

SUSTAINABLE BANKING NETWORK (SBN)

COUNTRY PROGRESS REPORT

ADDENDUM TO SBN GLOBAL
PROGRESS REPORT

KENYA



Sustainable
Banking
Network

IFC | International
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Creating Markets, Creating Opportunities

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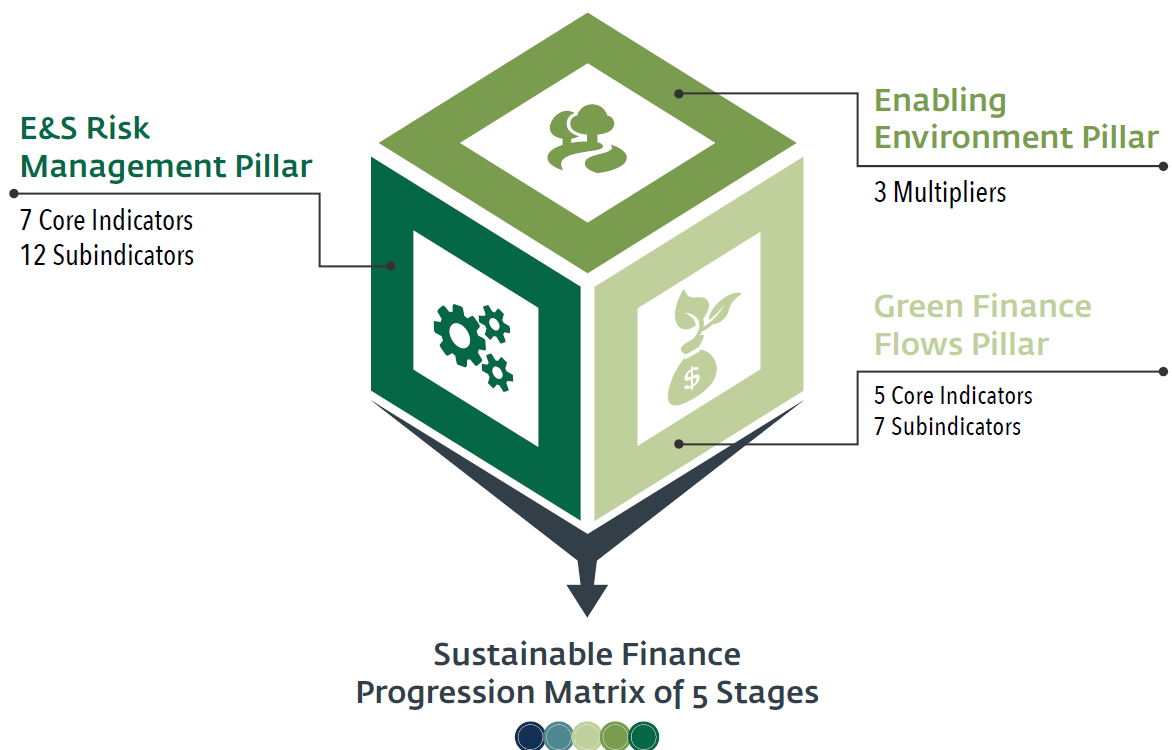
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1. Introduction

Market-based sustainable finance initiatives led by members of the Sustainable Banking Network (SBN) have made significant progress in directing the financial sector toward sustainability. Established with International Finance Corporation's (IFC) support in 2012, SBN represents a community of financial sector regulators and banking associations from 34 emerging markets. SBN members now represent over US\$42.6 trillion in banking assets, accounting for more than 85 percent of the total banking assets in emerging markets.

The SBN Global Progress Report is based on a unique measurement framework, the first of its kind to assess sustainable finance initiatives across emerging markets. The SBN Global Progress Report for the first time presents a systematic view of progress on sustainable finance among emerging economies that are represented by SBN. A rigorous measurement framework was developed and agreed on by members. The SBN Measurement Framework draws on international best practice as well as SBN members' experiences and innovations. This framework will be continuously applied to measure progress annually.

