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ZAMBIA TAKES PIONEERING STEPS: THE GREEN LOANS GUIDELINES, 2023

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Zambia Takes Pioneering Steps: The Green Loans Guidelines, 2023

1. Introduction

Zambia has joined the select group of African nations taking early initiatives to explore innovative green financing methods for funding projects focused on adaptation and sustainable development. On 29 September 2023, Zambia's Minister of Finance and National Planning unveiled the National Budget for 2024. In paragraph 142 of the presentation, the Minister emphasized the increasing risks related to climate change affecting the financial system. The Minister announced the government's dedication to strengthening the legal and regulatory framework in 2024 to support green finance and incorporate environmentally friendly practices into the financial sector.

In response to the Minister's announcement, on 6 October 2023, the Bank of Zambia, exercising its authority under the Banking and Financial Services Act of 2017, promulgated the Banking and Financial Services (Green Loans) Guidelines, which were officially published in the Government Gazette under Gazette Notice No. 1349 of 2023 (the "Guidelines"). These guidelines represent a significant step towards aligning the Zambian financial sector with global sustainability goals and fostering environmentally responsible lending practices. By doing so, Zambia aims to ensure not only the country's economic resilience but also a more sustainable and climate-resilient future.

2. Application and Aim of the Guidelines

These Guidelines are designed to be applicable to all financial service providers in Zambia, considering the diverse range of their characteristics, sizes, levels of complexity, and interrelationships. The Bank of Zambia acknowledges this diversity and underscores the importance of a tailored approach to effectively implement these Guidelines.

The Guidelines have been developed in alignment with internationally recognized Green Loans Principles, which are widely accepted in global green loan markets. They serve as a framework to establish standards for the provision of green loans in Zambia, promoting a more sustainable and environmentally responsible approach to financing.

Essentially, these guidelines are aimed at preserving the integrity, stability, and soundness of the financial sector. They also acknowledge the financial sector's critical role in financing green projects aimed at mitigating the impacts of climate change, biodiversity loss, and land degradation, contributing to a greener and more sustainable future for Zambia.

Furthermore, these Guidelines aim to ensure that financial service providers develop policies, structures, and practices for offering green loans while upholding the safety and stability of the financial system. They also emphasize the importance of financial service providers monitoring borrower compliance with disclosure, reporting, and information-sharing requirements, thus ensuring transparency and accountability in the green finance landscape.

3. What are Green Loans in Zambia?

The Guidelines provides a definition for green loans, categorizing them as “any form of financing or instrument made available exclusively to finance or re-finance, in whole or in part, new and/or existing eligible projects that contribute to environmental objectives.” It is important to emphasize that green loans are specifically designated for the financing of eligible projects. The Guidelines outline these eligible projects, which are further detailed in Schedule 1. These projects encompass a wide spectrum of environmentally beneficial activities, including:

- (a) Renewable energy;
- (b) Pollution prevention and control;
- (c) Sustainable water and wastewater management;
- (d) Climate change adaptation;
- (e) Sustainable or green buildings;
- (f) Energy efficiency;
- (g) Terrestrial and aquatic biodiversity conservation;
- (h) Environmentally sustainable management of living natural resources and land use; and
- (i) Eco-efficient and/or circular economy adapted products, production technologies and processes.

It is important to note that projects falling within the above-mentioned categories are considered eligible for green loans in Zambia. This definition of green loans, as outlined in the Guidelines, aligns with the definitions provided in the Green Loan Principles and the International Financial Corporation (IFC) of the World Bank Group ¹.

4. Salient Features of the Guidelines

4.1 Green Loans Governance

The Guidelines place specific responsibilities on the Board of Directors (the “Board”) and Senior Management of financial service providers in Zambia when it comes to offering green loans. Notably, the Board is tasked with approving green loan policies and strategies, as well as overseeing their implementation. Furthermore, the Board is required to establish the parameters for green loans and guarantee that the institution possesses the necessary resources for offering such loans. The Board also holds the responsibility of ensuring the recruitment of suitably qualified and experienced senior management and staff to effectively carry out their duties.

On the other hand, Senior Management holds the responsibility of formulating strategies, administrative procedures, and accountability mechanisms for executing green loan policies approved by the Board, adhering to the Green Loans Principles. Their duties encompass establishing an information management system dedicated to green loan management, regularly assessing staff capabilities, and implementing capacity enhancement plans for those involved in green loan matters. They are also tasked with disseminating green loan policies to staff, clients, and stakeholders, as well as disclosing green loan activities and initiatives to the Board, regulatory authorities, and stakeholders.

