Case Study:

Nedbank Innovation through Green Investment

"Our stated objective to be an African leader in environmental sustainability includes a commitment to become recognized as South Africa's green and caring bank. As Africa's first carbon neutral financial services organization, Nedbank Group remains dedicated to proactively finding new ways to reduce its carbon footprint and lessen its impact on the environment."

– Mike Brown, Nedbank CE

Abstract

On April 30, 2019, Nedbank launched South Africa's first Renewable Energy (Green) Bond at the Johannesburg Stock Exchange (JSE) through an auction process. The Renewable Energy Bond issue received bids worth R5.5 billion and raised an initial amount of R1.7 billion. According to Bruce Stewart, Head of DCM Origination at the bank, the uptake was phenomenal. "We left money on the table, lots of money." The Bond that was certified by Climate Bonds Initiative (CBI) and Carbon Trust, was issued to finance four renewable energy projects. These assets had already been identified by the bank in the areas of wind and solar energy. The issue was unique as it was the first such instrument in the South African capital market, considered among the most sophisticated on the continent. Given the absence of an existing template to learn from or on which to model its own issue, Nedbank was operating from limited market knowledge. The other peculiarity with this issue is the fact that despite its relative sophistication and depth, the South African capital market does not have a one-stop, state-sponsored regulatory regime for the issuance of Green Bonds. However, the JSE's (Johannesburg Stock Exchange's) Green Bond segment, which largely mirrors the ICMA (International Capital Markets Association) Green Bond Principles provides a universally accepted framework. The greater challenge was to determine a taxonomy internally that could withstand scrutiny from external as well as internal parties.

This case study seeks to document this issue and its origination, from conceptualization to the point at which it went to market. Of significant interest are its critical success factors, and how Nedbank was able to innovate in a virgin environment that did not have all the conventional prerequisites for a Green Bond issuance in place, but also lacked a precedent against which it could benchmark in South Africa. It also examines how private sector players can leverage existing government programs and non-state initiatives to craft capital market instruments that allow investors to underwrite not just sustainable financial returns, but also a sustainable society, in line with the United Nations' Sustainable Development Goals (SDGs).

Background

Nedbank is one of the four largest financial service companies in South Africa and has Nedbank Limited as its principal banking subsidiary. It was stablished in 1890 and has been listed on the Johannesburg Stock Exchange (JSE) since 1969 (NED) and the Namibian equivalent since 2007. Nedbank has been present in the Kenyan market since the establishment of its Kenya Representative Office in 2010 which has greatly assisted in developing Nedbank's understanding of the requirements of their clients and the opportunities offered in the region.

With a market capitalization of R136 billion, total assets in excess of R1 trillion and some R297 billion worth of assets under management as at December 31, 2018, Nedbank's principal market is South Africa, but with a growing African footprint. Presently, Nedbank is in six SADC countries, namely Namibia, Swaziland, Malawi, Mozambique, Lesotho and Zimbabwe, while representative offices take care of business in Angola and Kenya. Its areas of expertise include wholesale and retail banking, insurance, asset management and wealth management. In addition, Nedbank has an alliance with Ecobank Transnational Incorporated ("ETI" or "Ecobank") with a 20.7 percent shareholding. Together, ETI and Nedbank Group offer a unique one-bank experience to their clients across the largest banking network in Africa, comprising more than 2,000 branches and offices in 39 countries.

The bank has always prided itself on its solid green and sustainability credentials. Says Mr Stewart. "Green is not just our corporate color. It is our way of life. It is something we have always been very deliberate and proactive about. It is not an attribute we just project on the outside, but it is strongly embedded in our day-to-day operations. For instance, a large proportion of our campuses are now green or carbon neutral buildings."

Even before it started the process of originating and listing a Green Bond, Nedbank already had a clear sustainability footprint in several of its operations, guided by the catchphrase, "we use our financial expertise to do good." This adherence to a sustainability and green agenda is evidenced by the bank's financing activities dating back to 2012 and which include several sustainable affordable housing projects since 2015.