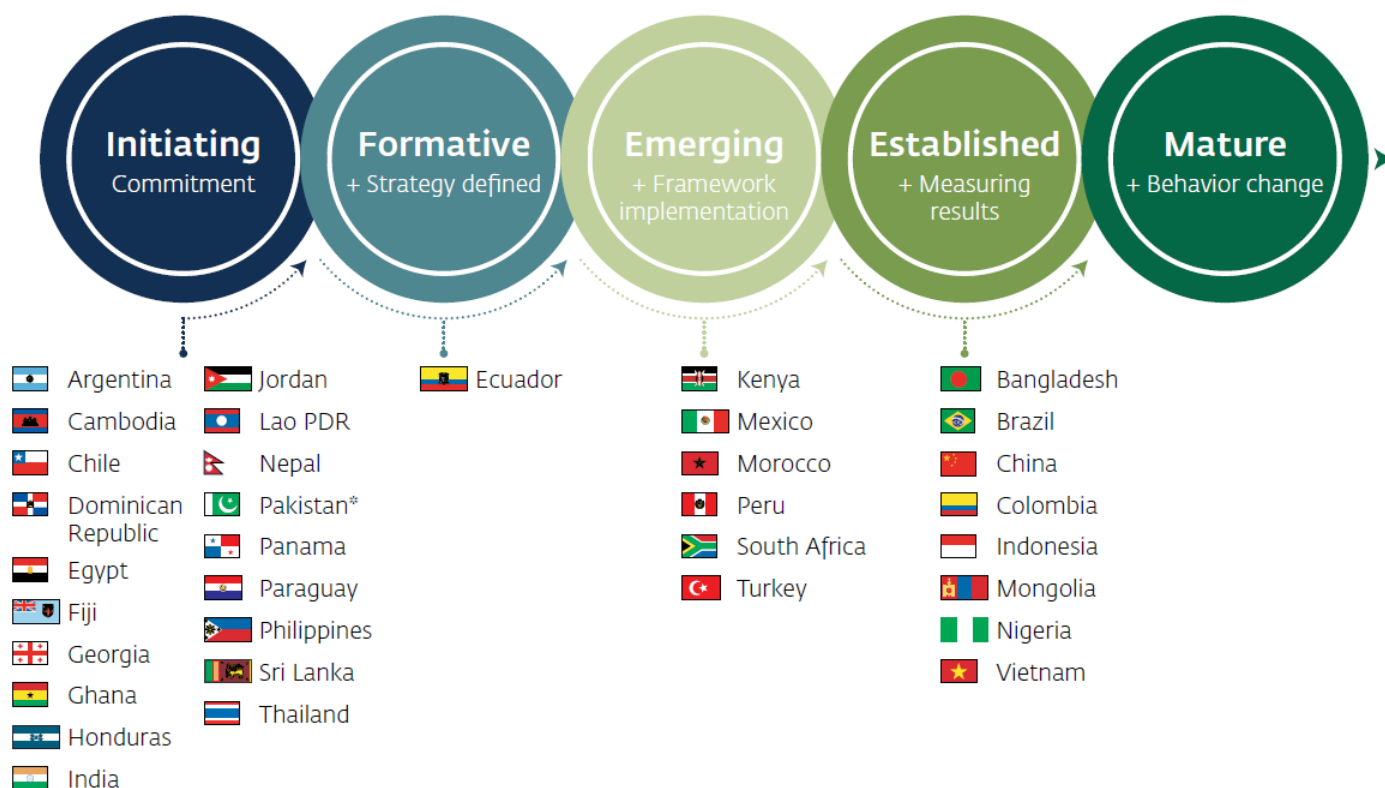


The Global Progress Report draws on the findings of **15 individual country progress reports prepared for members, including this report**. These 15 countries, with US\$38.3 trillion in banking assets, account for more than 76 percent of emerging market banking assets.

Country-specific progress reports were prepared for 15 SBN members with sustainable finance initiatives. These reports contain a thorough analysis of the country's policy or principles in relation to the environmental and social (E&S) risk management and to the green finance flows, as well as a contextual analysis of the local policy landscape and the enabling environment. Country reports detail each country's good practice and highlight areas of focus in order to support and encourage members to further accelerate sustainable finance.

