-off report which confirms that the proceeds have been applied and the systems (documentation, processes, systems, etc.) have been set up as described in the pre-issuance Green Bond Framework.

Nigeria sought Second Party Opinions for the first green bond: Moody's (through its Green Bond Assessment) and DNVGL (in applying the CBS). Moody's provided an assessment of GB1 (Excellent) as the government had created the structures needed to track how the proceeds were being used, while DNVGL provided a verification opinion that resulted in Climate Bonds Initiative (CBI) issuing a certification to the green bond indicating it meets the CBS. Nigeria's green bond was the world's first certified sovereign bond using this standard.

Egypt's green framework has also been externally and independently verified by Vigeo Eiri – an ESG solutions company. The company issued the opinion that the framework is aligned with the four core components of the ICMA's GBP 2018.

3.6 Risk of non-compliance and importance of political commitment

Labelled bonds such as green or social bonds also introduce a new risk to debt managers – the risk of non-compliance with the official framework or guidelines. Non-compliance can take many forms, ranging from providing inadequate information on the use or impact of proceeds to more overt non-compliance such as using the proceeds for some alternative purposes not related to the labelled bond framework or guidelines.

However, non-compliance is unlikely to be regarded as a default or step-up event since the use of proceeds and annual reporting are not normally included as direct covenants in the terms and conditions of labelled bonds (Boitreaud et al., 2020). Nevertheless, non-compliance could result in investors selling in the secondary market and various negative reputational effects. There is currently no sufficient evidence to assess this type of risk.

Political commitment is potentially important for managing the risk of non-compliance. It can help to mitigate this risk by (a) ensuring cooperation across key ministries, (b) communicating political commitment to investors, and (c) alleviating any legal concerns of the Debt Management Unit about the proper use of the funds borrowed.

3.7 Sovereign issuances can encourage growth of a local green capital market

Given their benchmark role in the domestic debt markets, sovereign green bonds can support the market's further development. They can provide a nascent green bond market with the scale and liquidity it needs to encourage trading and facilitate price discovery. A sovereign issuance will also automatically raise the profile of green bonds with other potential issuers and indirectly set good-practice issuance processes and standards for the whole market.

The green bond issuance by the Federal Government of Nigeria has spurred the development of a local green finance market. In 2019, Access Bank, which is one of the biggest commercial banks in Nigeria, issued the country's second green bond, raising N15 billion (US$41 million). The bank also became the first certified corporate green bond in Africa to issue a green bond (CBI, 2019b). The proceeds of the bond would be allocated for water infrastructure and solar energy generation facilities. This was followed by another corporate issuance by North South Power Company Limited (NSP). Also due to the increased investor interest, the Nigerian stock exchange has issued regulations on the issuance of green bonds aimed at promoting integrity within the local green bond market in Nigeria.

However, the proliferation of corporate labelled issuances has preceded the issuance of sovereign labelled debt in many emerging economies (Boitreaud et al., 2020). A sovereign issuance is therefore not the only signalling device for supporting local capital growth. Another strategy that has been successfully adopted by African governments is working with other public and private sector stakeholders to create proper institutional arrangements and policies to guide the green bond market development. Kenya, for example, launched a multi-stakeholder Green Bonds Program[6] in March 2017 with the aim of supporting the development of a domestic green bond market. This led to Acorn Holdings successfully issuing Kenya's first green bond. The KES4.3 billion (US$40 million) climate bonds certified issuance will finance environmentally friendly student accommodation. The South African government has also taken steps to demonstrate its commitment to combating climate change by developing key climate change policies in the past decade. This was followed by the issuance of municipal bonds and a few green bonds from the private sector on the Johannesburg Stock Exchange (JSE). More recently, the South African National Treasury also launched a multi-stakeholder process to develop a national Green Finance Taxonomy.[7]

6 Endorsed by the National Treasury, Central Bank of Kenya and Capital Markets Authority.

7 For further details, see http://www.treasury.gov.za/public%20comments/GreenFinance2021/Call%20for%20inputs%20-%20Green%20Taxonomy%20-%207%20June%202021.pdf.