Moreover, the bank's Corporate Social Investment (CSI) programs are largely informed by and fashioned along the UN's SDGs. It is also active in promoting equal employment opportunities and working with several partners on social development programs.

"It was out of the recognition that we have a passion in driving this theme, that we could be thought leaders in this field, starting in SA. We took the initiative at Nedbank to bridge the theory with something tangible as our intention is to contribute meaningfully to the delivery on the nine SDGs that Nedbank has adopted. That took us to a point internally that resulted in each member of our executive being tasked with the responsibility of championing an SDG," argues Mr Stewart.

South Africa’s Green Bond Legacy

Nedbank is an example of other green investment activities in South Africa. The JSE listed its first Green Bond on June 9, 2014. The R1.46 billion ($140 million) bond issued by the City of Johannesburg was dedicated to the funding of green initiatives in South Africa's largest city.

The bonds were priced at 1.85 percent above the R2023 South African government bond. The bond auction, which took place in the week before the listing, was 150 percent oversubscribed. The bond, referred to as COJGO1, will mature in 2024.

The bond was used to fund climate change mitigation strategies especially those that include greater use of gas and natural energy. One of the city council's green programs included the installation of 43,000 solar water heaters by City Power that will collectively save the equivalent of 22.5 GW-hours of electricity a year, enough to run a small town.

The Nedbank Renewable Energy Bond

In step with the country’s adoption of green investments and a focus on sustainable finance, Nedbank has developed a remarkable sustainability track record. Significant to note is the fact that the bank was already active in the renewable energy space in South Africa, before it initiated a Green Bond. “We have already committed about R35 billion towards the power projects awarded under the Department of Energy’s Renewable Energy Independent Power Producer Program (“REIPPP”), which currently represents about 40 percent of the sector in SA. Under REIPPP, Nedbank is the only SA bank to have funded all technologies supported, which includes solar, wind, CSP, hydro and biomass,” notes Mr Stewart.

The REIPPP framework was useful to Nedbank in furthering its Green Bond program. For starters, it allowed the bank to identify the projects to be financed, whether solar or wind. It also allowed the bank to measure the carbon emission reduction impact, beyond giving investors and other participants the requisite level of credit and return comfort in the subsequent issuance.

"We developed an extremely robust framework, with a catalogue of the projects themselves. It allowed us to measure impact, in the form of CO_2 emission factor. The framework resulted in a higher level of confidence among the investor community, assured by the fact that the projects had undergone due process and had been verified by Carbon Trust and certified by the Climate Bonds Initiative(both universally recognized and credible authorities), giving that extra layer of comfort in the linked instruments," says Mr Stewart.

The JSE had promulgated listing requirements for Green Bonds and launched the segment at the bourse in October 2017 as an "effective tool to raise capital for investments that are specifically earmarked for climate and environmental projects." Equally critical to Nedbank in guiding its Renewable Energy Bond issue was the Green Bond Principles, the latest version of which was issued by International Capital Markets Association (ICMA) in June 2018. Nedbank is a member of ICMA. Internally, Nedbank had developed its own SDG Issuance Framework. This provides the bank with a broader scope as opposed to just Green Bond or Sustainability Bond guidelines, providing it with a robust, tangible roadmap on which to overlay its journey towards the eventual listing of the Nedbank Renewable Energy Bond and subsequent bonds aimed at supporting its SDGs.

Opportunities and limitations in the Green Bond market in South Africa

The success of the Nedbank Renewable Energy Bond is evidence of the huge appetite for investment opportunities that carry a sustainability tag in addressing Africa's huge infrastructure deficit. Africa's low development indicators mean that a lot of investment is still required to develop its infrastructure to match developed world standards. Modeling an investment instrument to meet this huge demand for capital, while addressing investors' ESG (environmental, sustainability and governance) concerns, was a significant opportunity worth tapping into, both in terms of crowding in private capital but also in support of Nedbank's own ethos around sustainability.