All SBN member countries are advancing sustainable finance at differing stages of development. Countries are mapped to five different stages of their development, from initiating to mature.

SBN Progression Matrix with Assessment Results, based on progress up to and as of June 2017



* Pakistan launched its policy in October 2017, after the cut off date of June 2017 for the report

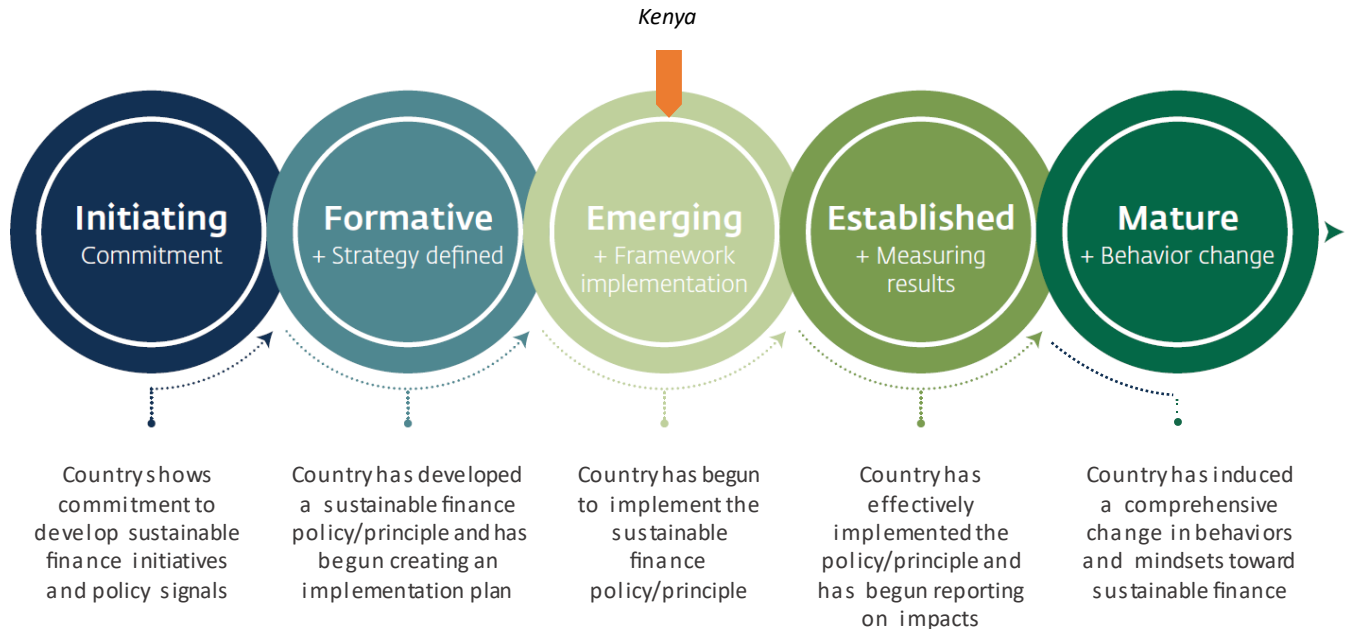
2. Executive Summary

Kenya's involvement in addressing environmental, social and governance (ESG) issues began in the 1990s with the **Code of Corporate Governance**. In 2016 the country launched the **Climate Change Act** to mobilize both public and private sector actors to transition to a low-carbon economy. Kenya launched its Green Economy Strategy and Implementation Plan (GESIP) in 2017.

In 2015 the Kenya Bankers Association (comprising 47 active bank members) launched the **Sustainable Finance Initiative (SFI) Guiding Principles** (the Principles), which aim to raise awareness on sustainable practices and ESG risks within the banking sector, in particular through a dedicated e-learning training platform intended to reach all Kenyan bank employees. The application of the Principles is not mandatory. The Principles could be strengthened if practical guidance and shared definitions are provided. Some of these aspects are addressed via the e-learning platform, which is now publicly available to all banks.

