ESG integration by pension regulators in Kenya

Diagnostic study

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25 YEARS OF UNLOCKING VALUE

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1. INTRODUCTION

1.1 Project background

Increasingly, companies and investors are being looked at to lead the charge in mitigating and adapting to climate change, reducing discrimination, and increasing transparency.[1] Pension funds are major investors whose decisions can have a powerful impact on ESG factors. In just 22 countries, pension funds control $56.6 trillion in assets.[2] But, given the variety of disclosure and reporting requirements, such as EU Taxonomy regulation and the Task Force in Climate-related Financial Disclosures, pension funds rely on their regulators to guide them on how to incorporate ESG factors in their investment and risk management processes.

These challenges are significant in Sub-Saharan Africa. The region has a Corruption Index score of 32 out of 100; the lowest scorer in the region was Somalia which scored 13 out of 100 as the president has recently dissolved anti-corruption commissions.[3] This low regional ranking has economic implications seen by the recent grey listing of Nigeria and South Africa by the Financial Action Task Force.[4] When it comes to human development, all the Sub-Saharan countries except Seychelles and Mauritius fall below the global average Human Development Index score.[5] Additionally, African countries are some of the most vulnerable to climate-related risk, with drastic climate change causing knock-on effects within African economies that impact poverty, food security, and economic development. To mitigate these impacts and support global climate targets (such as the 2 degrees global goal under the Paris Agreement), African countries will need to dramatically increase investment in climate-related assets. Pension funds have the finance to mobilise for this cause and are therefore key role players.[6]

Despite these challenges, Africa is lagging global developments in ESG disclosure including in the pension industry. Half of African pension funds do not disclose sustainability information about their investments.[7] This is largely driven by a lack of regulation, policy, and voluntary[8] initiatives to regulate and monitor ESG adoption by the pension industry.

To support the development of regulations and guidelines on ESG disclosures, regulators and the industry need to work together to identify gaps and solutions in each country. This will require capacity building and an in-depth knowledge of ESG risks.

In this context, this project aims to:

Develop effective ESG toolkits and guidance/guidelines that will enable pension regulators in Ghana, Kenya, and Nigeria to integrate ESG considerations into their supervisory processes, regulations, and reporting requirements.

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[1] Edelman Trust Barometer. (2023). *2023 Edelman Trust Barometer: Global Report.* [Online]. Available: https://www.edelman.com/sites/g/files/aatuss191/files/2023-03/2023%20Edelman%20Trust%20Barometer%20Global%20Report%20FINAL.pdf. [March 2023].

[2] Thinking Ahead Institute. (2022). *Global Pension Assets Study - 2022.* [Online]. Available: https://www.thinkingaheadinstitute.org/research-papers/global-pension-assets-study-2022/. [March 2023].

[3] Transparency International. (2023). *CPI 2022 for Sub-Saharan Africa: Corruption compounding multiple crises.* [Online]. Available : https://www.transparency.org/en/news/cpi-2022-sub-saharan-africa-corruption-compounding-multiple-crises. [March 2023].

[4] Institute for Security Studies. (2023). *Shades of grey: FATF lists South Africa and Nigeria.*[Online]. Available :https://issafrica.org/iss-today/shades-of-grey-fatf-lists-south-africa-and-nigeria#:~:text=Greylisting%20means%20that%20South%20Africa,the%20financing%20of%20serious%20crimes. [March 2023].

[5] United Nations Development Programme. (2023). *Human Development Index.* [Online]. Available: https://hdr.undp.org/data-center/human-development-index#/indicies/HDI. [March 2023].

[6] Climate Policy Initiative; Children's Investment Fund Foundation; FSD Africa and UKAid. (2022). Landscape of Climate Finance in Africa. [Online]. Available: https://www.climatepolicyinitiative.org/wp-content/uploads/2022/09/Landscape-of-Climate-Finance-in-Africa.pdf. [March 2023].

[7] Stewart, F. (2021). *The elephant in the room: Bringing sustainable investment to Africa.* [Online]. Available: https://blogs.worldbank.org/psd/elephant-room-bringing-sustainable-investment-africa. [March 2023].

[8] For example, we don't see a large number of pension funds taking significant independent initiative around ESG without regulatory/similar prompting or requirements.

There are two **key objectives** for this project:

1. **Review ESG-related regulatory practices in the pension industry in Ghana, Kenya and Nigeria. Identify gaps and areas for improvement.**
2. **Develop ESG toolkits, ESG focused regulations/policy guidance or guidelines and capacity building to support supervisors in integrating ESG principles and targets in the pension industry.**

This report delivers on the first of these objectives, specifically for Kenya.

