

Global green
bonds market is
gaining traction –
Will it gain ground
in Zambia?

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Cumulative green bonds issued reach over a trillion dollars

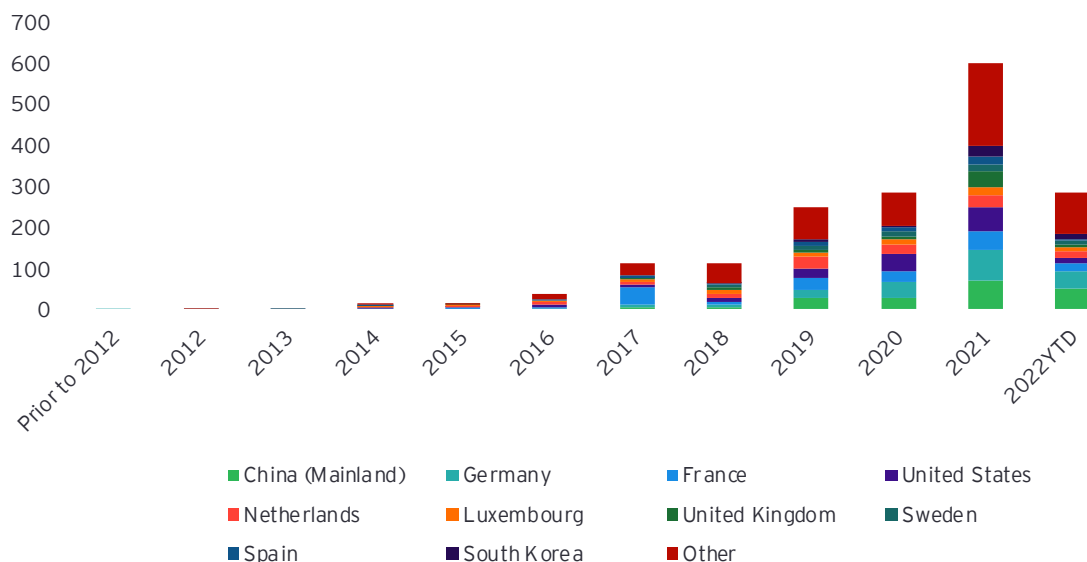
Green bonds are fast becoming a major financial instrument to access capital earmarked for climate change and sustainable initiatives and projects.

Green bonds issued in 2021 reached US\$600.6b in 2021, a 111% increase y-o-y.¹ Cumulatively, green bonds issued up to the end of 2021 reached well over a trillion dollars at US\$1.4t.

Three quarters of green bonds in 2021 originated from Europe and the Americas. Asia-Pacific issued US\$98.1b in 2021, predominantly from non-financial corporate entities in China, Japan, and Singapore.²

Africa is an emerging market with increased interest from various financial and development institutions to facilitate green bonds. South Africa has been at the forefront of green bond issuance because of the development of sustainable finance taxonomy and green listing rules. Zambia is currently a nascent market for green bonds with opportunities to inject capital for energy transition projects.

Global Green bond issuance by countries, in US\$b



The first green bond was issued by the World bank over a decade ago and as pressure from investors and regulators to invest in sustainability initiatives is increasing rapidly, companies across sectors have been scrambling to secure this alternative form of funding.