The country is striving to promote green financial flows, especially through the Climate Change Act (accompanied by a **Climate Change Fund**) and **Kenya's Green Bonds program**. Kenya has not yet launched green finance guidelines covering the operations of the entire financial market. A draft Green Bond Guidelines background document have been developed.

Overall Results



Good Practice

- The Sustainable Finance Initiative (SFI) Guiding Principles were developed by Kenya Bankers Association (KBA), with the active participation of 12 Kenyan banks and the endorsement of the Kenyan Central Bank.
- The Principles cover all extra-financial aspects, including governance. This is good practice among SBN members as most of policies and principles focus primarily on E&S topics.
- A dedicated website and an e-learning platform have been developed to raise awareness of sustainable banking practices in the financial sector. 80 percent of bank employees have been trained using this tool.
- The financial sector and government authorities are involved in the development of green finance through the Climate Change Act, Kenya's Green Bond program and the Kenya Green Bond Guidelines Background Document.

Areas for Improvement

- The SFI Guiding Principles could be further strengthened by providing financial institutions (FIs) with technical guidance and skills to help them implement the Principles. The technical training currently in an e-learning platform, could be scaled up to achieve broader dissemination.
- The Principles do not make reference to climate change and do not require FIs to formalize a climate risk management plan.
- Green finance is not defined, nor mentioned, in the Guiding Principles.

CONTEXT:

3. Enabling Environment

Country Profile

Kenya has been classified as a lower middle income country since 2014. Agriculture remains the major component of Kenya's economy, contributing to around a quarter of Gross Domestic Product (GDP). In addition, tourism holds a significant place in Kenya's economy. The country is also home to booming high-tech and service industries, with promising young companies. The lack of infrastructure continues to hamper the country's efforts to improve its economic growth, which could help to reduce poverty and unemployment.

Environmental sustainability is a long-acknowledged challenge in Kenya, as those living below the poverty line rely mainly on water and soil that is close to their community. With only eight percent of arable land, farmers face pressing issues of soil erosion, water pollution and desertification. Other ESG issues relate to corruption, rising violence among the poorest communities of the Kenyan population and challenges brought about by a booming manufacturing sector.

Kenya is highly exposed to climate change and is striving to act on this: the country released the **Climate Change Act** in May 2016 and ratified the Paris Agreement in December 2016. The outcomes of the Kenya's Climate Change Act will include, among other things, providing incentives and obligations for private sector contributions towards achieving low carbon, climate resilient development, mobilizing and transparently managing public and other financial resources for climate change responses, and a Climate Change Fund that will provide long-term finance to project developers. In 2017, Kenya launched its Green Economy Strategy and Implementation Plan (GESIP).

With regard to the banking industry, Kenya has a low concentration. The sector benefits from strong growth potential but is facing a lack of confidence from customers, and an increase in non-performing loans.

Background and Strategy of the Sustainable Banking Framework

Regulators have worked for many years on corporate governance which is perceived as a major issue. In the 1990s, the Private Sector Initiative for Corporate Governance launched the **Code for Corporate Governance** (the Code). This Code was at first neither prescriptive nor mandatory but, in 2002, the Capital Markets Authority (CMA) required all listed companies to comply with this Code. The 2015 **Companies Act** places full responsibility on corporate boards to take their fiduciary roles seriously, and contains punitive penalties for those who don't.

The sustainable banking journey, which integrates all extra-financial risks and opportunities (governance, but also E&S) into banking activities, was initiated by the financial industry itself. The Kenya Bankers Association (KBA), which includes 47 active banks (commercial banks, microfinance institutions, insurers, investment banks and asset managers), set up a Sustainability Agenda in 2012, and launched the Sustainable Finance Initiative (SFI) in 2013. The SFI, which includes 12 banks, has worked from the very start to define sustainability finance concepts, to set priorities and to build capacity.

