KENYA BANKERS
ASSOCIATION

Landscape of Sustainable Finance in Kenya's Banking Industry

WWF
KENYA

2024

economic.
social.
environment.
Sustainable
Finance Initiative

About SFI

The Kenya banking industry in March 2015 adopted the KBA Sustainable Finance Initiative (SFI) Guiding Principles that guide the banks in balancing their business goals with the economy's development priorities and socio-environmental concerns. The SFI Principles that were officially launched by former Central Bank of Kenya Governor Dr. Patrick Njoroge on 1st December 2015 are grounded in three main priorities, namely equipping the financial services sector to perform optimally in the area of comprehensive risk management; enhancing business practice, leadership and governance; and promoting industry growth and development by fostering a culture of innovation and inclusivity enabled by new technology. The Principles draw from and harmonize several global best practice standards, including the Equator Principles, IFC Performance Standards, Nigerian Sustainable Banking Principles, African Development Bank (AfDB) Green Growth Policy, Global Reporting Initiative (GRI) Reporting Guidelines, UNEP Finance Initiative (UNEP-FI) Guidelines, UN Global Compact Principles, ISO 26000:2010, and Kenya's National Climate Change Policy (draft). Since 2016, KBA has actively built capacity of banks to entrench the SFI Guiding Principles through its e-learning platform. Over 50 thousand bank staff have been reached with the training.

About ASI

The WWF-Kenya Africa Sustainable Investment and Infrastructure Programme (ASI) is a regional programme implemented in three countries of Africa (Tanzania, Kenya, and Madagascar) and China, that seeks to promote sustainable investment in the development of sustainable infrastructure in sub-Saharan Africa. The programme works with local civil society partners to lobby regional institutions, national governments, private companies, and financial institutions in Africa to develop, adopt, and implement legislations, policies, and plans required to shift finance and infrastructure development on a sustainable path. ASI adopts a top-down approach to influence legislations, policies, and plans that will drive sustainable finance and infrastructure, and a bottom-up approach to pilot Nature-based solution (NBS) projects and monitor infrastructure projects to inform the design and implementation of new and existing legislations, policies, and plans.

Funders

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Norway

> **"The Kenya banking industry in March 2015 adopted the Kenya Bankers Association (KBA) Sustainable Finance Initiative (SFI) Guiding Principles to guide banks in balancing their business goals with the economy's development priorities and socio-environmental concerns."**

Abbreviations & Acronyms

AFDB	African Development Bank
ANDE	Aspen Network of Development Entrepreneurs
BMGF	Bill and Melinda Gates Foundation
CBK	Central Bank of Kenya
CBK	The Central Bank of Kenya
CBR	Central Bank Rate
CCM	Compliance Carbon Markets
CIF	Climate Investment Funds
CMA	Capital Markets Authority
CRRM	Climate Related Risk Management
EBA	European Banking Association
EHS	Environmental Health and Safety
EIB	The European Investment Bank
EP	Equator Principles
ESG	Environmental, social, and governance
FMO	The Dutch Entrepreneurial Development Bank
FSD	Financial Sector Deepening
GBP	Green Bond Principles
GBPK	Green Bonds Program Kenya
GCCA	Global Climate Change Alliance
GCF	Green Climate Fund
GEF	Green Environment Facility
GESIP	Green Economy Strategy and Implementation Plan
GFS TA	Government Finance Statistics technical assistance
GLP	Green Loan Principles
GOK	Government of the Republic of Kenya
GRI	Global Reporting Initiative
ICMA	International Capital Market Association
IFC	International Finance Corporation
IFC PS	The IFC Performance Standards on Environmental and Social Sustainability
ISSB	International Sustainability Standards Board
KBA	The Kenya Bankers Association
KCB	Kenya Commercial Bank
KEBS	Kenya Bureau of Standards
LSTA	Loan Syndications and Trading Association
LT-LEDS	Long-Term Low Emission Development Strategy
MFBs	Microfinance banks, MSMEs Micro, Small and Medium Enterprises
NCCAP	National Climate Change Action Plan
NDC	Nationally Determined Contribution
NSE	Nairobi Stock Exchange
PRI	Principles for Responsible Investment
SBG	Sustainability Bond Guidelines
SBP	Social Bond Principles
SFI	Sustainable Finance Initiative
SGBs	Small and Growing Businesses (SMEs)
SLBP	Sustainability-Linked Bond Principles
SLL	Safaricom Sustainability-Linked Loan
SLLP	Sustainability-Linked Loan Principles
SLP	Social Loan Principles
TCFD	Task Force on Climate-related Financial Disclosures
TNFD	Taskforce on Nature-related Financial Disclosures
UNCTAD	United Nations Conference on Trade and Development
UNEP FI	United Nations Environment Programme Financial Initiative
UNEP	United Nations Environment Programme
UNFCCC	United Nations Framework Convention on Climate Change
USD	United States Dollar
VCM	Voluntary Carbon Markets
WWF	World Wide Fund for Nature
CBI	Climate Bonds Initiative
SFI	Sustainable Finance Initiatives
IRF	Integrated reporting framework
SASB	Sustainability Accounting Standards Board

Foreword

IT GIVES ME GREAT PLEASURE to present to you the Landscape of Sustainable Finance in Kenya's Banking Industry Report. The Report captures the commendable traction made by the banking industry in embedding Sustainable Finance practices in lending and operations, outlines opportunities for policy intervention and emerging trends that will shape the sustainable finance landscape in Kenya.

As highlighted in the Report, financial institutions operate in a rapidly evolving environment, heightened by complex regulatory requirements. Ensuring maintenance of confidence , the institutions are increasingly embracing sustainable finance practices.

Since 2016, Kenya Bankers Association (KBA), through its Sustainable Finance Initiative has been at the forefront in building the capacity of financiers to operate optimally in the area of comprehensive risk management, while equipping them to drive inclusive green and sustainable growth. Through this proactive measure, KBA has made it possible for banks to seamlessly navigate a complex compliance environment and ensure trust is enhanced through the Initiative.

KBA is appreciative of WWF-Kenya's funding support that has made it possible to document the milestones and areas of intervention to further advance the Sustainable Finance agenda in Kenya's banking industry.

Inquiries and comments on the Report should be sent through sfi@kba.co.ke.

Raimond Molenje
Ag Chief Executive Officer
Kenya Bankers Association

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A Note from WWF-Kenya CEO

AS THE WORLD WIDE FUND for Nature-Kenya (WWF-Kenya), we are delighted to co-publish ***"The Sustainable Finance Landscape Report in Kenya's Banking Sector"*** with the Kenya Bankers Association (KBA). The report highlights the journey towards the integration of sustainable finance practices in Kenya's banking sector and recommends policy interventions to support and amplify the gains achieved so far. In the face of unprecedented environmental challenges, harmonising financial advancement and ecological stewardship remains crucial. This document testifies to the sector's commitment and progress towards supporting a prosperous, inclusive, and greener future.

Sustainable finance, as a holistic approach and catalyst critical in addressing the systemic risks posed by climate change, biodiversity loss, and social inequalities, fosters long-term economic stability and growth towards the achievement of Sustainable Development Goals. Kenya is endowed with rich natural resources, a dynamic entrepreneurial spirit, and a robust financial sector that provides a unique platform to champion sustainability. However, with these opportunities come significant responsibilities to adopt an integrated approach that aligns economic activities with the sustainable development agenda. At WWF, we believe that sustainable finance can connect people, nature and economy.

To achieve these goals, it is imperative that we have a conducive and enabling policy environment that incentivizes the sector, promotes and safeguards sustainable practices while encouraging responsible production and consumption patterns. We are confident that we can achieve this goals with our partners working on a common vision.

The path to sustainable finance, however, comes with myriad challenges that call for a fundamental shift in mindsets, robust regulatory frameworks, capacity building, and continuous stakeholder engagement. Giving a futuristic view of the impact of financial markets, addressing information asymmetries that hinder the integration of environmental and societal factors in investment decisions, and encouraging the development of innovative financial instruments and mechanisms will offer opportunities to catalyse the sustainable finance sector. By integrating sustainability in systems and practices, the banking sector can enhance their competitiveness, reduce risk, attract more investments, and contribute to the national and global sustainability agenda.

A conducive environment for sustainable finance is only possible with a multi-sectoral approach that makes it possible for the public, private and civil society, in both finance and sustainability agenda, to partner. Education and awareness creation also remain critical in empowering individuals and organizations to make informed decisions that align with sustainability principles.

WWF-Kenya will continue to collaborate with KBA and other financial sector actors to advance sustainable finance, supporting Kenya's commitment to a resilient and inclusive financial sector. We believe that a future of financial prosperity grounded in sustainability will create a safe legacy that we can all be proud of.

Mohamed Awer

Chief Executive Officer WWF-Kenya

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Executive Summary

The KBA's Sustainable Finance Initiative (SFI) defines sustainable finance as financial flows that create long-term value for the environment, society, and the economy. It also takes into consideration responsible utilization of capital in order to also deliver value to shareholders. Global trends indicate that investment in sustainable businesses is on the rise, driven by market demand and customer preferences.

As primary providers of finance, banks have a key role in driving the transition towards a sustainable future in a low-carbon regime. The banking industry in Kenya has made strides in aligning the banking business with the global trends in sustainability but more needs to be done to improve transparency, address greenwashing, facilitate capital mobilisation and empower market participants to identify and invest in sustainable assets.

The study of landscape of sustainable finance in Kenya's banking industry is motivated by the need to establish the state of play in sustainable finance. The study aimed to explore the level of adoption and integration of Environmental, Social and Governance (ESG) considerations into financial services. Key objective of the study is to lay an overview of sustainable finance in the banking industry, assess the policies, strategies and legal framework in place and establish how they are supporting or hindering sustainability, and document the existing opportunities to steer the financial sector towards integrating sustainable finance principles into business operations.

The study employs a combination of approaches and methodologies including literature review, case studies, and surveys. Whereas this report presents comprehensive information on the status of sustainable finance in the banking industry, there remains significant data limitations and gaps due to lack of a central database that can provide comprehensive sustainable finance data. A significant number of banks do not publish integrated sustainability reports and those that publish apply different standards that make comparability difficult.

"As primary providers of finance, banks have a key role in driving the transition towards a sustainable future in a low-carbon regime."

State of Sustainable Finance in Kenya

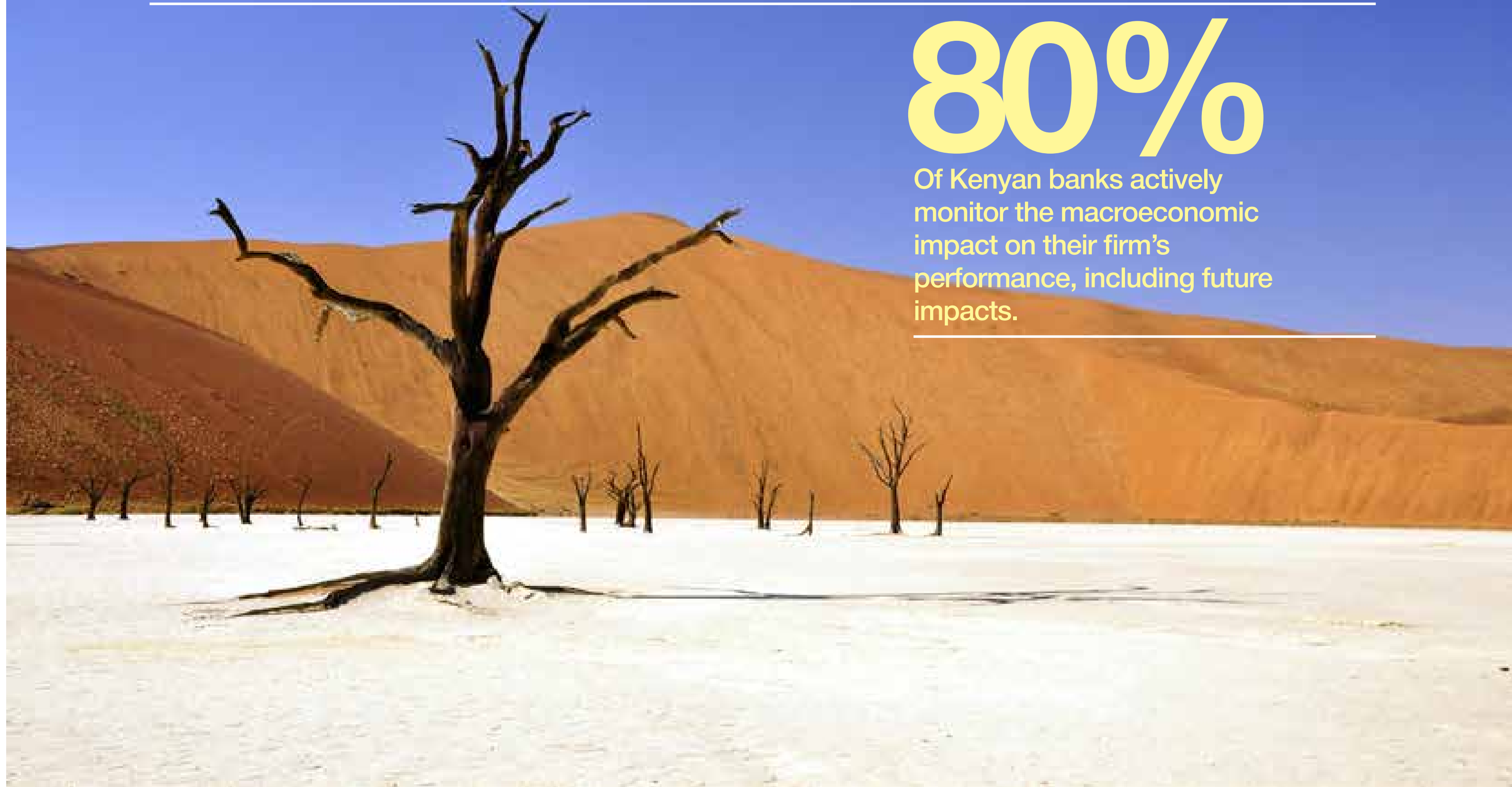
The study finds that Kenya's socio-economic landscape, as depicted by various global indices, presents a challenging yet opportune canvas for sustainable finance. The indices highlight the pressing issues facing Kenya such as severe hunger, biodiversity loss, stark inequality, vulnerability to climate change, and an urgent need for green growth. The challenges present the country with opportunity for greater commitment to sustainable finance for survival and progress.

The National Climate Change Action Plan (NCCAP) which sets out to advance the attainment of the country's sustainable, climate resilient growth goals estimates te annual funding requirement at a KES 844 billion . While the total gross loans from banks across 11 key sectors was KES 3.6 trillion as at end 2022, the value of the micro, small and medium enterprises (MSMEs) loan portfolio was KES 783.3 billion, reflecting a growth of 23% from 2020. The growth mirrors a robust expansion in access to finance for MSMEs within the banking sector and a positive signal for sustainable finance efforts, as MSMEs are pivotal in driving economic growth, innovation, and job creation.

The banking industry in Kenya has made advances in adopting sustainable reporting standards and guidelines. A KBA survey of banks in December 2023, indicates the following.The survey identifies barriers to, and opportunities arising from, alignment to sustainability goals. Double reporting for listed banks poses a challenge and point to the need for standardisation. Further, green and sustainability linked bonds issuance costs are high, disincentivising issuers.

Amidst the challenges are opportunities across the various sectors that are compelling across various sectors in which the banking industry is actively involved. Increased funding to agriculture, energy and energy efficiency, and water that is underpinned by sustainability principles could yield significant sustainable growth benefits. So does lending to manufacturing, trade, and real estate sectors.

93% of the surveyed banks are committed to supporting the attainment of the Sustainable Development Goals (SDGs) in Kenya



80% Of Kenyan banks actively monitor the macroeconomic impact on their firm's performance, including future impacts.

100%

All banks factor in economic viability in their credit analysis and decision-making process

87%

Indicated that their credit policy ensures responsible and sustainable lending that promotes Kenya's sustainable economic development.

67%

All the banks surveyed actively engage in supporting minority groups, including persons with disabilities, women, youth, and indigenous communities, with the aim of fostering their economic inclusion.

