Green Financing and Sustainability of the Nigerian Banking Sector: The Role of Central Bank of Nigeria

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Abstract
The role of central banks in fostering a sustainable financial ecosystem has been a subject of increasing interest due to the escalating environmental issues. Owing to this, the study evaluated the role of the central bank in greening the financial system to ensure the sustainability of the Nigerian banks. The study is qualitative in nature and secondary data were sourced. Content analysis was employed in analyzing the data. The study contends that central bank plays an instrumental role in implementing green policies and regulatory measures. The Central Bank of Nigeria occupies a unique position within the financial ecosystem, wielding unparalleled influence over monetary policy, financial stability, and regulatory oversight. As such, they are strategically poised to act as catalysts in the propagation of green finance to ensure the sustainability of the Nigerian financial system. Through a combination of regulatory measures, financial instruments like green bonds, and traditional tools like reserve requirements and interest rates, central banks can significantly influence the direction of financial flows towards more sustainable avenues. It is recommended that the CBN should solicit the support of all stakeholders towards greening the financial sector and develop collective initiatives for greening the financial system. The CBN should ensure that financial institutions lend to activities that promote a sustainable financial system while protecting the environment.
Keywords: Green Financing, Sustainability, Banking Sector, Central Bank

Introduction

The effect of unfavourable climate change on the financial sector of the economy has become an important emerging issue in the global economy. In response to this, monetary authorities particularly the central bank have begun to assess the potential effect of climate change related risk on the banking sector. One way to prepare the financial system to withstand climate change shocks in Nigeria is to embark on an aggressive green finance program for the financial system. Green Finance is introduced to make this world a better place for corporate and individuals. Currently, the top-most political leaders throughout the world are introducing and implementing green finance in their countries to create a sustainable and eco-friendly environment (Ozili, 2023).

Green finance is financing that yields economic benefits while protecting the environment (Dikau & Volz, 2021). Green finance is finance that protects the environment while pursuing economic profits which aims to promotes the financing of projects and activities while being mindful of any damage to the environment to ensure that firms do not damage the environment in the pursuit of profits. Green financing covers broader areas, including green investment activity, green trade and economic projects, green environmental and climatic projects, and green social projects and policies. The importance of Green finance had been highlighted by introducing investment products that protect the environment and make sure to provide economic prosperity. Society asks banks to create and allocate green financial products but

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now, green finance policies are binding on financial institutions and corporates. However, green finance will be a key determinant for the banking sector (Akomea-Frimpong, 2021).

Green Finance provides a vital way to introduce and develop policies also to reduce global warming. In order to achieve a green economy, it is encouraged to build a green finance system. When the government with their political support failed to build a green finance system that supports reduction in carbon emission, a green policy introduced green debt market instruments via Green bonds and Green loans (Wang & Zhi, 2016). The market for green financing has been growing for years. The common options under green finance would be Loans, bonds, and promissory notes. More products are available at large volume financing but the predominant finance instruments are debt and equity as well as risk management products, guarantee equity financing.

Greening the financial system is considered by the CBN for two reasons. One, unfavourable climate change events can impede the productive capacity of the Nigerian economy and weaken its ability to generate employment and income. Two, greening the financial system can support the central bank's efforts to diversify the economy away from its dependence on carbon-laden crude oil products. It can help to grow the non-oil sector of the economy (Berensmann & Lindenberg, 2016). In Nigeria, the Banker's Committee as a commitment to sustainable development adopted the Nigerian Sustainable Banking Principles in 2012 and this means the integration of social and environmental consideration into its operations, policies, processes, procedures and strategies, as well as provision of structural mechanism to support implementation as the industry level. Based on the foregoing, the study investigated the role of central banks of Nigeria in greening the financial system for its sustainability.