Box 2: Summary of key terms, conditions and other considerations for African public debt managers

1. No empirical evidence of a 'greenium' and, where it does exist, it is likely to be small relative to the spreads for African sovereign bonds (over US treasuries). At the same time, public debt managers could potentially use a well-developed ESG narrative to improve investors' understanding of a country and reduce the premium in the price of African bonds linked to uncertainty.
2. Tenor of green bonds (3–5 years on average) is much less than that of vanilla bonds in Africa (median of 15 years) and emerging markets in general.
3. ESG bonds can attract a new class of investors, and thus can contribute to a diversified investor base. Debt Management Offices (DMOs) may need to make efforts to engage with new investors and gauge the level of potential demand for labelled instruments. This can be done through regular interaction with banks as well as through irregular investor engagements.
4. Significant work and costs are involved in issuing green bonds since it requires additional steps to the normal bond issuing process to ensure the credibility of the green label to investors. This can put DMO capacity and resources under pressure. However, external technical assistance (from development banks and other organisations) and learning from other DMOs can offer much-needed support.
5. Green bonds and other types of labelled bonds introduce compliance and reputational risks, and political buy-in may help to manage these risks.
6. Green bond issuances can encourage local capital market growth by establishing best practices, providing a reference benchmark and highlighting the priorities of the government in the ESG space. Alternatively, the government may first attempt to support the growth of the local green market in other ways by working together with other public and private sector actors.

4 Recommendations for public debt managers

Considering the findings above, this section recommends how African public debt managers can engage in the ESG financing space in a sensible and strategic manner given the level of capital market development and other country-specific circumstances.

1. Assessing the costs and risks of ESG-related instruments. Although DMOs are increasingly coming under pressure from other government departments, investors, political and academic circles, and market participants to issue ESG-related debt instruments, certain instruments may not be suitable for every country given the context and level of development of a country's bond market. As for any borrowing instrument, the government debt manager needs to assess the cost risk trade-offs involved in absolute and comparative terms with other instruments, together with market development considerations. Critical factors to consider before issuing an ESG-related bond like a green bond include the preparation costs, potential investor demand and level of political commitment. In many cases, there may be other financing options that are operationally less burdensome and offer a better cost-benefit proposition.

2. A green bond financing framework can help nurture a sustainability narrative for the country. Though a green/ESG-related bond may not be cost effective from a technical standpoint in the short term, it can convey a powerful message regarding the government's commitment to improve environmental and social outcomes. This can be advantageous for commodity-based and hydrocarbon-rich economies that currently have relatively low ESG scores but wish to attract those investors who are seeking to support sustainability goals, not only lending or portfolio flows, but also FDI and private equity. Other frontier sovereigns in Africa should therefore learn from Egypt's and Nigeria's approach and experience in developing and implementing their green bond and financing frameworks.

3. The DMO can undertake other ESG-related activities that send an important signal to the wider financial market and act as a spur for change. This includes highlighting ESG issues more prominently in its annual debt report and other communication and outreach material (World Bank, 2020). Before doing this, the DMO may first want to proactively engage with investors to understand their ESG concerns and then share relevant information on what the government is doing in these areas. Given the complexities of these issues and sensitivities around them, DMOs may also need to coordinate closely with relevant line ministries to collate information and convey a consistent message to investors that is aligned to the broader national-level ESG strategy or framework, if one exists. Alternatively, if governments do not make a concerted effort to answer these questions, investors will rely on third-party sources, increasing the likelihood of subjective assessment by investors, rating agencies or data providers.

4. Countries where local bond markets are at a more nascent stage should focus on local currency bond market (LCBM) and capital market development more generally, as this facilitates the provision of stable long-term finances to the sustainable economy in the medium to long run. Moreover, efforts to develop the preconditions of market development such as institutional setting and governance often incorporate ESG aspects, mainly via the 'G' strand (and 'S' to a lesser extent), indirectly contributing to a more sustainable future (Boitreaud et al., 2020).

5. ESG factors, particularly the 'E', are gaining prominence in the debt relief and restructuring space. The president of the World Bank has stated that 'There's a way to put together ... the need for debt reduction with the need for climate action by countries around the world, including the poorer countries' (Shalal, 2021). Attaching conditions to debt relief, for example a debt-for-climate swap (see Box 3), is likely to be critical for generating political commitment among official bilateral creditors and their citizens. Public debt managers are likely to play a key role in coordinating inputs from the government's side to fulfil criteria for accessing these initiatives and may want to use this as an opportunity to integrate ESG factors into their routine operations and planning, as discussed above.