Recommendations

The study makes key recommendations, including:

- Banks should lead the way as market makers in issuing, and facilitating issuance of, market instruments and mobilising private sector capital to ESG priorities.
- There is a need for a robust approach to developing policy and regulatory frameworks to ensure alignment to the evolving financial landscapes. Policies and regulatory frameworks should be transitional in nature to allow for sufficient time for implementation.
- The industry needs to move towards standardisation and convergence of sustainability reporting. Mandatory adoption for agreed upon standards should be pursued to create uniformity and enhance consistency and comparability in ESG disclosures.
- All banks should align their portfolios, businesses, and strategies with the SFI Guiding Principles, as well as the Paris Agreement. Alignment can help banks secure opportunities created by the low carbon transition in the country as laid out in the key policy documents, laws, and sectoral plans.
- Data collection and management remains a hindrance to quality reporting. Banks should collect, analyse and report on various sectors' data points to demonstrate alignment to sustainability principles.
- To sustain disclosure of quality data, banks need to invest in better systems, raise awareness internally and within their client base, build capacities and expertise in sustainable finance and set-up procedures and tools for reporting.
- It is imperative to match the progress made in adopting sustainability reporting with development of innovative and diversified sustainable finance products and services. This way banks will grow the green portfolios, facilitate capital mobilisation, empower market participants to invest in sustainable assets and enhance brand reputation.
- Advocate for consistent tax incentives for sustainable investments for funding the transition to a sustainable economy such as zero or reduced VAT rates for certain green products and service offered by banks and enhanced tax deductions for Research and Development, and innovation expenditure.

Chapter 1

Introduction

Background to the Study

FINANCE IS AN IMPORTANT economic driver. A well-functioning financial system enables a strong environment which ultimately impacts nature through production and consumption. According to KBA's Sustainable Finance Initiative (SFI) , Sustainable finance is realised when financial flows create long-term value for the environment, society, and the economy. It takes into consideration responsible utilization of capital in order to also deliver value to shareholders.

Global trends indicate that investment in sustainable businesses is on the rise, driven by market demand and customer preferences. The United Nations Conference on Trade and Development (UNCTAD) estimated the global sustainable market value in 2022 to be USD5.8 trillion[1] . The market has recorded noticeable increase in green bonds and sustainable debt instruments that are key in funding renewable energy , infrastructure, and conservation efforts.

As primary providers of finance, banks have a key role in driving the transition towards a more sustainable future and support the transition to a low-carbon economy. It is increasingly becoming critical for the financial sector to integrate sustainability in its decision making. The concept of sustainable investment has gained traction across the globe partly contributed by the push for integration of Environmental, Social and Governance (ESG) considerations into investment strategies by financial institutions as well as investors. Formulation of and deployment of voluntary and mandatory sustainable finance guidelines have helped financial institutions better appreciate sustainable banking[2].

The banking industry in Kenya has made strides in aligning business practices with the global trends in sustainability, in pursuit of resilience and competitiveness. The study of landscape of sustainable finance in Kenya's banking industry is therefore motivated by the need to establish the state of play in sustainable finance.

Study Objective

The study seeks to provide an overview of sustainable finance in the banking industry, assess the policies, strategies and legal framework in place and document the existing opportunities to steer the financial sector in adopting and integrating sustainable finance principles. The study report paints a picture of progress in in sustainable finance in the country, highlighting areas of opportunity as well as policy interventions necessary for scaling up and mainstreaming sustainability practices.

Methodology and Approach

The study employed a systematic approach that encompasses literature review, case studies and surveys. Arising there from are comprehensive insights into sustainable finance in Kenya's banking industry.

Literature Review: The literature review involved the scrutiny of selected reports and publications on sustainable finance for the last 5 years. The review is organized in themes with key insights and lessons summarized.

Case Studies: This involved a review of case studies selected from the KBA Sustainable Finance Initiative program. The review identified best practices in sustainable finance. Regional and continental experiences are considered, contributing to a summary report that captured essential insights and lessons.

Survey: A survey seeking to establish a baseline on adoption and implementation of sustainable finance initiative (SFI) guiding principles administered on all banks by KBA. The data gathered is analysed to inform the findings of the study.

[1]UNCTAD, 2023.*World Investment Report 2023-Investing in sustainable energy for all.*

[2]*KBA, 2020. Report on the State of Sustainable Finance in Kenya's Banking Industry*

Interviews: Utilizing both purposive sampling and snowballing, the study selected interviewees from a predefined list of institutions. An interview guide, shaped by literature and case study reviews, was utilized to gather information from key industry stakeholders. The data collected is analysed to produces a summary of key insights and lessons learned from each interviewee.

A combination of the above approaches and methodologies provide a comprehensive understanding of the state of sustainable finance in the Kenya's banking industry.

Data Gaps and Limitations

Whereas this report presents comprehensive information on the status of sustainable finance in Kenya's banking industry, there remains significant data limitations and gaps. This is mainly because there is no central database maintained within the industry that can provide detailed sustainable finance or ESG data. A significant number of banks as indicated in the findings do not publish integrated or separate sustainability reports. In addition, the banks that publish these reports do not follow the same sustainable finance reporting standards and guidelines, therefore creating a challenge in comparability.

A significant number of banks as indicated in the findings do not publish integrated or separate sustainability reports.

Chapter 2

State of Sustainable Finance in Kenya's Banking Industry

STATE OF SUSTAINABLE FINANCE

Kenya's socio-economic and environmental landscape as depicted by various global indices presents a challenging yet opportune canvas for sustainable finance. The 2023 Global Hunger Index (GHI) assigns Kenya a score of 22.0, indicating a "serious" level of hunger across the nation. This is in addition to the World Inequality Lab's Inequality Index for 2022 , where Kenya's score of 64.9 points to a significant degree of inequality.

Further emphasizing the urgency of the situation is the Notre Dame Global Adaptation Initiative (ND-GAIN) Index , which in 2021 ranked Kenya 152nd out of 181 countries, categorizing it as "extremely vulnerable" to climate hazards and other related challenges. The Global Green Growth Institute's (GGGI, 2022) National Green Growth Index , a recent development specific to Kenya, places the country 15th out of 20 African nations with an overall score of 47.08, denoting a moderate performance in green growth.

These indices collectively highlight the pressing issues facing Kenya: severe hunger, biodiversity loss, stark inequality, vulnerability to climate change, and an urgent need for green growth. Confronted with these challenges, Kenya's commitment to sustainable finance becomes not just a choice, but a necessity for survival and progress.

Sustainable finance, which integrates environmental, social, and governance (ESG) considerations into financial decision-making, emerges as a critical tool in navigating the complexities of climate change, rising inequality, and resource scarcity. It forms the bedrock of Kenya's strategy to achieve its ambitious development goals as outlined in its Vision 2030. This blueprint for inclusive and sustainable growth recognizes that traditional financial practices, if left unchecked, may exacerbate environmental degradation, social conflict, and widen the inequality gap.

Within this context, the banking sector in Kenya assumes a pivotal role. As the primary conduit for financial resources, banks are strategically positioned to steer capital towards investments that are not only economically viable but also socially responsible and environmentally sustainable. This includes funding for renewable energy s, green infrastructure, circular economy initiatives, and social development initiatives.

The Integration of Sustainable Finance

To delve into the intersection of sustainable growth and financial mechanisms in Kenya, particularly focusing on the banking sector, it is imperative to explore three key dimensions that influences the outlook of sustainable finance within Kenya's banking industry :

Demand for Sustainable Finance in Kenya: This aspect centres on the National Climate Change Action Plan (NCCAP) 2023-2027, which delineates the financial requirements for achieving sustainable growth across multiple sectors. The NCCAP serves as a blueprint, highlighting the monetary commitments necessary to implement sustainable initiatives and address environmental challenges effectively.

Entrepreneurship and Access to Finance: In Kenya, a burgeoning middle class and expanding domestic markets have sparked a surge in youth entrepreneurship. With over 80% of the population under 35 , a significant shift is occurring from traditional job-seeking to job-creation. This change is driven by limited formal employment opportunities and the rise of domestic markets, leading to a growing trend of entrepreneurship as a viable livelihood. As of 2020, the Kenya National Bureau of Statistics (KNBS) reported approximately 1.5 million formally registered Micro, Small and Medium Enterprises

[3]GHI 2023, Kenya:
https://www.globalhungerindex.org/kenya.html#:~:text=In%20the%202023%20Global%20Hunger,of%20hunger%20that%20is%20serious
[4] See https://wir2022.wid.world/
[5]Notre Dame Global Adaptation Initiative: https://gain.nd.edu/our-work/country-index/
[6] GGGI 2022 Green Growth Index: https://greengrowthindex.gggi.org/wp-content/uploads/2023/02/2022-Green-Growth-Index-1.pdf

(MSMEs). Kenya has an estimated 1.5 million formally registered MSMEs and over 5 million informal MSMEs. According to the USAID, these enterprises collectively generate 30 percent of the GDP and provide non-agricultural employment . These enterprises range from high-growth ventures, which are attractive to impact investors, to businesses sustaining livelihoods. Evaluating the interaction between the banking sector and MSMEs is crucial, as it sheds light on the level of financial support and services provided to these burgeoning enterprises, which are instrumental in driving the country's sustainable economic growth.

Innovation in Sustainable Finance: The landscape of sustainable finance is continuously evolving, with new products and services emerging to meet the challenges of sustainable growth. It is critical to assess how banks are innovating within this space. This involves examining the development and implementation of novel financial products and services designed to support sustainable initiatives, thereby contributing to the broader goals of environmental conservation, social development, and economic growth.

The three pillars – the demand for sustainable finance as outlined by national plans, the burgeoning entrepreneurship landscape with its unique financial needs, and the imperative for innovation in financial products and services – collectively provide a framework to understand and evaluate the role and effectiveness of Kenya's banking industry in advancing the nation's sustainable development objectives.

[7]NCPBD 2021, Youth Bulge in Kenya: https://ncpd.go.ke/wp-content/uploads/2021/02/Brief-56-YOUTH-BULGE-IN-KENYA-A-BLEESING-OF-A-CURSE.pdf
[8]Kenya Small Business Development Centres Fact Sheet: https://www.usaid.gov/sites/default/files/2023-05/Kenya%20Small%20Business%20Development%20Centers%20%20Fact%20Sheet.pdf

The demand for Sustainable Finance in Kenya

Launched in September 2023, the National Climate Change Action Plan (NCCAP) 2023-2027 charts Kenya's course towards a low-carbon, climate-resilient future. This ambitious plan, with its focus on governance, resource management, adaptation, mitigation, and sustainable growth, hinges on effective resource mobilization. In this context, the banking sector in Kenya plays a pivotal role, with its endeavours in sustainable finance serving as a critical complement to these efforts.

This analysis dives deep into the budgetary allocations for NCCAP's priority actions, dissecting them alongside the volume of credit available for environmental and social goals from Kenyan banks. By examining this financial landscape, we uncover the alignment between NCCAP's goals and the banking sector's resources, assessing whether funding matches ambition and ultimately, paving the way for a future where environmental and social sustainability and economic prosperity go together.

The Kenyan government's indicative budget for priority sustainable growth goals across nine key areas of focus as outlined in Table 1, is approximately KES 844 billion annually. These sectors include Disaster Risk Management, Food and Nutrition Security, Water, Fisheries, and the Blue Economy, among others. In comparison, the total gross loans extended by Kenyan banks across 11 key sectors reached KES 3.6 trillion in FY 2022, as detailed in Table 3. While these figures illustrate a substantial financial commitment from both the government and the banking industry, it is important to recognize the need for a more targeted alignment of the banking sector's lending practices with the government's sustainable growth priorities. Despite the significant sum of gross loans, a deeper look into the distribution across sectors suggests potential areas for enhanced support in sustainability and climate-positive initiatives.

STATE OF SUSTAINABLE FINANCE

Table 1: Indicative Budget Allocations for Priority climate action areas 2023-2027

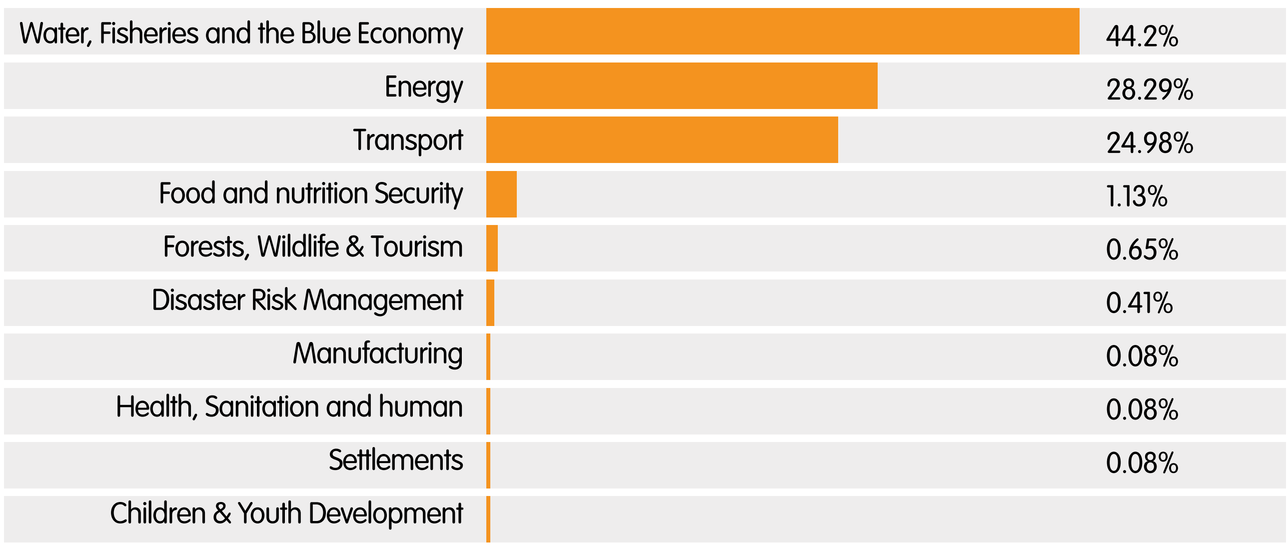
Priority Climate Change Action Area	5-year Estimates (Billions KES)	Annual Estimates (Billion KES)	Percentage (%)
Water, Fisheries & the Blue Economy	1,867.60	373.52	44.22
Energy [a]	1,194.90	238.98	28.29
Transport [b]	1,055.15	211.03	24.98
Food and Nutrition Security	47.83	9.57	1.13
Forests, Wildlife & Tourism	27.65	5.53	0.65
Disaster Risk Management	17.53	3.51	0.41
Manufacturing	3.43	0.69	0.08
Health, Sanitation & Human Settlements	3.42	0.68	0.08
Children & Youth Development	3.28	0.66	0.08
Total	4220.79	844.17	100%

Source: Author's compilation from the NCCAP 2023-2027

a. Figures in the Energy Sector are still pending confirmations and additional allocations.

b. Allocations within the Transport sector, amounting to USD 340.3 million, have been converted to Kenyan Shillings (KES) using the Central Bank of Kenya's (CBK) foreign exchange conversion rate as of February 16th, 2024, which is 1 USD = KES 145.855

Percentage of Indicative Budget Alllocations for Priority Climate Action Areas 2023-2027



Sectoral Distribution of Loans

The largest proportion of the banking industry gross loans and advances were channelled to the Personal and Household, Trade, Manufacturing and Real Estate Sectors. In total, these four economic sectors accounted for 72.57 percent of gross loans in December 2022, as indicated in Table below.