The Concept of Green Financing

Green finance is a broad term that can refer to financial investments flowing into sustainable development projects and initiatives, environmental products, and policies that encourage the development of a more sustainable economy (Höhne & Fekete, 2012). Green finance includes climate finance but is not limited to it. It also refers to a wider range of other environmental objectives, for example industrial pollution control, water sanitation, or biodiversity protection (Zadek & Flynn, 2013). Mitigation and adaptation finance is specifically related to climate change related activities: mitigation financial flows refer to investments in projects and programs that contribute to reducing or avoiding greenhouse gas emissions (GHGs) whereas adaptation financial flows refer to investments that contribute to reducing the vulnerability of goods and persons to the effects of climate change.

For the banking sector, green finance is defined as financial products and services, under the consideration of environmental factors throughout the lending decision making, ex-post monitoring and risk management processes, provided to promote environmentally responsible investments and stimulate low-carbon technologies, projects, industries and businesses (Pricewaterhouse Coopers Consultants (PWC), 2013).

Green finance encourages approach, strategy, culture, business process focusing environment throughout the industry. Although, currently, finance sectors are not entirely "Green". Green finance is a growing phenomenon in local and international markets with a global transition to a low carbon economy in the foreseeable future. Green finance increases the financial flow from public to sustainable development priorities. Green finance provides the opportunity to demonstrate social purpose and provides a transition in lower carbon sustainable world. Green finance mainly promotes the flow of financial instruments towards the development of sustainable business projects, social investment, social trade, and environmental policies (Lindenberg, 2021).

Ways Central Bank of Nigeria can ensure the Green of the Financial System

The role of central banks in the promotion of green finance is multifaceted, encompassing a range of regulatory measures and financial instruments. This section delves into these various aspects, focusing on regulatory measures, green bonds, reserve requirements, and interest rates. The first way the CBN can incorporate environmental considerations into its core policymaking activities. This requires the CBN to take into account environmental factors in its monetary policy, financial stability and development finance decision making. This will not only ensure that the central bank leads by example in the financial sector but will also ensure that the CBN exclude fossil fuels from its development finance programs so that the central bank is not seen as contributing to climate change risk by encouraging lending to businesses involved in fossil fuel activities (Șimandan & Păun, 2021).

Furthermore, the CBN may consider creating a green bank. A green bank is a financial institution that offers loans only for green projects or projects that have sizeable benefits for the environment and society. The need for a green bank arises when traditional financial institutions are unwilling to issue loans for green projects primarily because green investments often have very low return on investment (Shaydurova et al, 2018).

Also, CBN can establish green finance labs that would develop innovative green financing products that incorporate ESG considerations into traditional and non-traditional financing instruments. Central banks wield significant regulatory power that can be harnessed to promote green finance. For instance, they can introduce guidelines that mandate financial institutions to disclose their environmental risks, thereby encouraging transparency and accountability. Some central banks have also started to incorporate Environmental, Social, and Governance (ESG) criteria into their supervisory frameworks. These measures not only incentivize banks to adopt green practices but also provide a risk assessment tool that can be used to evaluate the sustainability of various financial assets. This would ensure the development of financing instruments that integrates ESG factors, lead to better long-term returns for investors, and generate positive benefits for society (Cerqueti, Deffains-Crapsky, & Storani, 2023).

Central banks have the authority to set reserve requirements for commercial banks, dictating the minimum number of reserves that must be held in the central bank. By offering preferential reserve ratios for green assets, central banks can encourage financial institutions to allocate more resources to sustainable projects. The central bank can achieve the greening of the financial system through the use differentiated cash reserve requirement as an incentive to lenders. Under this approach, banks that give out substantial loans to green project and activities will be required to keep a lower cash reserve ratio with the CBN so that they can have more money to give out as loan for green projects and for green investment (Volz, 2017), while banks that do not lend to green projects and activities will be required to keep a higher cash reserve ratio with the CBN.

