

Green Bonds and Sustainable Finance Instruments

The transition towards a more sustainable economy requires substantial investment, with financing needs that extend beyond the capacity of public resources alone. Capital markets therefore play an important role in mobilising private capital towards projects and activities that advance environmental and social objectives. As discussed in the previous edition of this series, Environmental, Social, and Governance (“ESG”) considerations provide investors with a framework for assessing sustainability-related risks and opportunities. Sustainable finance complements this framework by providing mechanisms to direct capital toward activities that address these considerations, including instruments such as green bonds, social bonds, and sustainability-linked instruments.

Among the instruments supporting this transition, green bonds have emerged as an important channel for financing projects with environmental benefits. This article examines how green bonds work, explores other sustainable finance instruments, and highlights the development of Nigeria’s green bond market.

Green Bonds: Financing Environmental Projects Through Capital Markets

A green bond is a debt instrument whose proceeds are allocated, in whole or in part, to finance or refinance eligible projects or activities that deliver clear environmental benefits. Like conventional bonds, green bonds offer investors financial returns and require issuers to meet specified repayment obligations. The key distinction lies in the **use of proceeds**, which is linked to eligible green projects or activities such as renewable energy, clean transportation, energy efficiency, sustainable water management, waste management, climate change adaptation, and biodiversity conservation.

For issuers, green bonds may provide access to a broader pool of investors, including those with sustainability-focused mandates, while supporting the financing or refinancing of environmentally beneficial projects. For investors, they provide an opportunity to allocate capital towards projects with identifiable environmental objectives while retaining the financial characteristics of a fixed-income investment.

Comparison: Conventional Bonds vs. Green Bonds

S/N	Conventional Bond	Green Bond
1.	Proceeds may generally be used for the issuer’s broader financing needs	Proceeds are allocated to eligible green projects or activities
2.	No specific environmental objective is attached to the use of proceeds	Proceeds are linked to defined environmental objectives
3.	Subject to standard financial and regulatory reporting requirements	Includes reporting on the allocation of proceeds and, where applicable, environmental impact

The Green Bond Principles, developed by the International Capital Markets Association, provide voluntary guidance based on four (4) core components: **use of proceeds, process for project evaluation and selection, management of proceeds, and reporting**. Issuers may also obtain an independent external review to assess the alignment of their green bond framework with recognised market standards. Following issuance, issuers

are encouraged to provide information on the allocation of proceeds and, where applicable, the environmental impact of the projects financed.

Beyond Green Bonds: The Sustainable Finance Toolkit

Green bonds form part of a broader range of sustainable finance instruments, each designed to address different financing needs and sustainability objectives.

S/N	Instrument	Primary Purpose
1.	Green Bond	Finances or refinances projects or activities with environmental benefits, such as renewable energy and clean transportation
2.	Social Bond	Finances or refinances projects or activities that address specific social issues, such as affordable housing, healthcare, and education
3.	Sustainability Bond	Finances or refinances a combination of eligible green and social projects or activities
4.	Sustainability-Linked Bond	Links the bond's financial or structural characteristics to the issuer's achievement of predefined sustainability performance targets
5.	Transition Bond	Supports entities or sectors undertaking a credible transition towards lower-carbon or more sustainable operations
6.	Blue Bond	Finances projects related to marine ecosystems, sustainable fisheries, water resources, and other ocean-related activities

A key distinction among sustainable finance instruments is that **green, social, sustainability, and transition bonds are generally use-of-proceeds instruments**, meaning the funds raised are directed to defined eligible projects or activities. Sustainability-linked bonds, by contrast, do not require proceeds to be allocated to specific eligible projects; instead, their financial or structural characteristics are linked to the issuer's achievement of predefined sustainability performance targets.

Nigeria's Green Bond Market

Nigeria has played a pioneering role in developing Africa's green bond market. In 2017, the Federal Government issued a ₦10.69 billion sovereign green bond, becoming Africa's first sovereign green bond issuer. The proceeds were directed towards renewable energy and other environmentally sustainable projects. Nigeria issued a second sovereign green bond, valued at ₦15.00 billion, in 2019. Subsequent sovereign and corporate issuances have broadened market participation and shown the potential for green bonds to support sustainable financing across different sectors of the economy.

Regulatory and market development initiatives have also supported the growth of Nigeria's green bond market. In October 2018, the Securities and Exchange Commission ("**SEC**"), Nigeria introduced its Green Bond Rules, establishing a regulatory framework for green bond issuance in Nigeria. The rules set out requirements relating to eligible projects, independent assessment, management and reporting of proceeds, and environmental impact reporting.

The **Nigerian Green Bond Market Development Programme** (the “**Programme**”), launched in 2018, has also helped build market awareness and capacity. FMDQ Group PLC (“**FMDQ Group**” or “**FMDQ**”), FSD Africa, and the Climate Bonds Initiative initially established the Programme, which has supported green bond issuances and the development of Nigeria’s broader green finance ecosystem. It has also supported the development of Nigeria’s Green Bond Guidelines in collaboration with the SEC. In 2022, FMDQ Group and FSD Africa renewed their collaboration under the Programme to advance Nigeria’s green finance ecosystem further.

Opportunities and Challenges

The continued development of sustainable finance presents significant opportunities for Nigeria’s capital markets. These include diversifying funding sources for issuers, increasing access to sustainability-focused domestic and international investors, financing climate-resilient infrastructure and other sustainable development priorities, and developing new financial products and market opportunities.

However, challenges remain. These include a limited pipeline of eligible projects, gaps in ESG data and reporting, the cost of external reviews and ongoing disclosure requirements, limited technical capacity, and the risk of greenwashing. Addressing these challenges will require continued market education, credible and consistent disclosure practices, supportive regulation, stronger technical capacity, and collaboration among issuers, investors, intermediaries, regulators, and other market stakeholders.

Conclusion

Sustainable finance is increasingly connecting capital markets with environmental and social objectives. Green bonds and other sustainable finance instruments provide issuers with additional avenues for raising capital while giving investors opportunities to support clearly defined sustainability objectives. As Nigeria’s sustainable finance ecosystem continues to develop, **stronger market infrastructure, credible disclosure and reporting, enhanced market capacity, and greater investor awareness** will be essential to deepening the market and strengthening investor confidence.

In the next edition of this series, we will examine the **state of ESG adoption in Nigeria’s capital markets** including the regulatory developments shaping its integration and the opportunities and challenges facing market participants.