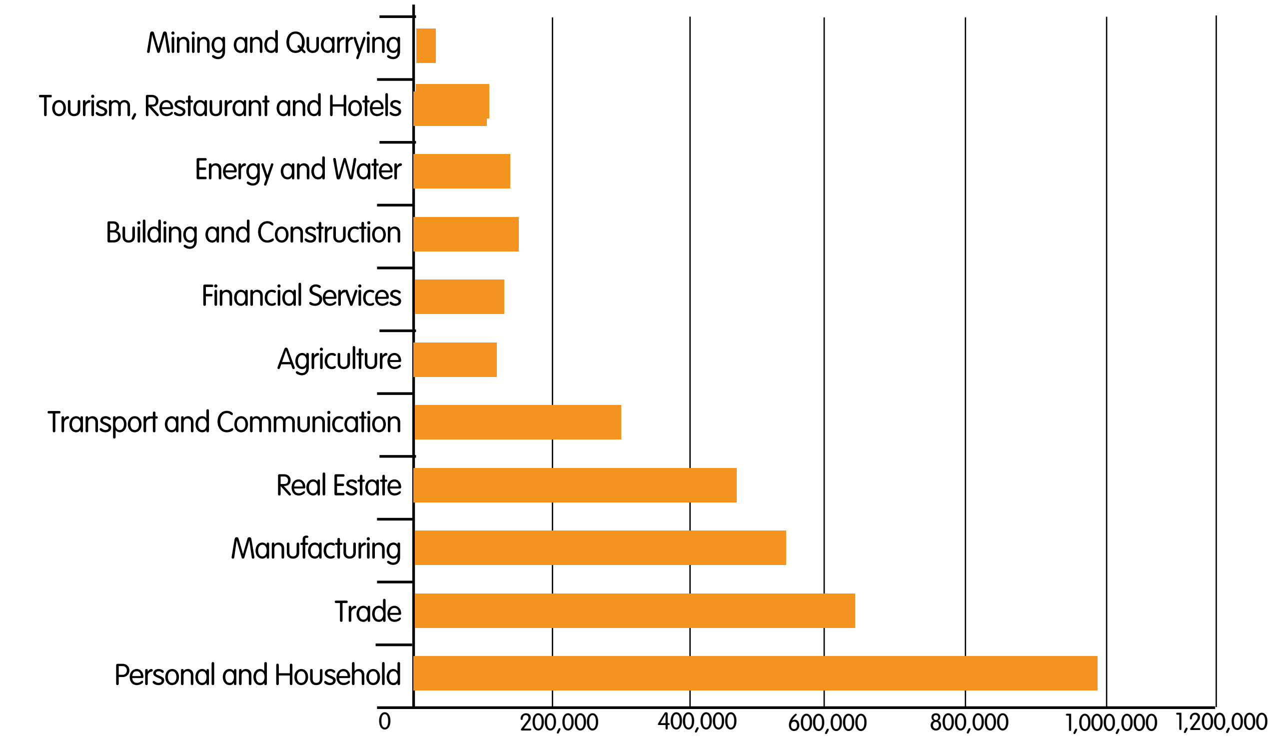
Table 2: Sectoral Distribution of Gross Loans as of December 2022.

Sector	Gross Loans (KES Million)	% of Total
Personal and Household	984116	27.1
Trade	652,574	18
Manufacturing	530,637.1	14.6
Real Estate	467,171.2	12.9
Transport and Communication	310,173.4	8.5
Agriculture	126,462.6	3.5
Financial Services	132,483.9	3.6
Building and Construction	144,795.7	4
Energy and Water	142,688.6	3.9
Tourism, Restaurant and Hotels	108,168.2	3
Mining and Quarrying	30,980.2	0.9
Total	3,630,251	100

Source: CBK, Bank Supervision Annual Report 2022.

STATE OF SUSTAINABLE FINANCE

Sectoral Distribution of Gross Loans (KES Million)



The Kenyan banking industry's loan distribution reflects a significant engagement with various sectors of the economy, some of which are directly linked to sustainable growth and climate action initiatives. For example:

- **Agriculture (KES 126.46 billion, 3.5% of total loans):** This sector is essential for food security and rural development. Investments in sustainable agricultural practices can contribute to climate resilience and reduce environmental impacts.
- **Manufacturing (KES 530.64 billion, 14.6%):** As a sector with a high potential for value addition to Kenya's agricultural produce and natural resources, Kenya's manufacturing sector holds high potential for sustainable growth by embracing a shift towards greener manufacturing processes and promotion of circular economy principles.
- **Energy and Water (KES 142.69 billion, 3.9%):** Investment in renewable energy sources and water conservation technologies is crucial for mitigating climate change and ensuring sustainable water management.
- **Transport and Communication (KES 310.17 billion, 8.5%):** Financing sustainable transport infrastructure such as mass transit systems, electric vehicles, and green logistics can substantially reduce greenhouse gas emissions while creating employment.
- **Real Estate (KES 467.17 billion, 12.9%):** The construction and operation of buildings have a substantial environmental footprint. Green building practices and energy-efficient designs can lead to more sustainable urban development. Investments in real estate can also provide affordable housing to Kenyans.
- **Tourism, Restaurant, and Hotels (KES 108.17 billion, 3.0%):** Ecotourism and sustainable hospitality practices can preserve natural resources and support conservation efforts while contributing to the sustainable livelihoods of local communities.

The sectors that align closely with the government's sustainable growth focus like **Agriculture, Energy and Water, and Transport and Communication** receive a notable but still limited portion of the total loans. For example, Agriculture, which is crucial for Food and Nutrition Security, receives only 3.5% of the total loans, while Energy and Water, pivotal for sustainable energy and water management, get 3.9%. This indicates room for growth in financing sustainable practices in these areas.

Furthermore, sectors like Manufacturing, Trade, and Real Estate, which collectively receive a substantial portion of the loans, could be pivotal in driving sustainable innovations. Banks can play a transformative role by encouraging and financing sustainable practices within these sectors, such as green manufacturing, sustainable trade solutions, and affordable eco-friendly real estate development.

Moreover, the banking industry's significant loan volume suggests it has the capacity to contribute meaningfully to closing the financing gap in sustainable growth and climate action. Banks could develop specific green finance products, invest in sustainable project financing, and collaborate with government initiatives to ensure that their financing aligns with national sustainability goals.

While the loan allocation to these sectors is a small fraction of the total lending, it is a starting point for assessing the banking sector's potential to drive sustainability. If banks were to increase their financing of green projects within these sectors, it could yield significant sustainable growth benefits. For instance, supporting agri-businesses to adopt climate-smart agricultural techniques or funding the development of eco-friendly manufacturing plants can promote sustainable growth.

Furthermore, by developing financial products and services specifically designed to support projects with sustainable and climate-positive outcomes, banks can play an initiative-taking role in closing the sustainability financing gap identified between the current loans and the indicative sustainable growth budget. Kenya's banking sector's financial commitment is substantial, strategically directing a greater portion of these funds towards environmentally and socially aligned outcomes can significantly impact sustainable growth in Kenya. By aligning more closely with the government's climate and sustainable growth priorities, banks can not only contribute to national and global sustainability goals but also tap into emerging markets for sustainable finance, potentially leading to new growth opportunities.

STATE OF SUSTAINABLE FINANCE

Product Innovation for Sustainable Growth

Product innovation for sustainable growth is not just a global trend, it is a necessity for the banking industry. With a rising sustainability-conscious population and government initiatives like NCCAP 2023-2027, Green Bonds Framework, Central Bank of Kenya's Guidance on Climate-Related Risk Management, and IFRS guidelines prioritizing climate action and sustainable growth, Kenya's banks face increasing pressure to offer sustainable products. This shift presents both challenges and opportunities. Adapting means managing risks like climate-related loan defaults, but also unlocking new markets like financing green infrastructure, sustainable manufacturing, and climate-smart agriculture. By innovating with products like green bonds, sustainability-linked loans, among other instruments, banks seek to meet customer demands and build brand loyalty, even as they contribute to the nation's sustainable growth objectives and position themselves for long-term success in a rapidly evolving landscape.

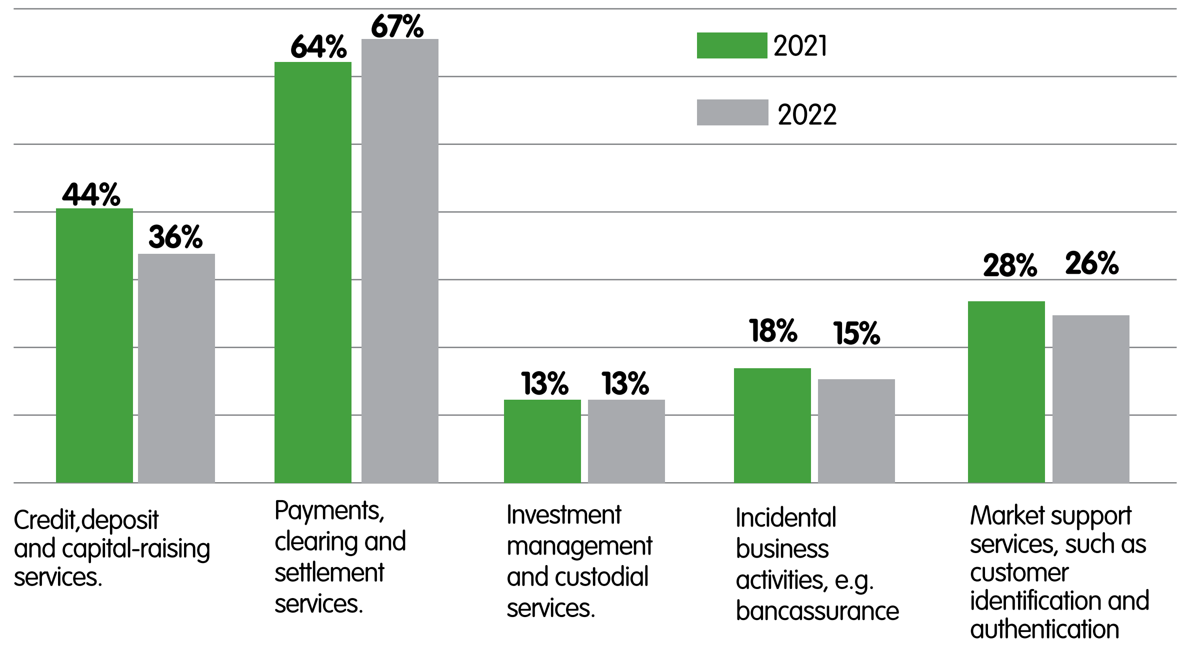


Figure 1: Innovative products by banks in Kenya.
Source: CBK, Bank Supervision Annual Report 2022.

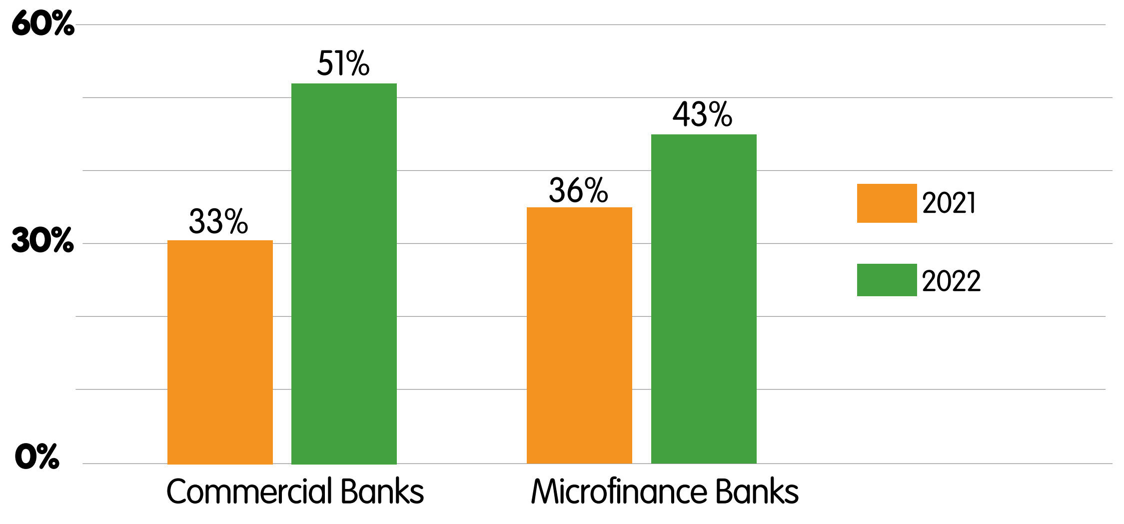
The recent survey by the CBK reveals a distinct focus among financial institutions on innovation within their services, highlighting varying priorities between commercial banks and Microfinance Banks (MFBs). According to the findings, 82% of commercial banks are channelling their innovation efforts towards payments, clearing, and settlement services. This contrasts with 71% of MFBs that share this focus. On the other hand, a 93% of MFBs are dedicated to enhancing credit, deposit, and capital-raising services, compared to 72% of commercial banks. This divergence in focus underscores a broader commitment to improving customer experience and advancing financial inclusivity.

However, the landscape of sustainable finance in Kenya calls for a more expansive approach to innovation, urging financial institutions to extend their priorities to incorporate the ESG criteria, green finance initiatives, social impact projects, and governance improvements.

Despite these pressing needs, the survey indicates that banks are making meaningful progress towards integrating innovation for sustainable growth and climate action. In 2022, 51% of commercial banks and 43% of microfinance banks reported innovations or ongoing projects related to climate change, marking an increase from 33% and 36%, respectively, in the previous year. These initiatives are crucial in addressing the emerging issue of climate change, with a focus on climate financing, lending for clean energy solutions, and the automation of services to minimize carbon footprints.

The shift towards climate-related innovations reflects an essential step towards aligning the banking sector's operational and strategic focus with the urgent need for environmental sustainability and climate resilience. As the sector continues to evolve, the integration of sustainable practices and green financing will play a pivotal role in fostering economic growth that is both inclusive and environmentally conscious.

Innovation in Climate Change Related Products by Financial Institutions in Kenya (2021 vs 2022)



Source: CBK, Bank Supervision Annual Report 2022.

Figure 2 presents a comparison of the percentage of commercial and microfinance banks in Kenya that have innovated or are in the process of innovating a climate change-related product in 2021 and 2022. This trend suggests a growing recognition within the Kenyan banking sector of the importance of addressing climate change through financial products and services. It reflects alignment with the broader global movement towards sustainable finance, where financial institutions are increasingly incorporating environmental and social considerations into their business models and investment decisions.

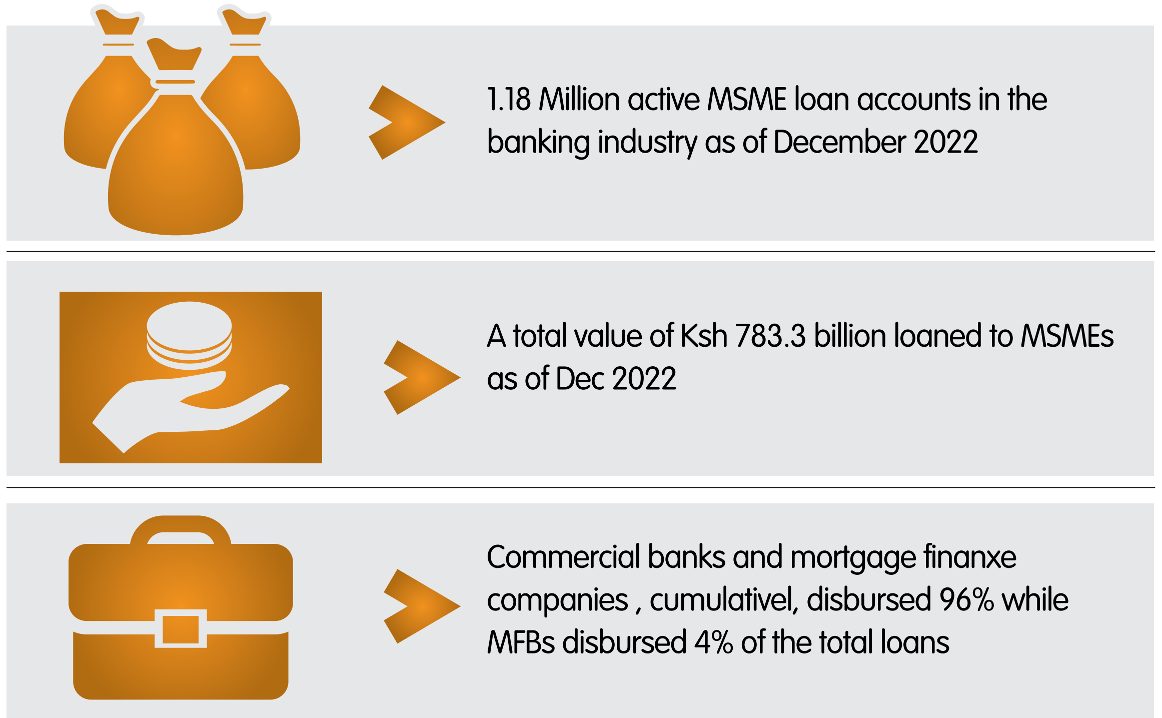
Micro, Small, and Medium Enterprises (MSMEs) and the Kenya's banking sector: *Towards enhancing access to finance.*

In Kenya, MSMEs are central to achieving Sustainable Development Goal 9, due to their significant contribution to the economy and social well-being, accounting for about 30% of the GDP and providing over 15 million jobs. Despite their crucial role, limited access to finance remains a major obstacle to their growth and potential to drive innovation and sustainable development. Enhancing financial inclusion for MSMEs is imperative to unlock their full potential, enabling them to scale up, create more jobs, and contribute to inclusive economic prosperity and improved living standards across the nation. By addressing these financial barriers, Kenya can achieve greater economic resilience and equitable development.