The CBN can introduce an environment protection strategy (EPS) disclosure requirement. This approach will require the CBN to introduce some disclosure requirement. CBN can require banks to ensure that corporate borrowers provide a comprehensive ‘environment protection strategy (EPS)’ documentation. The EPS is a documentation that require corporate borrowers to disclose the measures they have put in place to ensure that their corporate activities do not create any man-made risk to the environment and the climate. Such documentation requirement will ensure that borrowers’ activities do not harm the environment where they operate (Ozili, 2023).

CBN can also issue green bonds to support green finance. A ‘green bond’ is used to raise financing for green projects (Dikau & Volz, 2021). Green bonds have emerged as a popular financial instrument for funding environmentally sustainable projects. Central banks can play a pivotal role in the development of this market by issuing their own green bonds or by purchasing such bonds as part of their asset purchase programs. This not only provides a boost to the green bond market but also sets a precedent for other financial institutions. Moreover, central banks can offer tax incentives or lower collateral requirements for green bonds, making them more attractive to investors. It has positive environmental and/or climate benefits. It raises funds from investors and the realized funds are used to fund activities that protect the environment from man-made activities that damage the environment (Mehta, 2017).

Interest rates are a powerful tool in the arsenal of central banks, influencing borrowing costs across the economy. Central banks could potentially introduce a tiered interest rate system that favors green investments. For instance, lower interest rates could be offered for loans that are used to finance sustainable projects, thereby reducing the cost of capital for such initiatives. Conversely, higher interest rates could be imposed on carbon-intensive activities, serving as a disincentive for such investments (Magomed, 2023).

The can also play a significant role in greening the financial system through collaborations with governmental entities. This can be achieved through policy congruence that is the alignment of monetary policy objectives with governmental sustainability initiatives offers a highly effective avenue for central banks to foster green finance. Such initiatives corroborate the feasibility of integrating central bank objectives with governmental policies pertaining to environmental sustainability. Also, through public financing, the joint financial capabilities of central banks and governmental bodies can be leveraged to fund extensive green projects. There should be a proactive stance by the government in international standard-setting to mobilize necessary resources for a green economic transition (Magomed, 2023).

Central bank alliance with the private sector is also instrumental in greening the financial sector. Collaborative efforts between central banks and financial institutions can lead to the establishment of platforms specifically designed to enable green investments. This could manifest in the form of green bond markets, green indices, or digital platforms connecting investors with sustainable projects. Furthermore, The formulation of consultative groups consisting of central banks, commercial banks, asset managers, among other stakeholders, can provide invaluable insights into market necessities and hindrances, thus shaping policy directives (Falcone & Sica, 2019). In conclusion, the potential for central banks to magnify their influence in green finance is considerably enhanced through strategic partnerships. Such alliances offer not only the financial and legislative scaffolding necessary for the implementation of green initiatives but also cultivate a sustainability-oriented culture within the financial landscape.

Conclusion

Although green finance options come with a heavy cost, their long-term benefits give less reliance on natural resources and reduce gas emissions. Green financing is a must need so as to make business interconnected with the fulfillment of sustainability goals. Sustainable finance is now considered a vital component of the finance sector. Green financing provides an ecological approach to promote innovation in environmental costs. It involves an immense commitment to creating a positive but efficient economic and social environment for all industries. Green financing encourages cooperation between local and international players. It also helps to create a strong and trustworthy platform for sustainable finance.

Thus, the government through is regulatory agencies like CBN and NDIC should take every single effort to incorporate sustainable routes in a regulatory framework so as to be followed by the corporates as a regular trade practice. It is recommended that the CBN should solicit the support of all stakeholders towards greening the financial sector and develop collective initiatives for greening the financial system. The CBN should ensure that financial institutions lend to activities that promote a sustainable financial system while protecting the environment. Green finance offers an innovative approach to achieve this goal. The CBN should ensure that the lending decisions of financial institutions take into account environmental considerations when lending to corporate borrowers.

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