1.2 Introduction to ESG

A common understanding of ESG will be helpful for the purposes of this document. Put simply, ESG is an acronym for:

- Environmental;
- Social; and
- Governance.

Together, these three elements provide a framework for understanding the impact and risks of an organisation beyond its financial performance. However, these elements are often considered as distinct silos rather than being considered together. In particular, the international focus has been on incorporating the governance element typically by creating policies guiding corporate governance, anti-corruption and whistleblowing. Progress has been made in creating data protection and privacy policies which would fall under the social element along with more-established issues relating to workforce, safety, and communities (among others). Historically, less progress has been made in considering environmental factors - though this is rapidly changing with the increased global attention, it hasn't yet reached the level of establishment of governance factors, given its relative nascency from a regulatory perspective.

Each of the three categories refers to a range of related concerns and whilst there is no universal list there are common factors in each of them:

Table 1: ESG categorisation

Environmental factors	Commonly include climate change, carbon emissions, air and water pollution, biodiversity, deforestation, energy efficiency, waste management and water scarcity.
Social considerations	Commonly include customer satisfaction, data protection and privacy, gender and diversity, employee engagement, community relations, human rights and labour standards, and cybersecurity.
Governance considerations	Commonly include board composition, audit committee structure, bribery and corruption, executive compensation, lobbying, political contributions, and whistleblowing.

Understanding and measuring ESG is complex; which is why the common list is so broad. Adding to this complexity, an organisation's context plays a defining role in assessing its ESG impact and risks: the country/countries of operation, industry, size, business model, and geography of an organisation are all significant influences. ESG guidance for developed countries is unlikely to be immediately applicable in developing countries' context. Having said that, an advantage of being less advanced in ESG integration is that we can learn from global best practice. This serves as a baseline that is then customised based on examples from developed and developing countries, and enhanced by deep-dive assessments of Ghana, Kenya, and Nigeria.

Whilst the term ESG first was used in investment decision-making processes, it is also an important component of risk management processes.[9] Since both of these processes are essential to pension funds, it should not be surprising that key stakeholders from the pension industry are demanding that pension funds consider ESG factors.[10] The International Organisation of Pension Supervisors has provided guidelines for regulators as they support this process in their countries.[11]

With the definition of ESG and the importance of contextual factors in mind, the next section will introduce the diagnostic report.

1.3 Introduction to the Diagnostic Report

To create the diagnostic reports, we began by reviewing global best practice and understanding the status quo of ESG adoption by pension funds and pension regulators in the three focus countries.

We were looking to answer several key questions:

1. What ESG risk categories are pension funds in **Kenya**, Ghana, and Nigeria exposed to (or will become exposed to) and how are they anticipating and responding to them?
2. What tools, regulations, policies, or initiatives are currently guiding pension funds to consider ESG factors?
3. Is there appetite among pension funds and pension regulators to adopt ESG considerations? What are common concerns around adoption?
4. Which stakeholders are contributing to or influencing ongoing discussions on the integration of ESG issues in risk assessment and/or asset management? What are the driving factors?

This report summarises the current status and regulatory practice of pension regulators in Ghana, Kenya, and Nigeria in relation to ESG risks. The report aims to answer the above questions through a combination of desktop research, internal Genesis best practice and knowledge, stakeholder interviews and workshops, and pension fund surveys. Furthermore, the report identifies key gaps in ESG integration as well as potential opportunities for regulatory intervention and action.

These opportunities are not fully prioritised in this document. The prioritisation will occur in the next phase of the project, where FSD Africa, Genesis, and the regulators will co-create ESG toolkits and regulations/policy guidance or guidelines in each of the three focus countries. This Diagnostic Report is the foundation for that particular set of next steps.

In the first section of this Diagnostic Report, we review global best practice to introduce a benchmark view and global context to the discussion. This section contains detailed information so that it can continue to act as a reference for this and future work. We subsequently examine Kenya against the questions described above. Within each country, we seek to understand ESG at the country, financial services sector, and pension sub-sector levels. This enables us to present our findings as a set of preliminary gaps and opportunities which will be taken forward into the next phase of the project. The document closes with a brief conclusion and definition of next steps, and also includes additional details and documentation for reference in a series of annexures.