In fulfilment of its strategic goal to foster a robust and inclusive banking system, the CBK undertakes a biannual FinAccess Business Supply-Side Survey (FinAccess Business Survey). This survey examines the state of financing for MSMEs within the banking industry. By monitoring trends in the available financing modes and levels offered to MSMEs by commercial banks, mortgage finance institutions, and microfinance banks, the survey the primary impediments to MSME financing and the need to enact fitting policy interventions to address them.

The key findings of the FinAccess Business survey conducted as of December 2020 to assess the status of MSME financing in the Kenya's banking sector were as follows

The level of MSMEs financing in the Kenya's banking sector



- **>>** The cumulative value of the MSME loan portfolio as of December 2022 of Ksh.783.3 billion also increased by 23 percent from Ksh.638.3 billion reported in December 2020. The proportion of the MSME loan portfolio to the total banking sector loan book as of December 2022 stood at 21.3 percent compared to 20.9 percent as at the end of 2020.
- **>> *Implications:*** The increase in active MSME loan accounts and the corresponding growth in the total value of loans reflect a robust expansion in access to finance for MSMEs within the Kenyan banking sector. This growth is a positive signal for sustainable finance efforts, as MSMEs are often pivotal in driving economic growth, innovation, and job creation, which are crucial elements of sustainable development. By increasing lending to MSMEs, banks are not only facilitating the growth of small and medium-sized enterprises, which can contribute to a more dynamic and resilient economy, but they are also potentially supporting businesses that may have a direct impact on social and environmental outcomes. Moreover, most of the financing coming from commercial banks and mortgage finance companies suggests a strong potential for these institutions to further embed sustainability considerations into their lending practices.

MSMEs as a significant source of funding for Kenyan banks

MSME lending represent 24.4% of the total income generated from lending by the banking industry in 2022

MSME accounted for 14.9% and 59.5% of total customer deposits held in commercial banks and MFBs, respectively

Implications: The considerable increase in revenue generated from lending to MSMEs, along with their substantial contribution to bank deposits, underscores their critical role in the sustainability of the Kenyan banking sector. MSMEs not only bolster bank revenues, as evidenced by the growth from 12.2 percent to 24.4 percent of the total income from lending, but also provide a stable deposit base, especially for microfinance banks (MFBs), where they account for nearly 60 percent of deposits. This symbiotic relationship enhances financial stability and allows banks to reinvest in the community, furthering economic resilience and sustainability. Furthermore, as banks recognize the profitability of engaging with MSMEs, they may be more inclined to support and finance sustainable business practices, driving forward the sustainability agenda in alignment with the country's broader economic and environmental goals.

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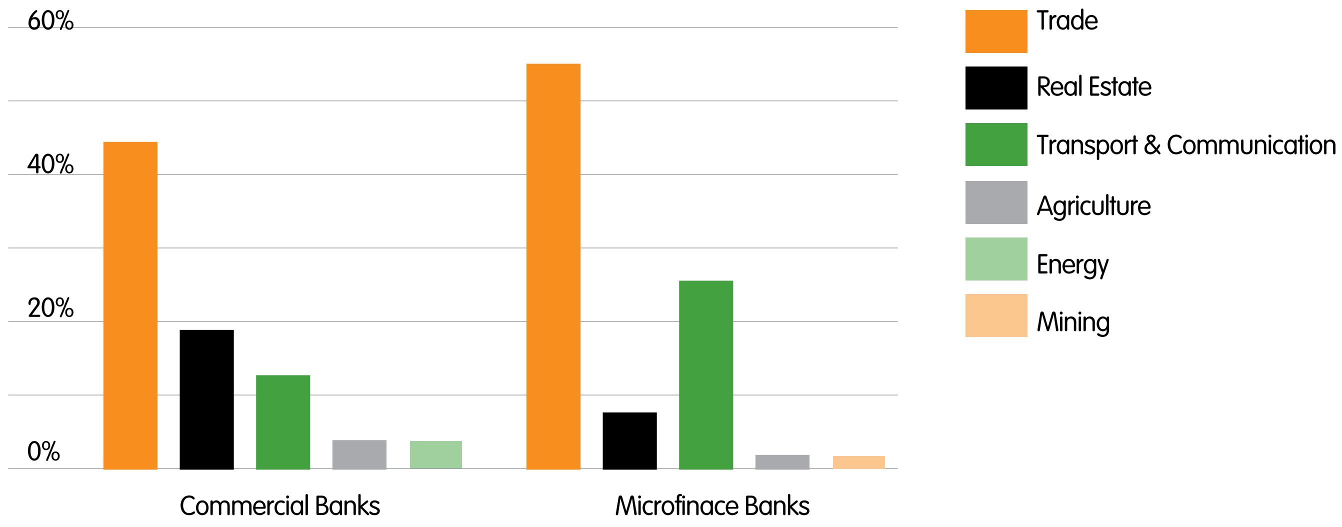
Financial Products for MSMEs

Implications: The diversification of financial products tailored for MSMEs across all categories micro, small, and medium indicates a strategic move by Kenyan banks to capture a broad spectrum of the business sector and address specific financial needs. With over half of commercial banks and a significant proportion of MFBs offering products for each MSME category, there is a clear recognition of the differentiated financial services required by enterprises of varying sizes. This targeted approach not only supports the growth and stability of MSMEs but also aligns with sustainable finance principles by fostering inclusive economic growth and potentially stimulating sustainable business practices. Such financial inclusivity can lead to a more resilient economy and promote a culture of entrepreneurship that is responsive to social and environmental needs, thereby contributing to the overall sustainable development objectives within the Kenyan banking industry.

Credit allocation to MSMEs by sector

In commercial banks, the largest credit allocation as of December 2022 was to MSMEs in the trade sector, followed closely by real estate, and transport and communication sector respectively. The agriculture, financial services sectors and mining had the lowest allocations. In microfinance banks, the largest proportion of the MSME loan portfolio was extended to the trade sector, followed distantly by transport and communication, and real estate sectors. Meanwhile, the energy and mining sectors had the lowest allocations.



Source: Author's compilation from 2022 FinAccess Business Survey Data.

Source: Author's compilation from 2022 FinAccess Business Survey Data.

Implications: The credit allocation patterns to MSMEs by sector in Kenyan banks highlight a pronounced emphasis on trade, real estate, and transport, with the trade sector receiving the lion's share of loans from both commercial and microfinance banks. This focus mirrors the pivotal role of trade in Kenya's economy and the significant demand for credit within this sector. However, the relatively low allocation to sectors like agriculture, energy, and mining, particularly from a sustainable finance perspective, may signal a missed opportunity for economic diversification and support for sectors that are crucial for sustainable development. Agriculture, for instance, is a key sector in Kenya's economy and is vital for food security and rural livelihoods, but it receives a disproportionately small fraction of credit. Increasing financial support to these underfunded sectors could stimulate sustainable practices, such as climate-smart agriculture and renewable energy projects, aligning with environmental objectives and potentially generating long-term economic benefits for the banking sector and the Kenyan economy.

Support to MSMEs

A total of 6,572 MSME loan facilities in the banking industry valued at Ksh.122.5 billion were restructured in 2022 to enable borrowers to better manage their credit performance. By comparison, in 2020, commercial banks and MFBs restructured a total of 17,381 loan facilities valued at Ksh.138.7 billion.

The restructured amount constituted 0.05% of the total loan accounts and 3.37% of the total value of the gross loan portfolio.

Ksh 122.5 Billion Were restructured in 2022 to enable borrowers to better manage their credit performance

Implications: The restructuring of MSME loan facilities in the Kenyan banking industry reflects an adaptive response to the financial challenges faced by businesses, especially in the context of economic stresses that may be exacerbated by events such as the COVID-19 pandemic. The decrease in both the number and value of restructured loans from 2020 to 2022 suggests an improvement in the financial health and credit performance of MSMEs, which could be indicative of a recovering economy. From a sustainable finance perspective, this supportive approach demonstrates the banking sector's commitment to maintaining the solvency and viability of MSMEs, which are essential for economic stability and growth. It also highlights the banks' role in fostering a resilient business environment, where adjustments to loan terms can help sustain enterprises through challenging periods, potentially enabling them to contribute to sustainable development goals over the long term. This strategy could enhance the reputation of banks as responsible lenders, strengthen customer relations, and solidify the sector's contribution to a sustainable economy.

The Integration of Sustainable Finance

Sustainable finance aims to support the transition to a low-carbon, green and inclusive economy, while generating positive returns for investors and society. The main sources of sustainable finance in Kenya are:

Development Financial Institutions

These are largely international public finance Institutions which include multilateral and bilateral development banks and subsidiaries set up to support developing countries. They include the International Finance Corporation (IFC), the European Investment Bank (EIB), the African Development Bank (AFDB), and the Dutch Entrepreneurial Development Bank (FMO) among others. These institutions provide loans, grants, guarantees, and technical assistance to support green projects and programs in Kenya, especially in the energy, water, agriculture, and infrastructure sectors. As of June 2023, IFC had committed $15.2 billion to climate-related projects through more than 210 emerging market financial institution partners, leveraging an additional $5.8 billion . Furthermore, IFC committed a $100 million subordinated loan to Equity Bank Kenya in April 2019, to grow its lending operations in Kenya. IFC's loan facility aims to assist Equity Bank increase its capital base and expand its lending program to small and medium enterprises and climate finance operations that support renewable energy, green buildings, energy efficiency, and climate smart agricultural projects in Kenya .

Multilateral Climate Funds

The multilateral climate funds play an important role in supporting countries to adopt low-emission, climate resilient development trajectories. They support capacity building, research, piloting and demonstrating new approaches and technologies, and removing barriers to other climate finance flows. The multilateral climate funds hold critical political significance, reflecting an acknowledgement by developed countries for historical greenhouse gas emissions and in line with the commitments made by developed countries under the UNFCCC to support developing countries mitigate and adapt to climate change. They include Green Climate Fund (GCF), Green Environment Facility (GEF), Climate Investment Funds (CIF) and Global Climate Change Alliance (GCCA) among others. Currently, the GCF has financed 19 projects in Kenya costing US Dollar 293.6m to support climate adaptation, mitigation and cross-cutting climate initiatives in the country .

The multilateral climate funds hold critical political significance, reflecting an acknowledgement by developed countries for historical greenhouse gas emissions and in line with the commitments made by developed countries

Governments

International and domestic governments provide funds towards sustainable investments. The domestic government institutions include the National Treasury, the financial regulators and authorities, the line ministries, and the county governments. These institutions allocate public funds from domestic and external sources to climate and green related projects, such as the Climate Change Fund, the County Climate Change Funds, and the Green Economy Strategy and Implementation Plan. The funds are mainly in the form of budgetary allocations, subsidies, and tax incentives. A study on the Landscape of Sustainable Finance in Kenya (2021) indicates that Green financial flows in Kenya are mainly from external loans and grants provided by international partners such as MDBs, Bilateral and government agencies. About 40% of green funds are raised locally and 60% from international sources

Private sector institutions

These include corporate companies and banks that mobilize and invest private capital in green projects and products, such as green bonds, green loans, green mortgages, and green SME financing. KCB Group, the only GCF accredited Bank in Kenya, reported an increase in its green loans' portfolio to 12.3% in 2022 from 8.4% in 2021. The bank further targets to attain a green loan portfolio of 25% by the financial year 2025. According to Business Daily Africa (2022), KCB bank disbursed Sh336 billion green loans over the past two years .

Safaricom's Sustainability-Linked Loan (SLL):

The company closed a monumental SLL deal of KES 15 billion (with an option to increase it to KES 20 billion), in partnership with a consortium of Kenyan banks, marking a significant step in advancing its ESG agenda and setting a new benchmark for sustainable finance in East Africa. The SLL is a first of its kind for Safaricom and the Kenyan market, and it serves as a catalyst for the company's ongoing efforts to promote sustainability across its operations.

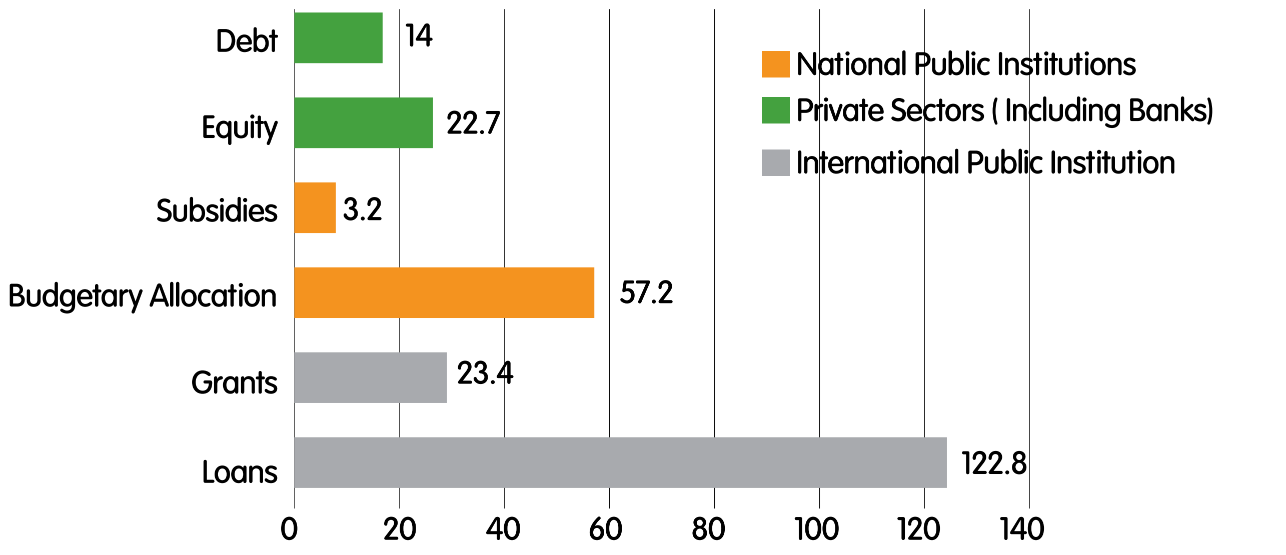
Another case of sustainable financing in the Banking Sector is the Co-operative Bank of Kenya which financed the Two Rivers Lifestyle Centre in Nairobi. The bank provided USD 80 million for the mall's construction, employing thorough risk management frameworks, economic viability assessments, and impact evaluations adhering to their environmental and social policies. The Co-operative Bank project's impact includes substantial MSME growth, job creation (particularly for women and youth), and environmental sustainability measures like a rooftop solar PV system and river conservation efforts.

Financing from philanthropic foundations in support of the sustainable development agenda has been growing over time, complementing official development finance. According to OECD, 2023 , private philanthropy for development has been rising since 2010, reaching USD 9.6 billion in grants in 2020 with the Bill and Melinda Gates Foundation (BMGF) providing about half of the amount . Other Philanthropy institutions include Visa, Mastercard Foundation, Rockefeller Foundation and Bloomberg. The Gates Foundation invests in tools, technologies, and market infrastructure to help smallholder farmers in Kenya improve their productivity and incomes and adapt to climate change. In April 2020, the Visa Foundation launched the Equitable Access Initiative, a five-year, USD200 million strategic commitment to support gender diverse and inclusive SMBs around the world. Part of the initiative is to provide $60 million in grants and $140 million in impact investments with a gender and diversity lens.

Sources and Uses of Climate Finance in Kenya

The distribution of sources and uses of sustainable finance in Kenya by sector is not well documented. However, a depiction can be derived from recent data on climate finance. According to the Landscape of Climate Finance in Kenya report, the total climate-related financial flows (from both private and public sectors) in 2018 amounted to KES 243.3 billion. The main sources of climate finance in 2018 were international public institutions, which provided 60% (KES 146.2 billion) of the total flows, mainly in the form of loans (KES 122.8 billion) and grants (KES 23.4 billion). National public institutions, which provided 25% (KES 60.4 billion) of the total flows, mainly in the form of budgetary allocations (KES 57.2 billion) and subsidies (KES 3.2 billion). Private sector institutions, which provided 15% (KES 36.7 billion) of the total flows, mainly in the form of equity (KES 22.7 billion) and debt (KES 14 billion) (Figure 3).

Figure 3: Sources of Climate Finance in Kenya (KES Billions)



Source: Landscape of Climate Finance in Kenya

The landscape of climate finance report shows that 79% of the funds (KES 192.2 billion) was applied to mitigation, mainly in the energy sector, followed by transport industry and waste. About 12% (KES 29.2 billion) was applied to adaptation, mainly in the agriculture sector (KES 16.9 billion), followed by water (KES 7.8 billion), environment (KES 2.9 billion), and health (KES 1.6 billion), and 9% (KES 21.9 billion) was applied to cross-cutting actions, mainly in the governance sector (KES 15.9 billion), followed by education (KES 3.9 billion), and disaster risk management (KES 2.1 billion) (Figure 4.