In 2015, the SFI published its **Guiding Principles**, which are meant to guide banks in the implementation and adoption of sustainable practices in day-to-day banking operations. The Principles deal with five main topics:

- Financial Returns versus Economic Viability
- Growth through Inclusivity and Innovation
- Managing and Mitigating Associated Risks
- Resource Scarcity and Choice
- Business Ethics & Values

The Principles include case studies, best practice standards, as well as a local and regional context description. Most of these resources are available on the SFI's website. Even though the Principles are not mandatory, the KBA have implemented a dedicated e-learning platform and organized training sessions. The Principles intend to raise awareness about sustainable banking practices. However, the medium-term ambition is to provide FIs with resources to help them implement these Principles.

Support from Regulators

The Central Bank of Kenya (CBK) supported the release of the SFI Guiding Principles, but the development of the sustainable banking framework was primarily driven by the banking association.

The National Treasury has sponsored a 2017 Cabinet Paper on Green Finance.

RISK:

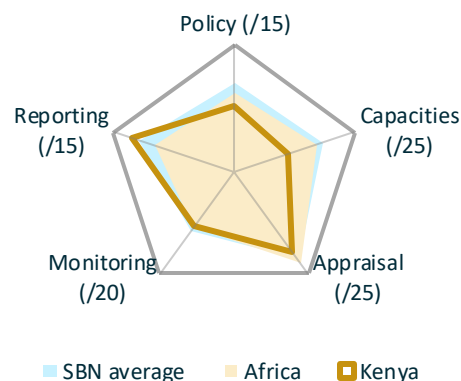
4. Environmental and Social Risk Management

The Kenyan banking sector is mainly comprised of 43 commercial banks (3 public, 25 locally owned and 15 foreign-owned) and 9 micro-finance institutions. The application of the SFI Guiding Principles is not mandatory, and the number of FIs implementing them is therefore not monitored. As of now, all areas for a sound sustainable banking framework are covered. However, in order to be more comprehensive, the Guiding Principles could provide more detailed guidance to help FIs develop their own frameworks with regard to their specific financing activities. As a priority, such guidance could focus on designing a policy (including on climate change), setting up a proper governance structure and evaluating/monitoring E&S risk exposure (at both project and portfolio levels).

The first objective of the framework is to raise awareness amongst FIs about sustainable practices. The Kenya Bankers Association has created an e-learning platform to train bank employees on sustainable principles and standards, local and regional ESG management, and good practice. Even though no formal reporting has yet been performed, it is estimated that 80 percent of Kenyan bank employees have been trained using this platform.

KBA is also quite active in engaging the Kenyan banking network via annual meetings, quarterly newsletters to banks, the promotion of the association in the national press, etc.

The SFI is planning to provide FIs with resources to help them implement the Principles. Some FIs are already developing sustainable practices: 6 Kenyan FIs have signed the UN Global Compact and the Nairobi Securities Exchange has joined the Sustainable Stock Exchange Initiative. In addition, several multinational banks operating in Kenya are signatories of the Equator Principles.



| Subpillars | Comments on good practice and areas for improvement |
|------------|---|
| Policy | <ul style="list-style-type: none"> - The Guiding Principles state that FIs should “<i>seek to mitigate social and environmental risks associated with their financing activities through client engagement and effective policies and risk assessment procedures</i>”. - The Principles could be strengthened by providing more detailed guidance to help all types of FIs implement them, depending on financing activity. FIs could also be required to formalize a climate risk management policy or develop a climate strategy aligned with Kenya’s climate commitment. |
| Capacities | <ul style="list-style-type: none"> - The Guiding Principles state that management should “<i>dedicate a resource person(s) to manage and mitigate risks</i>”. - The implementation of the Principles could benefit from SFI’s intensive training resources, in order to highlight the importance of training for people involved in the application of sustainable practices and environmental and social risk management (ESRM). This could also be used to define the roles, responsibilities and competencies needed. |
| Appraisal | <ul style="list-style-type: none"> - The Principles state that FIs should establish an ESRM system and categorize projects according to their level of ESG risk. - Requiring FIs to incorporate E&S provisions and investments conditions into their legal agreements would reinforce the E&S risk assessment process. |
| Monitoring | <ul style="list-style-type: none"> - The Principles state that FIs should “<i>develop an internal monitoring system to monitor commercial clients’ associated risks over time</i>”. - The process could be strengthened by including periodic portfolio reviews (including on climate risk exposure) and by requiring regular onsite visits of high-risk projects. |
| Reporting | <ul style="list-style-type: none"> - The Principles require FIs to report on their own footprint but they could also encourage the adoption of relevant good industry practice on the reporting of ESG risks. |