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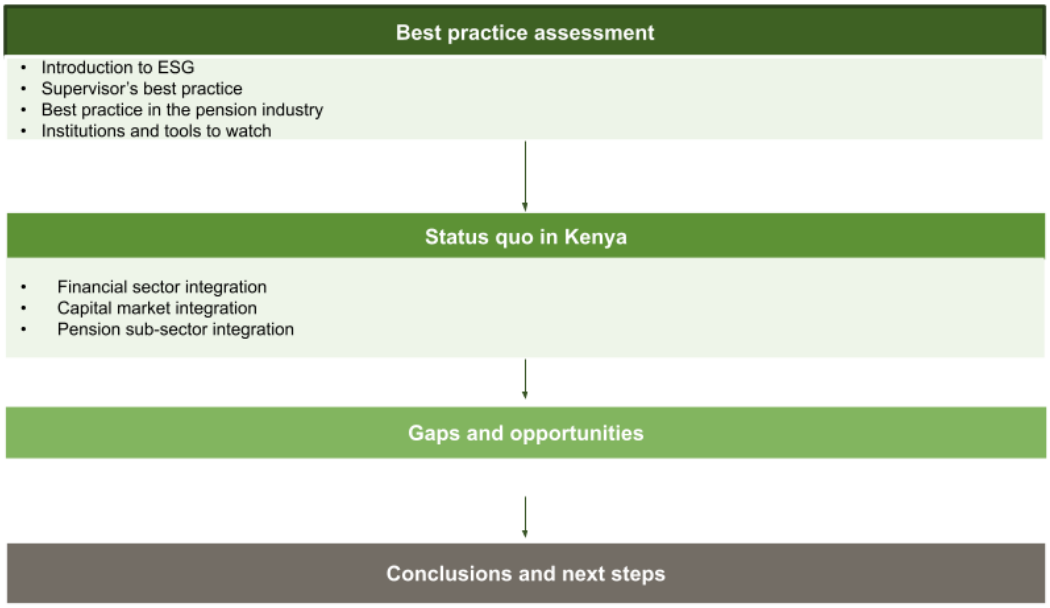
[9] The assets that pension funds have invested in may be affected by the physical, transition, technological and liability risks of climate change; as such, considering these risks before investing in assets is important.

[10] International Organisation of Pension Supervisors. (2019). *IOPS Supervisory Guidelines on the Integration of ESG Factors in the Investment and Risk Management of Pension Funds.* [Online]. Available: http://www.iopsweb.org/IOPS-Supervisory-guidelines-integration-ESG-factors.pdf. [March 2023].

[11] International Organisation of Pension Supervisors. (2019). *IOPS Supervisory Guidelines on the Integration of ESG Factors in the Investment and Risk Management of Pension Funds.* [Online]. Available: http://www.iopsweb.org/IOPS-Supervisory-guidelines-integration-ESG-factors.pdf. [March 2023].

Figure 1: Report structure



Source: Genesis Analytics (2023)