Nedbank's experience with its Renewable Energy Bond shows that while most local investors did not have dedicated green funds, they were not necessarily prescriptive. Eventually, what worked for the mandates of such investors was the need to have an infrastructure-based asset class in their portfolios. Critical to them was the green aspect and an aspect of external review (verification and certification) mechanism, in the absence of a Green Bond rating.

For the international investors, who have had a longer learning curve with Green Bonds, with the first issues coming to market in 2007, the mandates were keen on an investment that allowed them to ramp up their ESG credentials. However, a lot of the global funds could not participate in a rand-denominated instrument, and even asked

Nedbank for a dollar-denominated option. However, there were some international investors who were willing to take local currency risk, because of the sustainability angle of the investment.

In the absence of a state-initiated listing framework for Green Bonds, which is the reality in most African capital markets, Nedbank relied on the privately-owned JSE, which had established its own Green Bond segment in October 2017, complete with listing requirements. Equally useful in framing the issue was the Green Bond Principles, an updated version of which was launched by ICMA in June 2018. Nedbank leveraged its membership of ICMA.

The verification and certification aspect of the issuance also presented a potential limitation. However, Nedbank navigated and innovated around this by involving the Climate Bonds Initiative (CBI), a not-for-profit body based in the United Kingdom. Working with verifiers like Carbon Trust, CBI was able to certify the issue, lending it a legitimate international stamp and giving investors additional credit and return comfort in the issue.

Outcomes

Nedbank placed approximately R1.7 billion of bonds in the market, an issue which was three times oversubscribed as they received bids totaling R5.5 billion, showing strong investor appetite for good quality, ESG-focused assets. The auction attracted a total of 18 institutional investors, two of them foreign. The bonds had three, five- and seven-year tenures and were linked to four renewable energy projects (solar and wind).

Besides the funds raised, the issue was important in raising awareness about SDGs and the concept of ESG-focused investment in South Africa. Since the issue, Nedbank says it has received a lot of inquiries from clients. “Interest is peaking. This shows potential for market development,” concludes Mr Stewart.

Lessons

Having pioneered the first Renewable Energy (Green) Bond in the South African capital markets, Nedbank's experience offers several vital lessons.

- **A culture of sustainability:** Even before it launched its ground-breaking Renewable Energy Bond, Nedbank already had strong green and sustainability credentials. This is evidenced by its SDG Issuance Framework. It is equally important for investors to see an issuer directing finance towards sustainable projects as it is for the issuer to be "green" itself, evidencing its "sustainability" culture in its financial products, advisory services, internal operations and CSI initiatives.
- **Additionality is key**: Nedbank was already active in the renewable energy space in South Africa, setting aside some R35 billion for it, nearly 40 percent of the renewable energy portfolio in South Africa. So, the bank was not just re-financing existing projects on its balance sheet, but bringing in new, renewable energy projects, and in the process making the global energy mix more sustainable.
- **Understanding the investor's needs:** Nedbank invested in listening to what its potential investors (local and international) were looking for. It undertook extensive roadshows, even before it had a deal on the table. Part educating investors and part understanding their mandates created a match that would result in over-subscription in the bond auction.
- **Innovating with what is available:** One of the standout innovations in the Nedbank Renewable Energy Bond issue was the involvement of Climate Bonds Initiative (CBI) as the issuer's external review provider. A non-profit working out of the UK, CBI worked as a certifier, working in tandem with approved verifiers like Carbon Trust. Using best of breed reviewers and certifiers to maintain the integrity of the claim to be green, was as important as it was necessary.
- **Government and Regulator support:** The issue benefited from a much-lauded government initiative, the Renewable Energy Independent Power Procurement Program (REIPPP), which helped it identify the right renewable energy assets and to measure and understand the environmental impact.