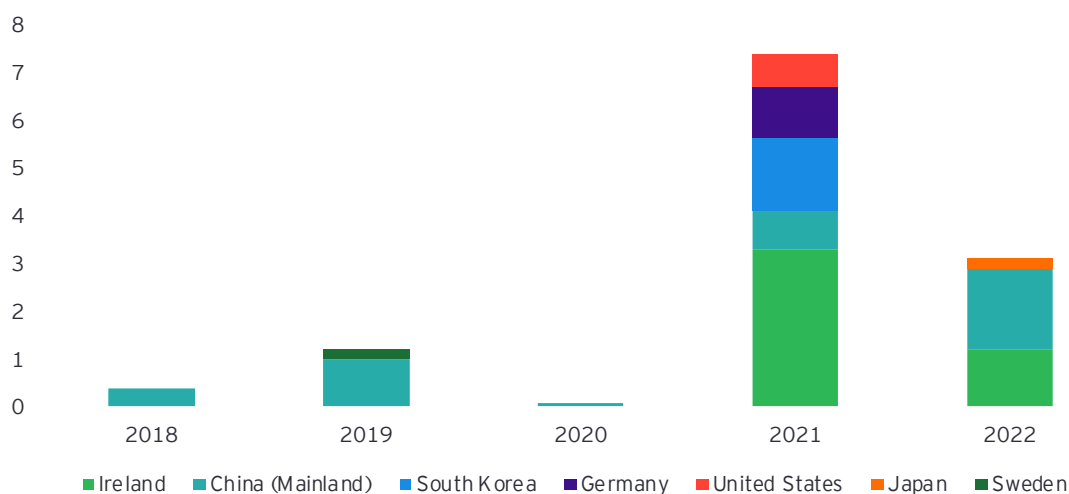
The proceeds of green bonds are used to finance sustainable projects and are traded on a secondary market if publicly issued. Green bonds are well positioned to facilitate the energy transition as it helps allocate capital to projects that contribute to net-zero targets.

¹ EYK analysis from Refinitiv Eikon
² ibid

Slow uptake of green bonds in M&M but momentum growing

The M&M sector constituted 1.2% of total green bonds issued, ending 2021 at US\$7.4b. Ireland, South Korea, Germany, and China issued 91% of the green bond volume from the M&M sector in 2021. Metallic rolling and drawing products, Iron and steel, and Aluminium rolling industries were the most active sub-sectors in issuing green bonds.

Green bonds in mining and metals sector*, by country of issue (in US\$b)



*metals and mining sector includes iron & steel, specialty metals and mining, Diversified mining, aluminium, gold and non-gold precious metals and minerals

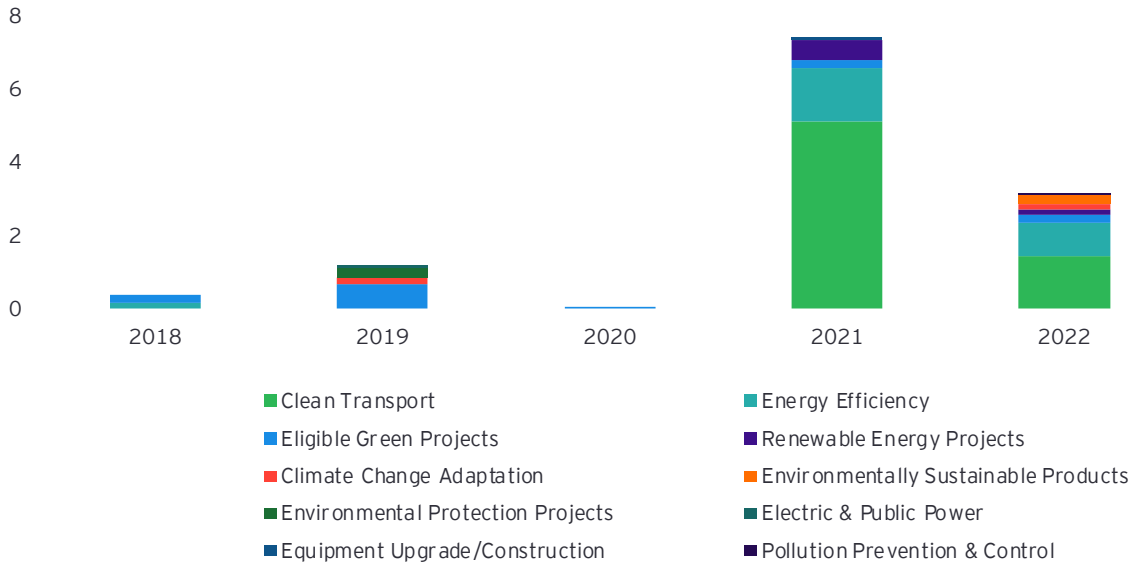
Source: Refinitiv Eikon, EY Knowledge Analysis