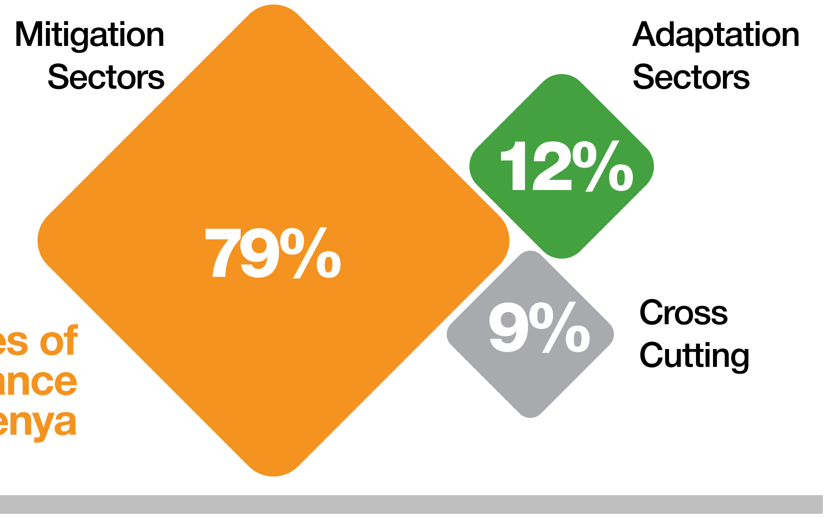


Figure 4: Uses of Climate Finance in Kenya

Source: Landscape on Climate Finance in Kenya.

The Integration of Sustainable Finance

In Kenya, sustainability has been gaining momentum in recent years, driven by several factors including:

Policy and regulatory frameworks

The Kenyan government has enacted various policies and regulations to support sustainable development and green growth, such as the National Climate Change Action Plan, the Green Economy Strategy and Implementation Plan, and the Kenya Vision 2030. The Green Bonds program for instance, was launched by KBA , Nairobi Securities Exchange (NSE), FSD Africa and FMO. It aims to catalyse the development of a domestic green bonds market in Kenya. The green bonds program offers a way for investors to diversify their portfolios and support green projects, while also benefiting from tax incentives and guarantees from the government and development partners. CBK has also issued guidelines on Climate-Related Risk Management for banks and other financial institutions, requiring them to integrate climate related risks into their risk management, governance, strategy, Metric and targets. These provide guidance and incentives for the financial sector to align with the national and global sustainability agenda .

Financial sector initiatives

To ensure the banking staff are well equipped to implement the SFI guiding principles, KBA developed an e-learning platform which had trained more than 50,000 staff (some staff may have transitioned to other sector) by the end of the year 2022 . Moreover, KBA recognizes the progress made by banks in adopting sustainable finance practices through its SFI Catalyst Awards ceremony held annually. The SFI also facilitates collaboration and innovation among banks and other stakeholders, such as regulators, academia, civil society, and development partners .

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Market demand and opportunities

There is a growing demand for and awareness for sustainable finance among various stakeholders such as customers, investors, regulators, civil society, and academia. Customers are increasingly seeking financial services that are aligned with their values and preferences, while investors are looking for opportunities to diversify their portfolios and mitigate risks. Regulators are encouraging financial institutions to disclose their ESG performance and risks, while civil society and academia are providing advocacy and research on the benefits and challenges of sustainable finance.

Kenya is seen as a regional leader in developing and issuing green bonds, which are debt instruments that raise capital for projects with positive environmental impacts. The first green bond in Kenya of USD 42 million was issued in 2019 by Acorn Holdings, a real estate developer, to finance green-certified student accommodation.

Innovation and Technology

Kenya is a leader in innovation and technology in Africa, especially in the fields of mobile money, fintech, and digital finance. These technologies enable greater access to finance, lower transaction costs, and enhanced transparency and accountability. They also create opportunities for developing and delivering sustainable finance solutions, such as mobile-based platforms for green lending, crowdfunding, and impact measurement. For example, M-KOPA, a solar company, provides affordable and clean energy to low-income households through a pay-as-you-go model using mobile money.

Civil society and international support

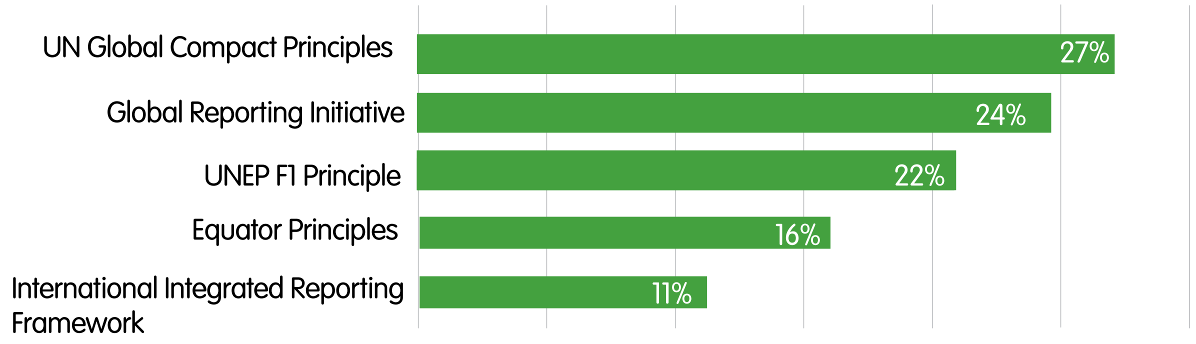
Kenya has a strong civil society and media sector, which have been raising awareness and advocating for sustainability issues, such as climate change, biodiversity, and human rights. The country has also been hosting various events and forums to promote dialogue and collaboration among different stakeholders, such as the Africa Climate e Summit. Kenya has been receiving technical and financial assistance from various international organizations and development partners, such as the United Nations Environment Programme (UNEP), the World Bank, and the African Development Bank (AfDB) .

Adoption of Sustainable Finance Guiding Principles

Sustainable finance guiding principles and standards outline methodologies and associated procedures to be applied to classify financial products and services offered by banks as sustainable finance. The principles specify the applicable environmental and social due diligence requirements, the verification process for sustainable finance and the reporting principles and requirements. Sustainable finance frameworks have become the best practice for the advancement of sustainable finance in the financial sector.

The Kenya Bankers Association conducted a survey in December 2023 to gather information on the progress made by banks on adoption and implementation of sustainable finance initiatives guiding principles. Out of 38 banks, 16 banks representing 42% responded to the survey. Most of the respondent institutions indicated they have adopted more than one sustainable finance framework, standard and or global best practice in their reporting. at least 27% of the respondents indicated they use UN global compact principles while 24% use the global reporting initiative (GRI) standards and22% used the UNEP Financial Initiative (UNEP FI) principles (see figure 5 below).

Figure 5: Kenyan banks adoption of sustainable finance frameworks.



Source: KBA Survey

The disclosure frameworks have emerged as essential tools to improve transparency, address greenwashing, facilitate capital mobilisation and empower market participants to identify and invest in sustainable assets . A range of principles, standards, and guidelines on sustainable finance that are relevant to the banking sector exist. This report has categorised them into local and international framework as shown in figures 6 and 7 below.

Figure 6: Kenyan Sustainable Finance Frameworks and Guidelines

CMA Policy Guidance	Capital Markets Authority Policy Guidance Note on Green Bonds provides for the guiding principles for the issuance of Green Bonds
NSE ESG Guidance Manual	Nairobi Securities Exchange Environmental, Social, Governance Disclosures Guidance Manual is intended to guide how listed companies in Kenya and other organisations collect, analyse, and publicly disclose important ESG information.
NSE Green Bond Issuers Guide	Nairobi Securities Exchange Green Bond Market Issuers Guide provide the listing rules for green bonds
CBK Guidance	CBK Guidance on Climate-Related Risk Management draw the attention of the banking sector players to the need to pay close attention to climate- related risks as part of their comprehensive risk management frameworks
SFI Guiding Principles	Kenya Bankers Association Sustainable Finance Guiding Principles guide banks to create long-term value for their clients, firm, economy and the environment.
Green Bond Guidelines	Kenya Green Bond Guidelines Background Document provide Green bond guidelines to guide issuers in the Kenyan market

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Figure 7: International Sustainable Finance Frameworks and Guidelines

Principles

- UNEP Finance Initiative Principles for Responsible Banking
- The UN Principles for Responsibible investment
- Equator Principles
- UN Global Compact Principles
- LSTA Green,Social, and Sustainability-Linked Loans Principle

Standards

- IFC Performance Standards on Environmental and Social Sustainability
- Global Reporting Initiative Standards
- International Sustainability Standards Board Standards
- Climate Bonds Initiative Climate Bond Standards and Taxonomy

Guidelines

- The World Bank Group Environment Health and Safety Guidlines
- Task Force on Climate related Financial, Disclosures Framework
- Task Force on Climate related Financial Disclosures
- European Banking Association Disclosure Requirements
- LSTA Guidance for Green, Social, Sustainability and Sustainability-Linked loans external reviews

Collectively the above frameworks, standards and guidelines form the financial sector best practices that help organisations in the banking and other financial sectors to develop ESG screening capability in their transactions, lending, and investment decision making process.

Sustainability Reporting Standards

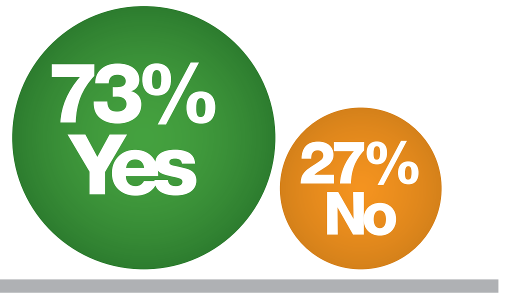
The landscape of sustainability reporting has evolved over the years in response to demands from a wide range of stakeholders including governments, investors, global organisations, and regulators, as well as non-governmental organizations. The principles, standards, and guidelines are largely aligned to the specific goals within target industries and sectors but overall seek to promote the disclosure of consistent and reliable information on ESG factors. Several reports have noted the fragmentation on ESG-related guidelines and call for a move towards standardisation in the same way financial reporting has converged under the International Financial Reporting Standards (IFRS). There is progress towards standardisation, demonstrated for instance, by the Task Force on Climate-Related Financial Disclosures handing over the monitoring of companies' climate-related disclosures to IFRS Foundation in October 2023.

The banking industry in Kenya has started to adopt sustainable reporting standards and frameworks providing them with an opportunity to demonstrate their commitment to sustainability. Through adoption and implementation of these standards, banks expect to gain benefits emanating from better risk management practices which may translate to improved financial performance. However, adoption of global best practice comes with an additional burden in the form of the need for better systems for collecting and managing data, compliance requirements, and additional operational cost. Banks have begun to integrate environmental and social risks and opportunities into their business models. Some of the banks have taken ESG reporting from a value addition perspective about their businesses as opposed to merely a risk mitigation measure. This is evident through the adoption of several sustainable finance frameworks and global best practices.

Risk Management Guidelines

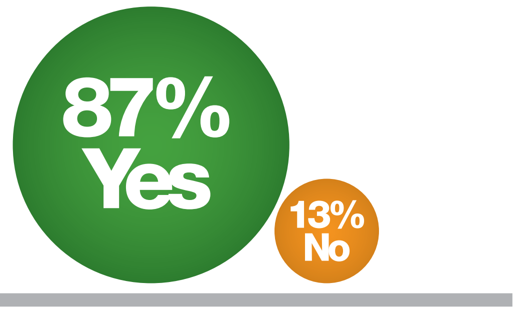
In terms of local guidelines, 73% of the respondent banks indicated they have implemented the CBK climate risk management disclosure guidelines (figure 8) and submitted a report to CBK on climate risk as expected by the 30th of June 2023. Furthermore, the Central Bank of Kenya reported that by end of June 2022, it had received board-approved climate risk implementation plans from 38 commercial banks and 1 mortgage finance institution for review. Moreover, all banks have been submitting status of implementation of their Climate-Related Risk Management (CRRM) guidelines to CBK on quarterly basis as from end of September 2022.

Figure 8: Implementation of CBK Climate-related Risk disclosure guidelines.



Further, 83% of the surveyed banks reported that they use KBA's Climate Related Financial Disclosures Template drawn from the 11 TCFD recommendations. They indicated that it was useful in their sustainability reporting (figure 9) for it provided a standardized approach and metrics for reporting within the industry, made granularity in reporting on climate risk possible, and supported banks to identify several initiatives that they could adopt. The above information is an indicator that banks are progressively moving towards integrating international and local standards and best practice in their reporting.

Figure 9: Adoption of KBA-TCFD Disclosure template



Despite the progress, there is need to map duplicate metrics across the various standards to minimise regulatory burden on reporting entities. For instance, Kenyan Banks are required by CBK to use the TCFD framework in their reporting while those that are listed in the NSE also apply GRI reporting standards recommended by NSE ESG Disclosures Guidance Manual. This is a case of double reporting on similar metrics for banks listed in the NSE and which could be eliminated through standardisation. Apart from the CBK Guidelines that are mandatory for banks, adoption of other sustainable finance frameworks is largely voluntary. Since issuing the guidance on ESG disclosures in 2021, NSE reports indicate a 15% increase in the number of listed companies that published sustainability reports in 2022 including the eight listed banks. This shows the importance of driving sustainability through a combination of regulation and self-governance. However, since adoption of ESG guidelines is voluntary, only 25% of NSE listed firms have complied.

Chapter 3

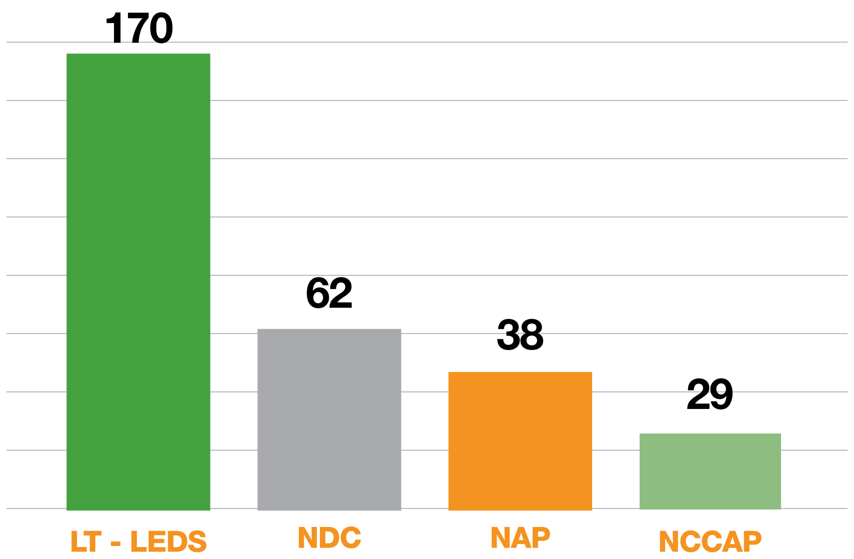
Opportunities for Sustainable Finance Deployment

Financing Low Carbon Economy

The sustainable finance market in Kenya presents an enormous potential underpinned by the need compelling need to finance the transition to resilient and low carbon economy. Numerous investment opportunities exist in Kenya's priority sectors such as agriculture, renewable energy and energy efficiency, resilient infrastructure, green buildings and affordable housing, health, blue economy, climate resilient technologies, water and wastewater management, and circular economy. However, these opportunities would only be realised if the banking sector puts in place new business models, instruments and systems that would enable banks to put into practice the sustainable finance standards that they have adopted.

Kenya estimates its finance needs for Nationally Determined Contribution (NDC) , Long-Term Low Emission Development Strategy (LT-LEDS) 2022-2050, National Adaptation Plan (NAP) 2015-2030, and National Climate Change Action Plan (NCCAP) 2023-2027 to be USD62 billion, USD170 billion, USD38 billion, and USD29 billion respectively (figure 10).

Figure 10: Kenya's NDC, LT-LEDS. NAY & NCCAP Financing Needs (USD Billions)



The banking sector has a key role in mobilising resources needed to finance the above strategies through the sector activity as financial intermediaries and in creating and placing of products and negotiated instruments in the market.