Box 3: Overview of debt-for-climate swaps

Debt-for-climate swaps provide debt relief in exchange for the freed-up fiscal resources to be spent on green investments that combat climate change and reduce fossil fuel emissions. The Government of Seychelles has undertaken one of the most successful debt-for-climate swaps to date, converting US$21.6 million of its debt into investments in coastal protection and adaptation in 2018. Several countries have also engaged in debt-for-health and debt-for-education swaps, with the Global Fund's Debt2Health initiative converting debt repayments into investments in public health programmes. In 2021, Debt2Health converted €50 million of debt owed by Indonesia to Germany into investments in health (Global Fund, 2021). **Though these swaps are small-scale and have not contributed significantly to debt sustainability, they indicate that there is interest and feasibility in conducting new swaps.**

The International Monetary Fund and the World Bank are expected to launch a debt-for-climate swap plan around the UN Climate Change Conference of the Parties (COP26) in November 2021. This initiative could potentially overcome high transaction and monitoring costs associated with previous swaps if it moves from project-based debt swaps to programme swaps (budget support), standardising terms and linking to existing cooperation frameworks and their monitoring (Steele and Patel, 2020).

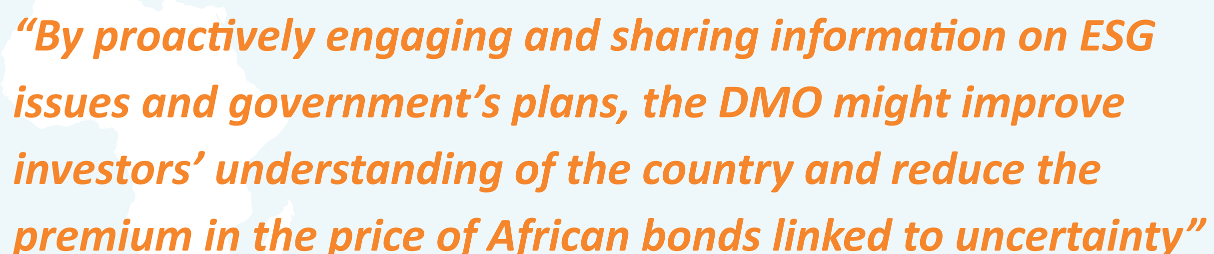
"Critical factors to consider before issuing an ESG-related bond like a green bond include the preparation costs, potential investor demand and level of political commitment"

5 Conclusion

ESG-related financing will be an important source of financing for African countries in their transition to low-carbon and climate-resilient economies. Through labelled bonds like green, social or sustainability linked bonds, sovereign governments can potentially tap the vast pools of financing held by institutional investors in domestic and global capital markets, such as pension funds, insurance companies and sovereign wealth funds. Another potential benefit of these types of bonds is that they can lead to a stickier and more diversified pool of investors.

However, before recommending the issuance of ESG-related debt instruments, public debt managers need to consider country-specific factors such as the stage of market development, political commitment to a green agenda as well as general macroeconomic conditions. Meeting the conditions for a successful issuance also requires a great deal of work and resources, and the DMO may ultimately decide that the broad costs to issue labelled instruments outweigh the immediate benefits.

At the same time, even where the issuance of an ESG-related debt instrument may not be viable, public debt managers in Africa should consider engaging in other ESG-related activities. Firstly, many investment managers are integrating ESG factors into their sovereign bond investment decisions, including vanilla bonds. By proactively engaging and sharing information on ESG issues and government's plans, the DMO might improve investors' understanding of the country and reduce the premium in the price of African bonds linked to uncertainty. Secondly, the influence of ESG analysis may rise further for credit from emerging and frontier markets as regulatory pressures and broader risk management lead issuers and investors to pay greater attention to sustainability over time. Thirdly, the effects of the COVID-19 pandemic and stronger commitment by politicians and policy makers to environmental issues are giving a new impetus to ESG considerations in other areas of development finance such as debt relief. The financing landscape is rapidly changing and the DMO needs to understand how these changes potentially affect its core mandate and possible areas in which ESG opportunities may arise.



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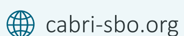
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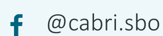
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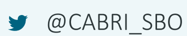
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