OPPORTUNITY:

5. Green Finance Flows

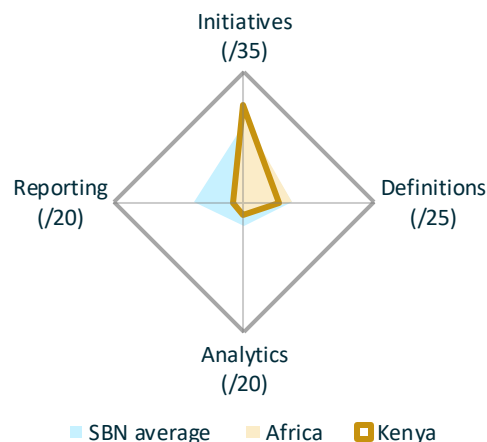
As of now, the existing Principles promote investments benefiting society (especially job creation, efficiency and service delivery) but do not set requirements or standards regarding the development of green finance flows. On the opportunity side, the Principles could be enhanced by providing a common definition of green assets/products, by requiring data collection on green finance flows, and by making FIs disclose their performance and impact.

That said, the Principles are complemented by notable initiatives that promote green finance flows. Firstly, the Kenyan government is determined to turn the country into a greener economy: in 2016, Kenya's Climate Change Act became law. This Act includes the creation of a **Climate Change Fund (CCF)** that will provide finance to project developers. Kenyan banks, as sources of climate finance, are expected to play a key role in supporting the transition to a low-carbon economy. The action plan will use the CCF to provide concessional credit lines for banks to lend on to firms on favorable terms. Hence, this will create an incentive for Kenyan banks to adopt sustainable finance, in order to access finance from the CCF, and from development finance institutions (DFIs), at preferential interest rates. In 2017, the government also launched its Green Economy Strategy and Implementation Plan (GESIP), which identifies specific areas and projects that require national and private sector finance.

Another noteworthy initiative is the launch in 2016 of the Sustainable Finance Catalyst Awards by KBA. Celebrating institutions that have a direct impact on the financial industry, the economy and society at large. For the 2017 edition, KBA decided to recognize "*exceptional institutions that have embedded Sustainable Finance Practices in their operations*".

The promotion of green finance is also triggered by the Green Climate Fund (GCF, supported by the national Treasury, and for which 2 banks are in line to receive GCF accreditation) and the presence of more than 10 DFI's on the Kenyan market.

Finally, the Kenya Bankers' Association, Nairobi Securities Exchange, Climate Bonds Initiative and Financial Sector Deepening Africa launched in March 2017 **Kenya's Green Bond program**, in conjunction with Netherlands Development Finance Company (FMO) and the International Finance Corporation (IFC). To date, no green bonds have yet been issued.



| Subpillars | Comments on good practice and areas for improvement |
|-------------|--|
| Initiatives | <ul style="list-style-type: none"> - The SFI Guiding Principles require FIs to develop business development strategies that seek benefits to the society. There are also policy-led (Climate Change Act) as well as voluntary initiatives (Kenya's Green Bond program and the 2017 edition of KBA's Sustainable Finance Catalyst Awards) that are helping to mobilize green finance flows and encourage innovation. - The Climate Change Act has stipulated that incentives will be granted to climate change initiatives, without yet establishing detailed criteria. |
| Definitions | <ul style="list-style-type: none"> - There are currently no requirements in terms of defining green finance/green assets. The KBA could take the initiative to set the criteria for green asset issuance. |
| Analytics | <ul style="list-style-type: none"> - There are currently no requirements in terms of environmental benefit calculation and monitoring. |
| Reporting | <ul style="list-style-type: none"> - There are currently no requirements in terms of green finance flow reporting and public disclosure. Guidelines encouraging reporting and public disclosure in a consistent manner regarding banks' green finance performance could positively impact the development of green finance flows. |