Lack of regular and reliable data is a major hinderance to tapping the existing opportunities. According to IMF 2022 report on Sustainable Finance in Emerging Markets, one of the key challenges with development of a sustainable ecosystem is progress on data disclosures. The report indicates that reliable and comparable data are crucial for financial sector stakeholders to assess financial stability risks, properly price and manage ESG-related risks, and take advantage of the opportunities arising from the transition to a green economy.

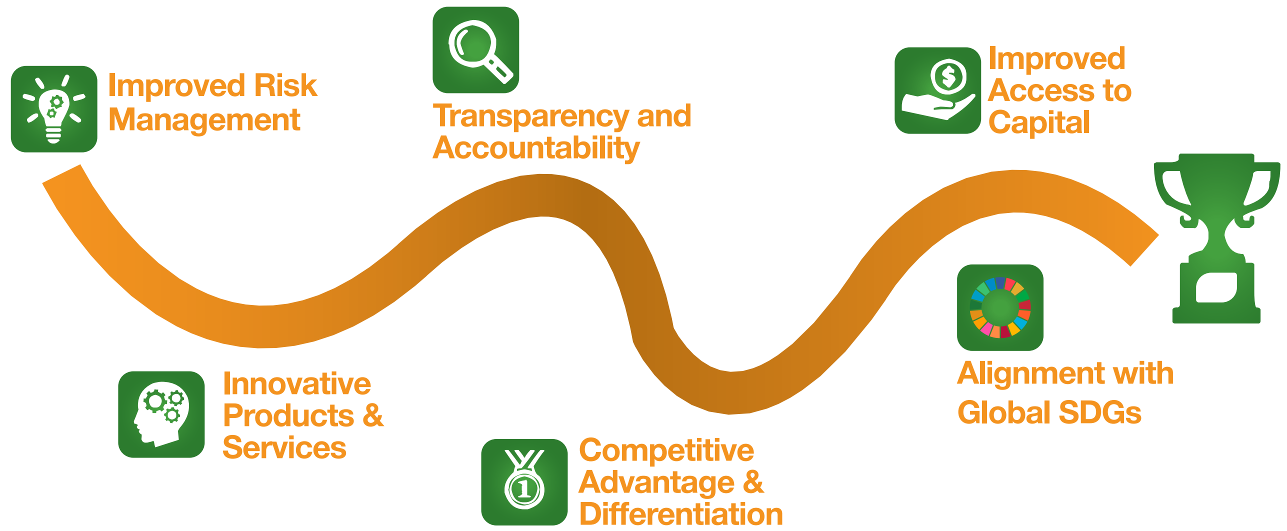
Despite the challenges in compliance, data collection and management, and cost of implementation of sustainable finance standards, financial institutions are seeking to align business, portfolios, and strategies with the objectives of the Paris Agreement consistent with achieving a global target of net-zero emissions by 2050.

Although this is a process, the World Bank notes that encouraging financial institutions to consider the Paris alignment of their portfolios, businesses, and strategy can help them capture

the opportunities created by the low carbon transition and manage the associated risks. Specifically, the Paris-aligned financial institutions can help fill the financing gap to meet the countries' climate goals set out in the climate change action plans.

Greenomy in a report on ***Navigating sustainable finance*** challenges and opportunities, indicate that through integrating sustainable finance into business strategy banks would be able to access growing markets and customer markets that are keen on sustainability and thereby generate new revenue streams and enlarge their market share. Additionally, this may lead to improved access to capital as more investors and lenders prioritise sustainable finance initiatives and other benefits along their transition journey as depicted in figure below.

Correctly tackling the challenges of sustainable finance will enable banks to focus on reaping all the benefits along the way of their transition journey to a future-proof business model.



Source: Geenomy, 2023

The landscape of climate finance in Kenya study, 2021, indicated that the country recorded a significant investment gap in NDC (Nationally Determined Contribution) priority actions amounting to over KES 63.3 billion in 2018/19, with the largest financing gap recorded in the water and blue economy sectors. This indicates that the country's needs are not being met at each stage of the investment cycle.

The UNCTAD World Investment Report 2023, noted that the value of the global sustainable finance market (bonds, funds, and voluntary carbon markets) reached UDD5.8 trillion in 2022, amidst a turbulent economic environment that have negatively affected the financial markets. The UNCTAD analysis indicates a sudden growth of voluntary carbon markets (VCMs) up to $2 billion value per year globally in 2022. Although this is small compared to compliance carbon markets (CCMs), with an estimated value of issued credits ranging from USD700 billion to USD800 billion per year, VCM is a growing element in the finance landscape that provides a cross-border channel for financing renewable energy, reforestation, and other climate-related projects in developing countries like Kenya. ***Kenya for instance has a potential to sequester, reduce, or avoid ~30 Mt CO2e/yr. (metric tons of carbon dioxide equivalent per year) and mobilize up to $600 million annually from regulatory compliance and VCM projects by 2030 using an average price of USD20 per ton.***

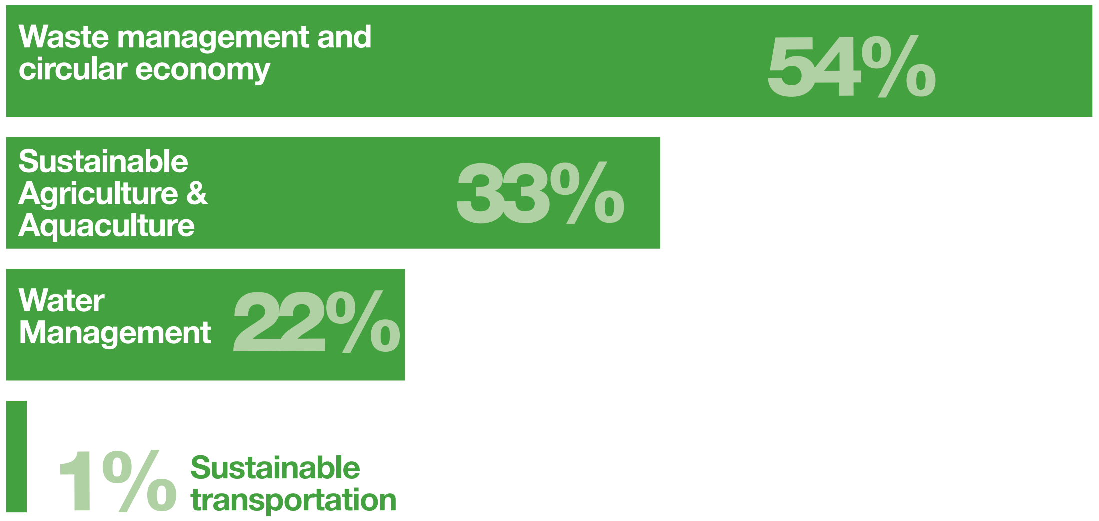
> "Opportunities for the banking sector are mainly in financing 'green' projects in key sectors including renewable energy, agriculture and forestry, public infrastructure, transport, and manufacturing. Banks can be key enablers in the green transition through provision of credit or investment capital. Kenya's updated Nationally Determined Contributions estimates the cost of implementing climate mitigation and the adaptation actions at approximately USD 62 billion. Of this, 13 percent (USD 8 billion) is to be mobilised from the government. The rest, 87 percent (USD 54 billion), is to be sourced from private sector (including banks and development partners)"
>
> *–Central Bank of Kenya*

Sustainable Enterprise Investing

Aspen Network of Development Entrepreneurs (ANDE) research in 2023 notes that green entrepreneurship in Kenya offers a USD123 billion market opportunity for small and growing businesses (SGBs)-active business segments. The study found out that the most significant market opportunity is in the waste management and circular economy sector (USD54 billion), followed by sustainable agriculture and aquaculture (US$33 billion) and water management (USD22 billion).

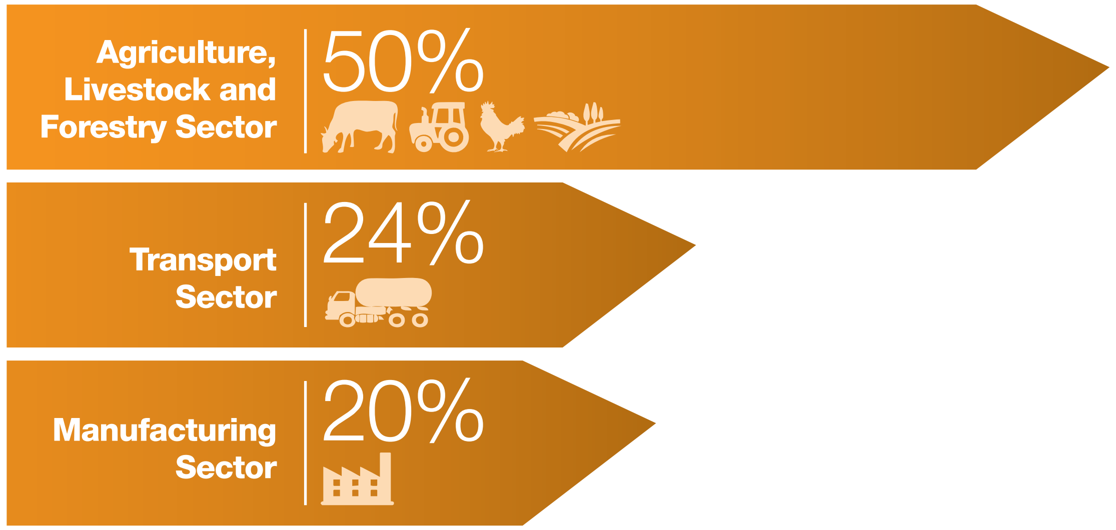
The sustainable transportation sector offers less than USD1 billion in market opportunities for SGBs due to limited government targets and the country's dependence on the implementation of large-scale infrastructure projects that would solve the supply of electricity and charging stations (figure 11). The banking industry can develop innovative products that would tap into the above opportunities in SGBs- active business segments and capture the 90% stakeholders in the segment who according to the ANDE research have limited access to finance driven by factors such as low investor confidence and lack of familiarity with green and sustainable finance models among financiers.

Figure 11: Market opportunity for SGB-active business segments (USD billion per year)



Green Bonds Investment

Green bonds proceeds could be applied to finance investments in climate priority sectors in Kenya including renewable energy, energy efficiency, clean transportation, water management, among others. As earlier indicated, the growth of green bonds market in the Kenya has been sluggish since guidelines were issued by CMA and NSE. An assessment of green investments opportunities in Agriculture, livestock and forestry, transport and manufacturing sectors carried out under the Green Bonds Program Kenya (GBPK), points to opportunities for green bonds amounted to USD 894 million per year. The transport sector is reported as having the largest potential for green bonds amounting to USD 500 million (56%), followed by manufacturing at USD 214 million (24%), and agriculture, livestock, and forestry at USD180 million (20%) as shown in figure 12 below.



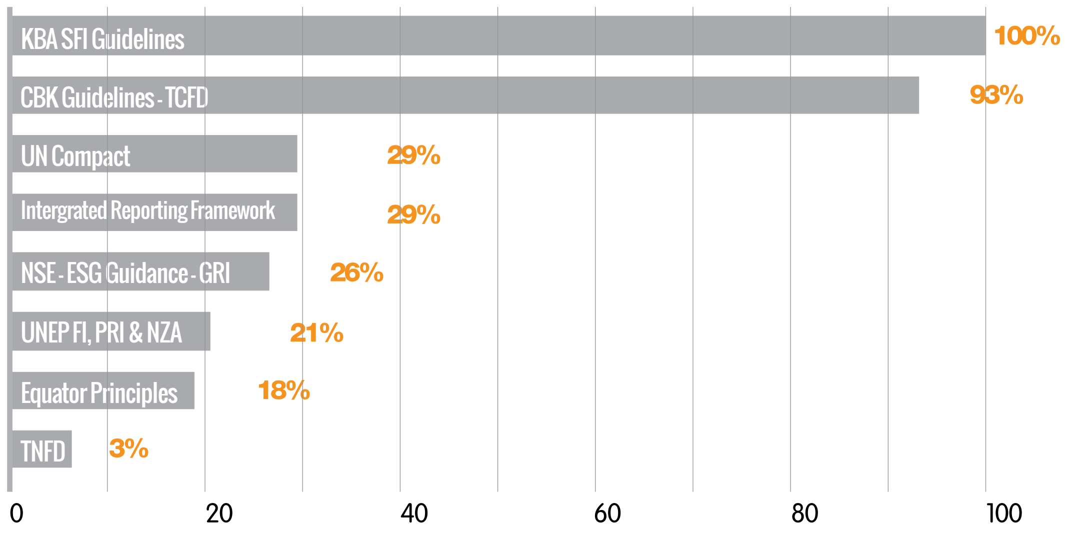
Transparency and Disclosures

(a) The Status of Sustainability Reporting and Disclosures in Kenya's banking industry

The banking industry in Kenya has started to adopt sustainable reporting standards and frameworks providing them with an opportunity to demonstrate their commitment to sustainability. Through adoption and implementation of these standards banks expect to gain benefits emanating from better risk management practices which may translate to improved financial, social, and environmental performance. However, adoption of global best practice comes along with additional burden in form of need for better systems for collecting and managing data, compliance requirements, and additional operational cost.

Despite the additional reporting requirement, the sector has made strides in increasing transparency through disclosures and reporting standards in alignment with regulatory sustainability and climate-related frameworks issued by Nairobi Securities Exchange- ESG Guidance using GRI Standards, and Central Bank of Kenya- Climate Related risk management guidance that encourages banks to benchmark on the TCFD framework (The Lawyer Africa, 2023) and other international sustainability reporting frameworks such as UNEP FI, Equator principles and UN Compact.

Figure 13: Status of Sustainability Reporting and Disclosures using various frameworks in 2023.

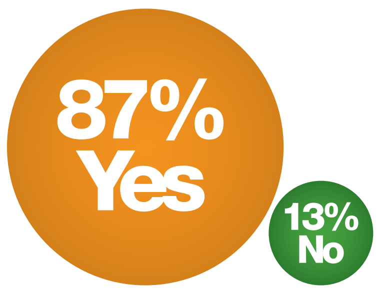


Source: Compiled from published reports, websites, and KBA surveys

In depth literature review and survey of banks in Kenya indicate that most institutions have adopted more than one framework, standard and or global best practice. Figure 14 above shows the status of Sustainability reporting among banks in Kenya in 2023. The most common sustainability practices and standards used for disclosures by banks in Kenya are led the KBA-SFI initiatives with 100% of banks indicated as having adopted the five principles of SFI (KBA website), this is closely followed by the TCFD with over 35 (93%) of banks having submitted their Climate-related financial disclosures on 30th June 2023 as required by Central Bank of Kenya guidance issued to banks in 2021. It is followed by Integrated Reporting framework, 11 (29%) banks published their annual integrated reports as of December 2022. Next was Global Reporting Initiative (GRI) sustainability reporting standards, 10(26%) banks issued annual sustainability reports, which is a marked improvement from a year before that had only 4 banks publishing sustainability reports. Equity bank listed as an early adopter, and it is expected to publish its inaugural disclosures in 2024(TNFD, 2024).

The success of implementation of TCFD disclosures by banks is attributed to KBA's efforts in partnership with WWF and FSD Kenya to build capacity for the banks.. In a survey by KBA, 87% of the banks reported that the use of template was useful in their disclosures (figure 15) for it provided a standardized approach and metrics for reporting in the industry, made granularity in reporting on climate risk possible, and supported banks to identify several initiatives that they could adopt. Additionally,

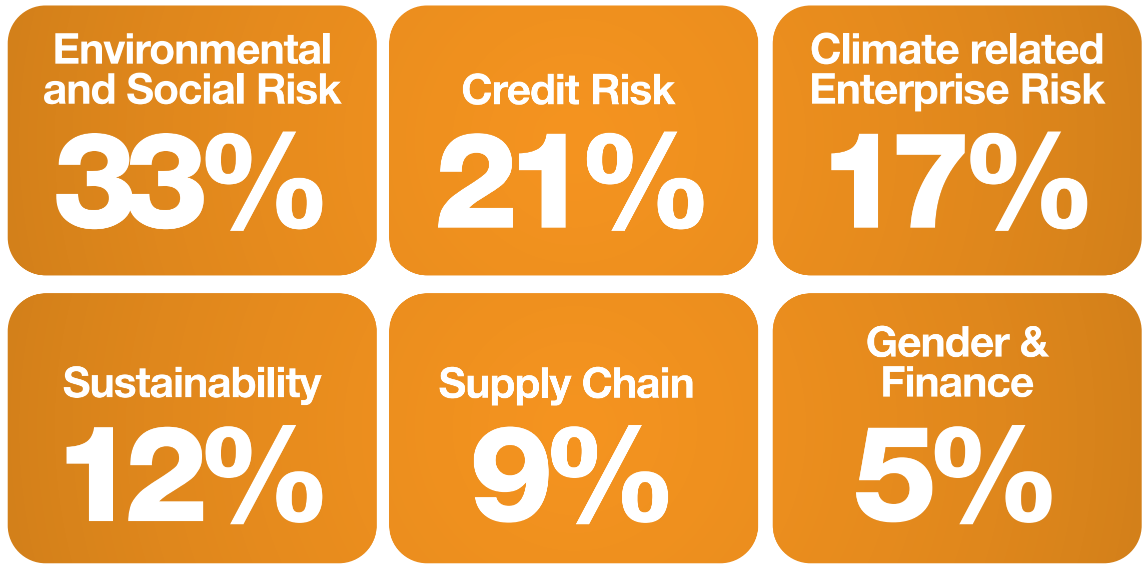
Figure 14: Adoption of KBA-TCFD Disclosure template



Listed banks in Kenya have double regulatory reporting requirements on similar metrics – the requirement by CBK to use the TCFD framework to report on Climate-related risks and NSE requirement to apply GRI reporting standards for their sustainability reports as recommended by NSE ESG Disclosures Guidance Manual.