¹The World Bank: What You Need to Know About Green Loans. 4th October 2021 <https://www.worldbank.org/en/news/feature/2021/10/04/what-you-need-to-know-about-green-loans>

In the context of providing green loans, financial service providers will be obliged to institute measures that ensure alignment with the Green Loans Principles, including the performance of environmental risk assessments.

4.2 Green Loan Risk Management

The Guidelines introduce about 11 additional credit risk requirements, complementing those outlined in the Risk Management Guidelines. These new requirements are essential to ensure the effective management of green loan risks. They include:

- a. Enhancing the development and refinement of policies, systems, and procedures for the management of green loan risks, thereby strengthening the financial institution's overall risk management framework;
- b. Establishing a standardized client green loan risk rating system, which is pivotal for accurately evaluating and categorizing the risks associated with clients' green loans, facilitating informed decision-making;
- c. Mandating clients with significant green loan risks to create and implement action plans. This proactive approach is vital in managing and mitigating the risks involved, ensuring the sustainability of green loan portfolios;
- d. Proficiently identifying, assessing, monitoring, controlling, and mitigating green loan risks within their business operations. This comprehensive approach is important to maintaining the financial institution's stability and integrity.; and
- e. Developing robust green loan risk management systems. These systems serve as the bedrock of green loan policies and procedures, enhancing the financial institution's capacity to uphold environmental and financial sustainability.

4.3 Green Loan Evaluation

Prior to approving a green loan application, the Guidelines set forth specific minimum criteria that must be met. These criteria play a pivotal role in ensuring that green loans are directed towards projects that genuinely contribute to environmental betterment and sustainability.

The financial service provider must diligently verify the following:

- a. That the loan proceeds will be exclusively dedicated to financing a green project that yields a tangible and assessable environmental benefit. This ensures that the impact of the project can be measured, reviewed, and tracked over time;
- b. That the borrower demonstrates a clear and transparent mechanism for articulating their environmental sustainability objectives, as well as the process by which their project aligns with the green project eligibility criteria. It is imperative that any related eligibility criteria are addressed, including any criteria that may be excluded, and a structured approach to identify and manage significant environmental risks associated with the project;

- c. That robust measures are in place to track the utilization of green loan proceeds in a manner that promotes transparency and maintains the credibility of the green loan market. This accountability is essential in assuring stakeholders of the loan's environmental impact; and
- d. That the applicant maintains up-to-date information regarding the intended use of green loan proceeds and anticipate any significant developments. These requirements serve to ensure the ongoing relevance and effectiveness of green loan projects.

Failure to meet these stringent criteria will render the application ineligible for classification as a green loan. Once an application is submitted, the financial service provider is responsible for evaluating it, which includes examining the project's scope, proceeds management tracking and reporting methods, risk management plan, calculation of expected environmental and social benefits, and the external review or self-certification process. These steps are very important in upholding the integrity and impact of green loans, promoting sustainable environmental practices, and ensuring transparency in the process.

4.4 Internal Management and Loan Disclosure

The Guidelines mandate financial service providers to undertake the following actions:

- a. Incorporate the assessment of green loan performance within their internal compliance reviews, making it an integral part of their ongoing evaluation process;
- b. Establish a routine internal audit process specifically dedicated to evaluating the performance of green loans. This ongoing audit ensures the effective implementation of green loan initiatives;
- c. Develop an internal reporting and accountability system designed to address significant risks associated with green loans. This system provides a structured approach to identify, monitor, and manage these risks; and
- d. In alignment with the guidelines outlined in the Corporate Governance Directives, disclose their green loans strategy and policies. This transparency helps to align their corporate governance practices with sustainable and environmentally responsible lending.

Moreover, financial service providers are responsible for ensuring that borrowers report or disclose the usage status of funds at least once annually until all the proceeds are fully utilized. Timely and accurate disclosure is critical to track the progress of green loan projects.

Further, the financial service provider must be promptly informed of any major changes in the situation, such as the sale of the asset or project for which the green loan proceeds are being used. This notification ensures that the financial institution is kept up to date on the status of the funded projects.

5. Implications of the Guidelines

The Guidelines serve to promote environmentally responsible and sustainable financial practices, align Zambia with international standards, and foster transparency and accountability in green financing transactions. They provide a structured framework for financial institutions to engage in green financing, contributing to both environmental well-being and economic growth. All financial institutions in Zambia will, on proportionate basis, be required to comply with these Guidelines to be able to provide green financing to its clients with eligible projects.



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