Although demand for green bonds in the sector has been slow, the market is expected to continue growing, particularly as companies aim to achieve a range of sustainability initiatives. The current focus of bonds issued has been on carbon reduction targets. However, the focus may shift towards greener metals needed for energy transition, pollution prevention and control projects (mine electrification, water purification, extraction of metals from residual materials, etc.) and financing of metals recycling projects.

Clean transport, energy efficiency and renewable energy projects accounted for the largest share of the use of proceeds in the M&M sector, collectively contributing 96% to the 2021 total. The pace of green bonds is accelerating as companies aim to achieve its decarbonization initiatives. For instance, Fortescue Metals recently issued a US\$800m green bond, with the proceeds going toward funding multiple decarbonisation projects.³

³ "Post Market Wrap | Fortescue raises US\$1.5b, including US\$800m Green Bonds," Ticker news, <https://tickernews.co/post-market-wrap-fortescue-raises-us1-5b-including-us800m-green-bonds/>, 7 April 2022

Green bonds in metals and mining sector, by use of proceeds
(in US\$b)



Benefits of green bonds

Investor diversification

Attracts diversified investor base such as pension funds, asset managers, central banks etc. with sustainability related mandates

Offers greater flexibility and liquidity

Green bonds were transacted even during the pandemic while the market witnessed lower activity for other types of instruments indicating that green bonds offer flexibility to the investors



Stakeholder benefits

Lower volatility

Green bonds are less risky than stocks and less reactive to macroeconomic factors due to its fixed-income nature. Investors can increase their exposure to less volatile instruments.

Enhances reputation

Investors holding green bonds can help boost its ESG scores
Increased investor appeal for issuers leading to more demand for its shares and a larger investor base due to enhanced transparency disclosure associated with a green bond issuance

Issues and challenges with green bonds

Significant challenges need to be addressed to accelerate the green bond market while an enabling regulatory environment is needed to facilitate the large-scale deployment of green funded projects.

Risk of greenwashing:

- ▶ 'Greenwashing' or misrepresenting the green credentials of a project funded by green bonds is an issue due to a lack of unified standards and transparency in disclosure.
- ▶ The absence of global standards can potentially lead to reputational risk if the green integrity of the bond is challenged.

Costs:

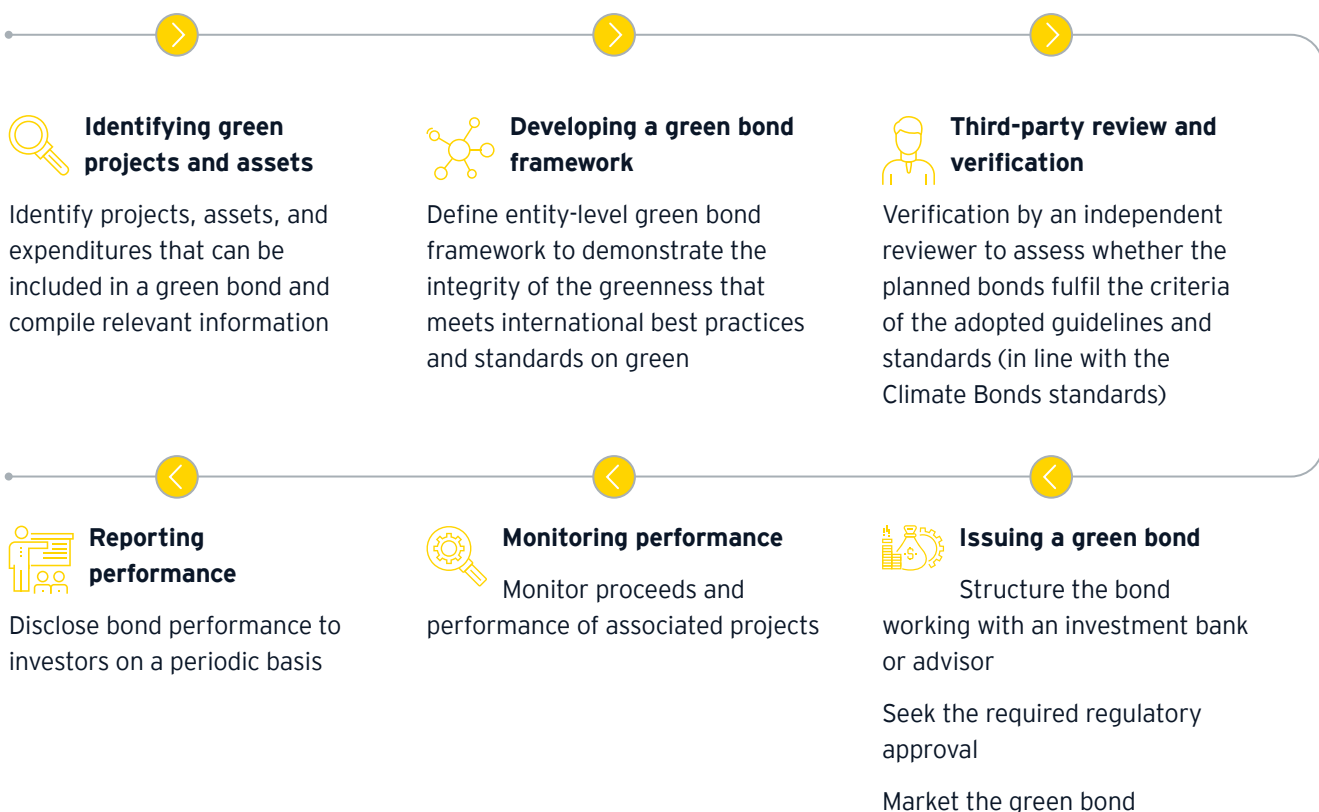
- ▶ Various costs are involved from labelling, issuance, certification, reporting, verification, and monitoring requirements of green bonds.

Additional cost is involved to track the reporting on the use and impact of proceeds.

- ▶ Compared to conventional bonds or loans, green bonds also require the issuer to spend additionally on engaging with an external approved verifier.

Steps involved in a green bond lifecycle

A typical green bond lifecycle involves a pre-issuance and post-issuance stage. External assurance/verification is obtained to confirm the alignment of the bonds with the four key ICMA principles or other relevant external standards.



Spotlight on green bonds in Zambia and call for actions

There is vast scope for green financing in a country that is more vulnerable to the impacts of climate change. Green finance in Zambia is in the early stages. Currently, there has been no green bond issued in Zambia since the publication of Green Bonds guidelines by the Securities and Exchange Commission (SEC) in 2020.

However, efforts are underway from various stakeholders to mobilise green funding for Zambia. For instance, ZANACO, WWF Zambia, and Kukula Capital have established a US\$60m small to medium-sized Enterprise (SME) green fund to help SMEs invest in green projects that create green jobs.⁴

There are several reasons why the uptake of green bonds is yet to fully realise in Zambia.

- ▶ Lack of expertise to handle the technical complexities involved in the design, verification, and reporting standards for green assets
- ▶ The lack of a pipeline of potential projects to be financed through green bonds not reaching the tolerance size needed to attract diversified investors
- ▶ Local investors with limited capacity to analyse green investments due to minimal awareness and structuring capacity on green bonds
- ▶ No accredited independent external verifiers for pre- and post-issuance of green bonds
- ▶ Lack of tax benefits and incentives attached to green bonds

The SEC has worked with multiple stakeholders, such as the Ministry of Finance, to develop a framework for various climate-friendly funding

initiatives resulting in the Zambia Capital Markets Development Master Plan (CMDMP). One of the core green finance instruments outlined in the CMDMP is the issuance of green bonds.