In efforts to integrate best global practice in sustainable finance and KBA recommended SFI into their operations, banks in Kenya have been updating their policy documents as well as formulating new policies. According to the KBA Survey, bank policies and procedures document that are in line with industry guiding principles and best practice standards, 33% of the banks point to environmental and social risk policies, 21% indicate credit risk policies and 17% listed climate-related and enterprise risk policies, among others (figure 15). The effect of these updates and changes in policy could however not be measured in relation to sustainable finance portfolios.

Figure 15: Bank policy/procedure documents integrating best Practice in SF



Source: KBA Survey of banks

The main sustainability and climate-related reporting under the main reporting frameworks- TCFD, GRI, IRF, SASBs, are set to be replaced by the IFRS S1 and S2 reporting frameworks which has incorporated these reporting requirements. Their adoption is expected to lighten the burden of banks from reporting under multiple frameworks and make it easier for banks and investors, to assess and compare sustainability performance of potential customers/ investees in making lending/investment decisions respectively. This will help drive the growth of sustainable finance in Kenya.

(b) Disclosure Quality and Content

The disclosure quality and content of sustainability reports by banks have been improving over time. For example, an analysis of KCB group sustainability reports since 2014 shows marked improvement in disclosure quality and content. The inaugural reports had information on the bank's Corporate Social responsibility initiatives but has now transitioned to providing data on its sustainability and climate change initiatives such as the bank's goal of attaining net zero status by 2030, disclosures on its green portfolio, GHG emissions, etc (KCB group, 2023). Other banks are expected to follow suit as they continue building their technical capacities in sustainability and climate-related reporting and disclosures.

A 2020 report by the Sustainable Banking and Finance Network (SBFN), indicated that there was improvement in sustainability reporting by Kenyan banks but noted that there were gaps in the quality, consistency and comprehensiveness of these reports owing to the adoption of multiple reporting frameworks and indicators. It recommended the use of common reporting frameworks and indicators to ease comparability and consistency in the reporting.

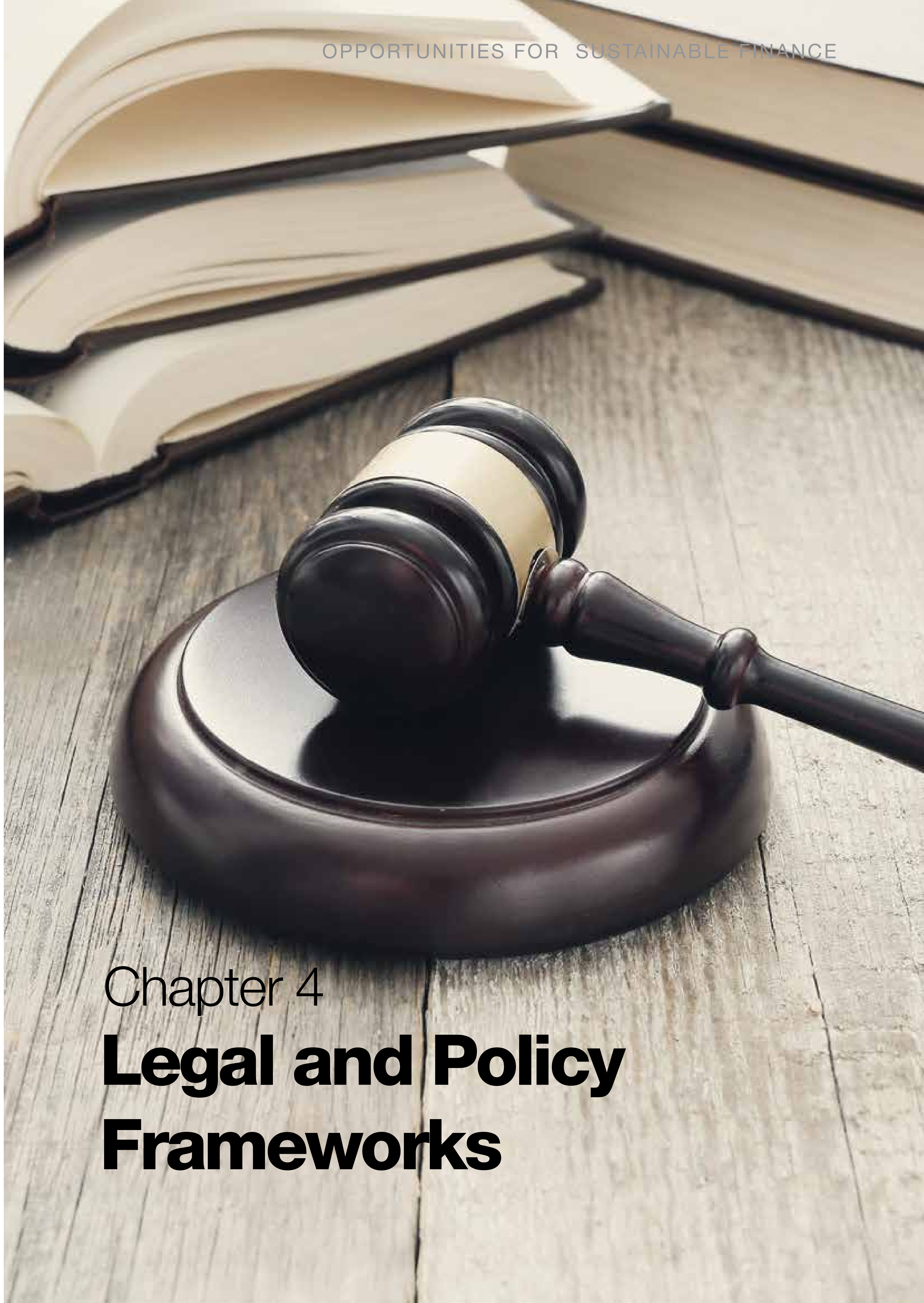
Challenges in Disclosure Practices

Some of the common challenges faced by banks in Kenya in implementing effective sustainability disclosure practices include.

- Lack of technical capacity by banks to measure, monitor, manage and report on ESG and climate-related risks.
- Lack data on ESG and climate risks and opportunities that makes it difficult for banks to identify, measure, manage, monitor, and report on ESG and Climate-related risks.
- Limited financial resources particularly for tier 2 and 3 banks make it difficult for these banks to allocate sufficient resources for engaging external experts to support the bank in sustainability reporting and training of staff.
- Banks failing to prioritize ESG and climate-related risks and opportunities in their strategies and operations and treating the disclosures and reporting as a good to have instead of a strategic opportunity.

With tools such as KBA TCFD reporting template and banking staff capacity building trainings, banks are expected to surmount the reporting challenges and narrow the reporting gap highlighted above.

> **“ In 2020, there was improvement in sustainability reporting by Kenyan banks, but there were gaps in the quality, consistency and comprehensiveness.**



Chapter 4

Legal and Policy Frameworks

Legal and Policy Frameworks

The key policies and regulations that have implications for the Sustainable finance objectives in the Kenyan banking industry include:

- National Climate Change Action Plan (NCCAP) 2023-2027
- Carbon Credit Trading and Benefit Sharing Bill, 2023
- The 2022 Draft National Green Fiscal Incentives Policy Framework
- The Green Economy Strategy and Implementation Plan (GESIP)
- The Kenya National Climate Finance Policy 2018

The National Climate Change Action Plan (NCCAP) 2023-2027

The NCCAP 2023-2027 is Kenya's third five-year plan for tackling climate change and achieving its Nationally Determined Contribution (NDC) goals. It is a key document for mainstreaming and implementing climate action across the country.

Key Features:

Focus areas: The plan outlines seven priority climate action areas:

- Water and sanitation
- Food security and sustainable agriculture
- Human health and well-being
- Ecosystems and biodiversity
- Infrastructure and built environment.
- Energy
- Industry and manufacturing

Actions: Each area includes specific adaptation and mitigation actions covering policy and regulation, capacity building, knowledge management, technology and innovation, climate finance, and monitoring, reporting, and verification.

Targets: The NCCAP aligns with Kenya's revised NDC target of a 32% reduction in greenhouse gas emissions by 2030 compared to baseline levels.

Integration with other plans: It links with the Long-Term Low Emission Development Strategy (LT-LEDS) 2022-2050 and the Medium-Term Plan 2023-2027, ensuring national climate action is coordinated and effective.

Enhanced legal framework: The launch of the NCCAP coincided with the amendment of the Climate Change Act 2016, strengthening the legal basis for climate action and accountability.

Funding: The plan estimates requiring KES 5.1 trillion (USD 42 billion) for implementation, emphasizing the mobilisation of resources from both public and private sectors.

Role of stakeholders: The NCCAP encourages active participation from government institutions, civil society organizations, the private sector, and local communities in achieving its goals.

Policy Implications for the banking industry

The NCCAP 2023-2027 is expected to have significant implications for the Kenyan banking industry, shaping and influencing their sustainability initiatives in several ways:

Increased Opportunities

- Green Finance: The plan's focus on mobilising KES 5.1 trillion for climate action opens vast opportunities for banks to offer specialised green financial products and services, such as loans for renewable energy projects, climate-smart agriculture, and sustainable infrastructure development. This can attract new client segments and generate additional revenue streams.
- Enhanced Risk Management: Integrating climate risks into lending practices and investment decisions becomes crucial. Banks can build expertise in assessing and mitigating climate-related risks, leading to a more resilient and sustainable portfolio.
- Innovation and Technology: The NCCAP's emphasis on technology and innovation encourages banks to develop and adopt digital solutions for green finance, such as mobile money-based microloans for climate-resilient agriculture or online platforms for carbon credit trading.

"Banks can build expertise in assessing and mitigating climate-related risks, leading to a more resilient and sustainable portfolio.

Challenges and Adjustments

- Shifting Market Dynamics: Banks need to adapt to the changing market landscape as demand for traditional fossil fuel-dependent activities may decline, while demand for green alternatives grows. This may require diversifying portfolios and investing in new skills and expertise.
- Regulatory Compliance: The NCCAP and the amended Climate Change Act may introduce new regulations and reporting requirements for banks regarding their climate impact and financial exposure to climate risks. Adapting to these regulations will be essential.
- Capacity Building: Building internal capacity to understand, assess, and manage climate and nature risks will be crucial for banks to navigate the transition towards a greener economy. This includes training staff, developing robust climate risk assessment methodologies, and integrating climate considerations into decision-making processes.

The Kenya's Carbon Credit Trading and Benefit Sharing Bill, 2023

Establishing a regulatory framework for the trading of carbon credits and ensure fair and equitable benefit sharing in Kenya is critical. This underpins the need for legislation on carbon credit trading and benefits sharing

Key aspects

Scope: Applies to carbon resources in rangelands, forests, soil, public/private/community land, water resources, and renewable energy projects.

Regulatory body: Creates the Carbon Credit Trading and Benefit Sharing Authority to oversee trading, registration, and regulation of the carbon credit business.

Benefit sharing: Requires projects to have community development agreements outlining how benefits will be shared with affected communities and stakeholders.

Project requirements: Projects must specify anticipated environmental, economic, and social benefits, align with Kenya's greenhouse gas emission targets, and adhere to constitutional environmental provisions.

Carbon credit trading: Establishes a permit system for carbon credit trading businesses, sets restrictions on trading, and mandates a public carbon registry for transparency.

Status

- The Bill was introduced in 2023 and underwent several drafts.
- As of January 2024, and has not yet been enacted into law

Policy implications

The Carbon Credit Trading and Benefit Sharing Bill, if enacted, could have significant implications for the Kenyan banking industry and its sustainable finance objectives. Here is a breakdown of the potential impact:

> **Carbon credits can be used as collateral for loans, potentially reducing risk for banks and encouraging lending to climate-friendly projects.**

Positive implications:

New investment opportunities: Carbon credit trading can create new asset classes and investment opportunities for banks. They can act as intermediaries, facilitating transactions between project developers and carbon buyers, or directly invest in carbon credit projects. This aligns with banks' growing focus on sustainable finance and ESG (environmental, social, and governance) principles.

Enhanced risk management: Carbon credits can be used as collateral for loans, potentially reducing risk for banks and encouraging lending to climate-friendly projects. Additionally, the Bill's focus on transparency and regulation could lower risks associated with greenwashing and ensure the quality of carbon credits.

Reputational benefits: Supporting the development of a vibrant carbon market in Kenya can enhance the reputation of banks as responsible and sustainable lenders. This can attract environmentally conscious investors and customers.

Challenges and considerations:

Regulatory uncertainty: The exact regulatory framework for carbon credit trading is still evolving, which could create uncertainty for banks. Clear and stable regulations are crucial for banks to confidently invest in this market.

Capacity building: Banks may need to develop expertise in carbon credit valuation, risk assessment, and compliance with the Bill's requirements. This could involve investing in training and technology.

Competition: New entrants, such as fintech companies, could emerge in the carbon credit trading space, posing competition to traditional banks. Banks need to innovate and adapt their offerings to stay competitive.

The 2022 Draft National Green Fiscal Incentives Policy Framework

The National Treasury and Economic Planning in 2012 compiled the Draft National Green Fiscal Incentives Policy Framework. This policy is pivotal in guiding the country towards a greener and more resilient economic trajectory. The core goal is to transition Kenya onto a path of low-emissions development, simultaneously prioritizing environmental sustainability and bolstering its climate resilience. At the heart of this policy are several key strategies.

- The government is directing its spending towards green production, consumption, and procurement practices. This realignment of governmental expenditure is critical in setting a precedent for environmental consideration in economic activities.
- The policy aims to attract private investment by offering fiscal incentives to businesses that adopt low-carbon and sustainable practices. This move is intended not just to encourage a shift in the private sector's approach but also to stimulate innovation and adoption of green technologies.
- Generating additional revenue for the government is a strategic focus. These funds are earmarked for investment in green projects, thus creating a sustainable cycle of funding and development in environmental initiatives.
- The focus of this policy is broad yet specific, targeting key sectors that have high potential for green transformation. These include agriculture, water management, energy, waste management, and disaster risk financing. Alongside these, cross-cutting initiatives are also emphasized, such as bolstering research and development in green technologies, creating green jobs, and enhancing environmental education.

Policy implications at a Glance

Creates a new paradigm for financial institutions

emphasis on investment into low-carbon and sustainable businesses

spending on green initiatives, means an increase in PPPs

Policy implications

The adoption of the Draft National Green Fiscal Incentives Policy Framework in Kenya carries significant implications for the country's banking industry, particularly in aligning with their sustainability objectives.

- This policy creates a new paradigm for financial institutions, where green financing becomes not just an ethical choice, but a strategic imperative. Banks and other financial entities will find themselves at the forefront of this transition, as the demand for green loans and investments surges. This shift aligns with global trends towards sustainable finance, offering Kenyan banks a competitive edge in the international market.
- The policy's emphasis on attracting private investment into low-carbon and sustainable businesses presents a unique opportunity for banks to innovate in green financial products and services. This could lead to the development of new green bonds, sustainability-linked loans, and other financial instruments focused on environmental impact. Such products would not only meet the growing consumer demand for responsible investment options but also enable banks to play a critical role in channelling capital towards sustainable projects.
- As the Kenyan government directs its spending towards green initiatives, there will likely be an increase in public-private partnerships in this domain. Banks could leverage these opportunities to collaborate on large-scale green projects, aligning their portfolio with national sustainability goals. This alignment with government policy also positions banks favourably in terms of regulatory compliance and potential incentives.