The Government is also taking several initiatives to encourage the issuance of green bonds. In its recent budget, the Government pointed to financing climate change interventions such as green bonds, carbon trading, and establishing a National Climate Change Fund.⁵

Some of the call for actions to improve the uptake of green bonds include:

1. Increase sustainability reporting

Sustainability reporting is not mandatory in Zambia, with a handful of companies across sectors reporting. Typically, Zambian companies report on CSR initiatives such as gender equality, community health, education, skills development, water, sanitation etc. The level of sustainability reporting needed for the investors to issue green bonds is below par in the country. For the green bond market to thrive, companies must start tracking, capturing, and reporting the right key performance indicators (KPIs) on sustainability metrics to gain investor confidence.

⁴ "Zanaco, WWF Lead Climate Resilient 'Market Debut,' Kukula Managed \$60m In SME Green Fund," The Business Telegraph, <https://thebusiness Telegraph.com/2021/10/28/zanaco-wwf-lead-climate-resilient-market-debut-kukula-managed-60m-in-sme-green-fund/>, 28 October, 2021

⁵ "2022 budget address by honourable Dr. Situmbeko musokotwane, MP, Minister of finance and national planning delivered to the national assembly on Friday, 29 October, 2021," https://www.parliament.gov.zm/sites/default/files/images/publication_docs/BUDGET%20SPEECH%20_%202022.pdf

2. Universally acknowledged criteria and standards for green financing

Globally, there is a need to standardize eligibility criteria, a common definition of green projects and green bonds, reporting, measurement, and verification steps to ensure that the securities fall under the green category. Transparency in the use of proceeds and disclosure is the need of the hour for investors to gather the information needed to assess and compare assets that claim to be green. Local guidelines must be adapted to reflect local market conditions (interoperable globally) to support the Zambian green bond market process.

3. Cost reduction and incentives

The additional costs borne by the issuer to engage with an external verifier and track the green use of proceeds dissuade the investors and may require additional benefits to hold interest. For instance, in the latest budget, the Zambian Government alluded to review the fee structure for environmental impact assessments. The downward revision, when implemented, will encourage green bond investment as the project cost for such green initiatives will likely reduce.

The Government may consider fiscal incentives for the stakeholders and cover the cost of third-party verification for issuers to expedite the green bond market. The signs are positive, with the Zambian Government currently working to introduce a zero-rating withholding tax on interest to attract green projects and tax deductibility for issuance costs associated with green bonds.⁶

4. Develop local capacity of the stakeholders

- ▶ Improve stakeholder capacity through training, collaboration, and investment in data and knowledge sharing of best practices.
- ▶ Conduct detailed research to identify the best practices and steps to overcome potential challenges from other countries on green bonds. This research can help to raise awareness among the stakeholders to encourage more issuers.
- ▶ Develop guidelines to encourage more local institutional investors to promote the green bond market.
- ▶ Develop local expertise to accredit the independent reviewer to bring cost savings.

5. Boost investor confidence through guarantees

Credit enhancement can play a pivotal role in developing the green bonds market in Africa, particularly in Zambia. The provision of guarantees as partial credit guarantees from financial organizations ameliorates the credit rating of the issuer's assets and ensures raising capital at a lower cost. For instance, The Power Sector Guarantees Project (PSGP) in Nigeria implemented several different instruments, including World Bank Partial Risk Guarantees and MIGA political risk insurance, which helped strengthen private sector foreign institutional investors along with public investment.⁷

⁶ "Climate change fund, carbon trading and green bonds," Lusaka Provisional Administration, <https://www.lsk.gov.zm/?p=951>, 25 January 2022

⁷ "Credit enhancement for green projects," IISD, <https://www.iisd.org/system/files/publications/credit-enhancement-green-projects.pdf>, May 2015



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