The Green Economy Strategy and Implementation Plan (GESIP)

The Green Economy Strategy and Implementation Plan (GESIP) is Kenya's national roadmap for transitioning to a low-carbon, resource-efficient, equitable, and inclusive socio-economic development model. It was launched in 2016 and covers the period up to 2030.

Key objectives:

- To achieve higher economic growth consistent with Kenya's Vision 2030, which emphasizes sustainable development.
- To address binding social and economic constraints that hinder Kenya's progress towards Vision 2030.
- To guide both national and county governments, the private sector, civil society, and other stakeholders in adopting greener development pathways.
- To contribute to achieving the outcomes of the United Nations Conference on Sustainable Development (Rio+20).

GESIP focuses on five thematic areas:

Sustainable infrastructure: This includes developing and implementing clean energy solutions, promoting energy efficiency, and improving water and sanitation infrastructure.

Building resilience: This focuses on increasing Kenya's ability to withstand climate change impacts, natural disasters, and other shocks.

Sustainable natural resource management: This includes protecting and sustainably managing Kenya's forests, water resources, biodiversity, and land.

Resource efficiency: This promotes the efficient use of resources in all sectors of the economy.

Social inclusion and sustainable livelihoods: This aims to ensure that all Kenyans benefit from the transition to a green economy, with a particular focus on creating jobs and improving livelihoods for the most vulnerable populations.

Implications for the Banking Industry

The Green Economy Strategy and Implementation Plan (GESIP) has significant implications for Kenya's banking industry and their approach to sustainable finance, pushing them to adapt and innovate in several ways:

Increased demand for green finance products and services- GESIP prioritizes sustainable development, leading to rising demand for green lending, green bonds, and other financial instruments that support environmentally and socially responsible projects. Banks need to tailor their offerings to cater to this growing demand.

Shifting Risk Management Paradigm- GESIP focuses on building resilience and managing environmental and social risks. Banks need to incorporate these considerations into their risk assessment and credit decision-making processes, potentially leading to stricter environmental and social safeguards.

Regulatory and Policy Changes- GESIP is likely to influence the development of new regulations and policies related to sustainable finance. Banks need to adapt their operations and products to comply with these evolving regulations, such as mandatory climate-related disclosures.

Opportunities for Green Investment- GESIP opens new investment opportunities in various sectors like renewable energy, clean technology, and resource efficiency. Banks can leverage their financial expertise and risk management skills to participate in these green investments, supporting economic growth and environmental sustainability.

Challenges and Potential Obstacles

- Transitioning to a green economy requires significant capital and expertise. Banks might face challenges in mobilizing resources and developing the necessary skills to assess and manage green investments.
- Lack of awareness and data on environmental and social risks could hinder effective risk management practices.
- Existing legal and regulatory frameworks might not fully support green finance instruments or enforce environmental regulations, posing potential uncertainties.

Kenya National Climate Finance Policy, 2018

The Kenya National Climate Finance Policy, launched in 2018, is a comprehensive roadmap for mobilizing and managing climate finance in the country. It aims to address the crucial challenge of inadequate financial resources for climate change adaptation and mitigation interventions.

Key Objectives of the Policy

- Establish a robust legal and institutional framework for accessing and managing climate finance, aligned with the Climate Change Act, 2016.
- Create a national Climate Change Fund as a central repository for climate finance resources.
- Identify and diversify climate financing sources from both domestic and international channels, including public, private, and philanthropic institutions.
- Develop a national system for tracking climate finance to ensure transparency, accountability, and effective allocation of resources.
- Promote equitable access to climate finance for vulnerable communities and sectors most impacted by climate change.

Key Policy Interventions

- Establishment of the National Climate Change Fund: This central fund will pool resources from various sources and allocate them to priority climate change projects and programs.
- Development of a National Climate Finance Strategy: This strategy will identify specific financing needs, target sectors, and investment priorities for climate action.
- Strengthening Institutional Capacity: The policy emphasizes building capacity within government agencies and other stakeholders to effectively manage and utilize climate finance.

> **TheNational Climate Change Fund will pool resources from various sources and allocate them to priority climate change projects.**

- Enhancing Access to Finance for Vulnerable Groups: The policy aims to ensure that women, youth, and marginalized communities have equitable access to climate finance resources.
- Promoting Private Sector Participation: The policy encourages private sector investment in climate-friendly projects and businesses through innovative financial instruments and incentives.

Implications for the Kenya' banking sector

The Kenya National Climate Finance Policy has significant implications for Kenya's banking sector and their sustainable finance objectives in several ways:

Increased Demand for Green Finance Products and Services: The policy's focus on mobilizing and managing climate finance fosters a thriving market for green financial products and services. Banks can adapt their offerings to cater to this growing demand, including green loans for environmentally friendly businesses, energy efficiency financing, and green mortgages.

Enhanced Regulatory Environment: The policy creates a more robust regulatory framework for climate finance, potentially leading to stricter environmental and social safeguards. This provides a clearer environment for banks to develop and implement sustainable finance solutions while managing their risks effectively.

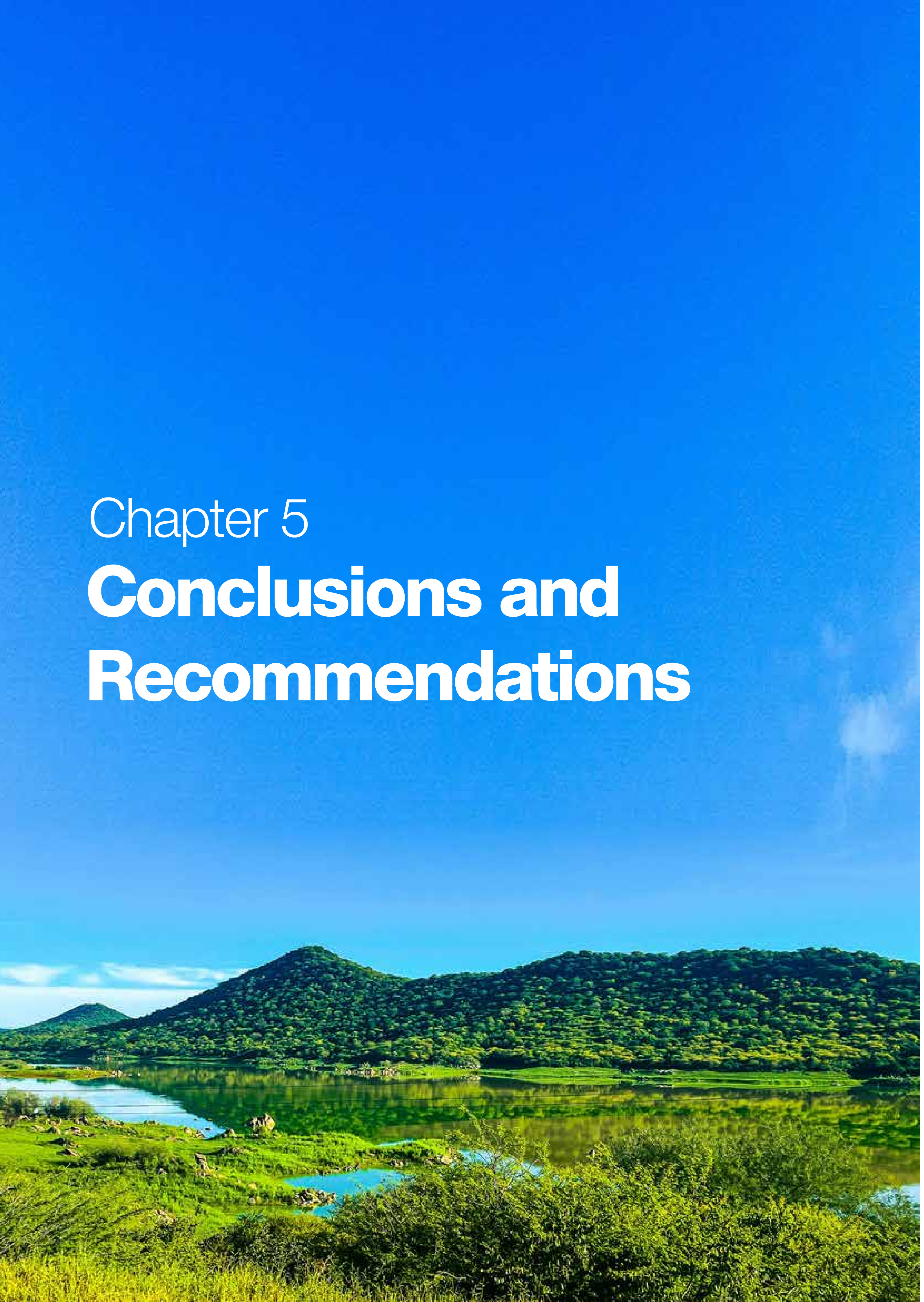
Enhanced Regulatory Environment: The policy encourages the development of innovative financial instruments, such as green bonds and climate action-focused investment funds. This provides new avenues for banks to participate in climate finance and leverage their financial expertise to support sustainable projects.

Addressing Climate-Related Financial Risks: The policy's focus on climate resilience helps banks address potential financial risks associated with climate change, such as extreme weather events and resource scarcity. By proactively integrating climate considerations into their risk management practices, banks can ensure long-term financial stability and contribute to building a more resilient economy.

Alignment with International Commitments: The policy aligns with Kenya's international commitments under the Paris Agreement and other climate change agreements. This facilitates access to international climate finance resources and strengthens Kenya's position as a leader in sustainable finance within the region.

Challenges and Considerations

- Implementing the policy effectively requires significant investments in capacity building, technology, and data infrastructure within the banking sector.
- Banks need to adapt their business models and internal processes to cater to the specific requirements of green finance instruments and projects.
- Managing the risks associated with climate change and identifying viable green investment opportunities require expertise and robust risk assessment methodologies.



Chapter 5

Conclusions and Recommendations

The analysis of sustainable financing in Kenya's banking industry unveils a critical intersection between economic growth, environmental stewardship, and social equity. The industry's substantial financial commitment, especially towards MSMEs, provides a foundation for strategic alignment with the government's climate action priorities. The National Climate Change Action Plan sets ambitious goals, suggesting a need for enhanced support in sectors crucial for sustainable development.

Directing more funds towards climate action-aligned sectors, such as agriculture, renewable energy and energy efficiency, resilient infrastructure, green buildings and affordable housing, health, blue economy, climate resilient technologies, water and wastewater management, and circular economy, offers a significant avenue for impacting environmental sustainability and resilience. The sector's innovation in sustainable financial products will position it to meet customer demands and contribute meaningfully to national sustainability goals.

The symbiotic relationship with MSMEs underscores the banking sector's pivotal role in fostering economic resilience, supporting sustainable practices, and contributing to inclusive development in Kenya. By navigating the intersection of financial commitments, climate action, and sustainable development, the banking sector can catalyse positive change in Kenya's economic and environmental landscape.

Kenya's regulatory landscape reflects a comprehensive commitment to addressing climate change and promoting sustainable development. The presence of key policies and regulations, such as the NDC, LT-LEDS, NCCAP, Carbon Credit Trading and Benefit Sharing Bill, Draft National Green Fiscal Incentives Policy Framework, GESIP, and the Kenya National Climate Finance Policy, among others signals a transformative shift in the banking industry's role. These policies create opportunities for banks to engage in green finance, align with global sustainability trends, and contribute to national goals. However, challenges like regulatory uncertainties and the need for capacity building underscore the importance of adaptability and innovation within the banking sector. Moreover, lack of regular and reliable industry-wide data is a major hinderance into developing a sustainable ecosystem and tapping into existing opportunities.

Recommendations

Recommendations on enhancing sources of sustainable finance in Kenya.

Several banks and other financial institutions are providing financing for sustainability and green initiatives in Kenya. However, data on sustainable finance granular portfolios is still not readily available. Although case studies mentioned in this report demonstrate that banks are undertaking sustainable financing, there is still a huge gap as only few of banks are actively involved. Banks should lead the way as market makers in issuing and facilitating issuance of market instruments and mobilising private sector capital to ESG priorities. The banking sector need to step up in providing sustainable finance across variety of assets and sectors. Leadership in sustainability will enable the financial institutions to take advantage of external funds channelled towards sustainability in the market from DFIs and other investors, provide them with opportunities for growth, and remain competitive in the dynamic environment.

Recommendation on policy and regulatory frameworks

There is a need for a robust approach to developing policy and regulatory frameworks to ensure alignment to the evolving financial landscapes. It is necessary to ensure new regulations and reporting requirements for banks regarding their climate impact and financial exposure to climate risks does not pose regulatory uncertainty to banks and regulatory burden on lower tier banks. Stability of policies, regulations, and standards will be fundamental for banks to confidently invest in the sustainable finance market.

Policies and regulatory frameworks should be transitional in nature and allow for sufficient time for implementation, this would go a long way in creating certainty for banks to invest in green sectors. While existing regulations lay a foundation, they need to be refined by adding additional measures to enhance clarity and depth to catalyse sustainable finance in Kenya.

Recommendations on overcoming barriers to sustainable finance in Kenya

To address the technical capacity gap that remains a barrier to mobilising financing for sustainability, banks with assistance of partners need to enhance capacities on sustainable finance for effective implementation of sustainable finance practices.

Encourage detailed analysis of industry loan portfolios to determine the proportion of green assets. This will help to close the green portfolio data gap, increase transparency, and support banks in packaging green products to attract international green finance.

Strengthen collaborations with regulators, development partners, and industry peers to remove silos, improve adoption of sustainable practices and increase sustainable finance.

Lobby for consistent tax incentives for sustainable investments for funding the transition to a sustainable economy such as zero or reduced VAT rates for certain green products and service offered by banks and enhanced tax deductions for research and development and innovation

expenditure. However, banks will need to be aware of how to structure tax incentives in order to meet the global minimum tax requirements.

Recommendations for Enhancing Transparency and Disclosure

Enhance regulatory oversight of the financial sector regulators through capacity building and technical assistance to equip them to effectively monitor and enforce sustainability and climate-related risks disclosure requirements.

Encourage collaboration amongst stakeholders, financial sector players, government, the private sector, the civil society, and the academia to create an enabling environment, awareness and share best practices on sustainability and climate-related risks management and reporting.

Expand incentives programmes to recognize banks that excel in implementing and reporting on their sustainability practices to motivate them to improve their reporting.

Recommendations on seizing opportunities arising from adoption of sustainable finance frameworks.

Sustainable finance frameworks adopted by Kenyan banks are many, fragmented and are largely voluntary. Therefore, there is need to move towards standardisation and convergence of sustainability reporting led by the financial sector regulators. Consideration for mandatory adoption for agreed upon standards should be pursued to create uniformity and enhance consistency and comparability in ESG disclosures.

Provide a clear strategy for mainstreaming sustainable finance practices in financial reporting in the financial sector to guide implementation and reporting. This should be accompanied by systematic capacity building on sustainable finance across the whole industry.

There is a pressing need for all banks to align their portfolios, businesses, and strategy with the Paris Agreement. Alignment can help banks capture the opportunities created by the low carbon transition in the country as laid out in the country's key policy documents, laws and sectoral plans.

Data collection and management remains a hindrance to quality reporting on sustainable portfolios. Banks must be able to collect, analyse and report on various sectors' data points to demonstrate compliance and avoid regulatory and reputational risks. Reliable and comparable data within the industry will be key for assessing financial stability risks, pricing and managing ESG-related risks, as well as tapping into opportunities arising from the planned transition to a green economy.

To commence and sustain disclosure of quality data banks will need to invest in better systems, raise awareness within their institutions and client base, build capacities and expertise in sustainable finance and set-up procedures and tools for reporting.

It is imperative to match the progress made in adopting sustainability reporting with development of innovative and diversified sustainable finance products and services. This way banks will increase their investments in green portfolios, facilitate capital mobilisation, and empower market participants to identify and invest in sustainable assets and enhance brand reputation.

> **Sustainable finance frameworks adopted by Kenyan banks are many, fragmented and are largely voluntary.**

WWF KENYA

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Sustainable Finance Initiative

KENYA BANKERS ASSOCIATION

Office: Kenya Bankers Association
13th Floor, International House
Mama Ngina Street, Nairobi

P.O.Box 73100 – 00200
Nairobi, Kenya

Call Us: +254-20-2221704 / +254-20-2217757 or
+254-20-2224014 / +254-20-2224015