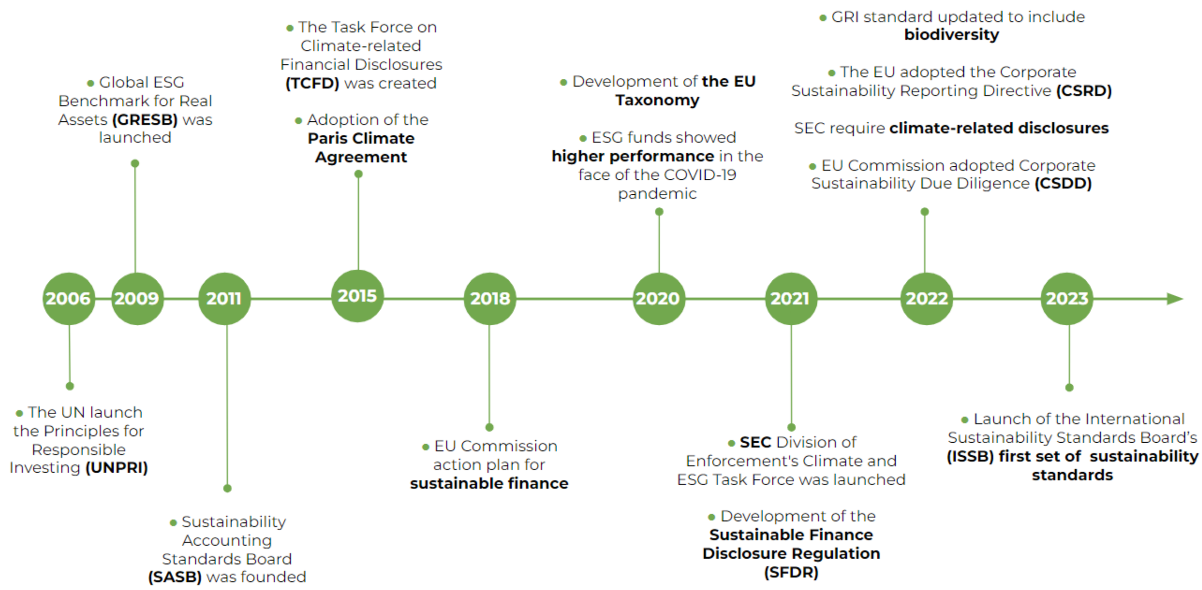
2. GLOBAL BEST PRACTICE

Sustainability standards - and climate-related risk prudential supervision - are still being steered and refined globally. Data availability remains a major challenge in this space, both for regulators and practitioners, and efforts are being made to achieve some consistency on the measurement mechanisms. While some of the frameworks adopted in the UK and the EU provide a model of best practice, the details of most ESG and climate-related risks are context-specific. Therefore, the tools developed by regulators in each country can learn from the experience in other economies, but should adapt their own guidance to the realities, tools and context of their own markets.

2.1 Supervisors' best practice

The Evolution of ESG rule making

Figure 2: The high-level evolution of ESG rule making



Source: Genesis Analytics (2023).

ESG regulation was initially introduced in the domain of institutional investment, and later followed into prudential regulation with a particular focus on environmental risk management. ESG risks are material considerations for the pension industry as they impinge on the investment portfolio. Pension funds were early adopters of sustainability related risk, an initiative spearheaded by the US pension industry, making them key institutional investors and early adopters of ESG regulation.[12] Investors were in the past encouraged and now obliged to include ESG metrics in the form of disclosures in their annual reports, standalone sustainability reports, and/or dedicated compliance documents, despite ESG metrics not forming a part of mandatory financial reporting.

This "first wave" of rule-making dates back to 2016, when France's *Article 173* for the first time asked investors to report on how they account for environmental, social, and corporate governance criteria - with specific mention of climate - in their investment policies; this was done on a comply-or-explain basis.[13] **Since then, further regulatory action focused on ESG, green, or sustainable finance has followed.** For

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[12] Hammond & O'Brien. *Pensions and ESG: An Institutional and Historical Perspective.* [Online]. Available:https://repository.upenn.edu/cgi/viewcontent.cgi?article=1717&context=prc_papers. [February 2023].
[13] Natixis. (2021). *Insurers: the ESG regulation challenge.* [Online]. Available:https://www.im.natixis.com/en-institutional/resources/insurers-the-esg-regulation-challenge-doc. [March 2023].

example, the EU drafted the *Green Taxonomy* was established to develop a common understanding of what counts as "green". This offers a common set of criteria that investors and banks can use to screen potential investments. The taxonomy entered in force in 2021 and its Technical Screening Criteria (TSC) will continue to be developed until 2023.[14] This example has been followed outside the EU, including in developing countries. In South Africa, for example, the National Green Finance Taxonomy was launched in April 2022.[15]

In the UK, disclosure guidelines have had a stronger focus on climate through the *Task Force on Climate-related Financial Disclosures (TCFD)*.[16] TCFD essentially strives for clear, comprehensive, high-quality information on the impacts of climate change, as a mandatory requirement for financial institutions of more than 500 employees from April 2022. In the United States, the Securities Exchange Commission issued a statement on 21 March 2022 expressing that it is considering a proposal to mandate climate-risk disclosures by publicly listed companies. Insurance sector ESG regulation primarily focuses on the climate-risk aspect of ESG, while pension funds are found to not be equally sensitive to climate-related risks.[17] While ESG funds are all sensitive to ESG risks, the levels of sensitivity to each ESG factor differs across countries**.** This variability makes it crucial that ESG regulation development prioritises country-specific risk sensitivities.

The most recent development in this space has been the launch of the International Sustainability Standards Board's (ISSB) first set of sustainability standards in 2023.[18] Comprising two IFRS Sustainability Disclosure Standards, these standards aim to improve transparency in ESG information presented by companies and to establish a global baseline for sustainability disclosures, allowing for more comprehensive and comparable data sharing in the global capital markets. The standards integrate the recommendations of the Task Force on Climate-Related Financial Disclosures, and for the first time, create a common language for disclosing climate-related risks and opportunities.

It is often difficult to see how ESG risks impact finance and investment, which is why it's important to understand how ESG risks create financial risks through transmission channels. Figure 3 below demonstrated how certain ESG risks, through transmission channels, result in financial risks.

[14] European Commission. (2020). *EU taxonomy for sustainable activities.* [Online]. Available:https://ec.europa.eu/info/business-economy-euro/banking-and-finance/sustainable-finance/eu-taxonomy-sustainable-activities_en#what. [March 2023].

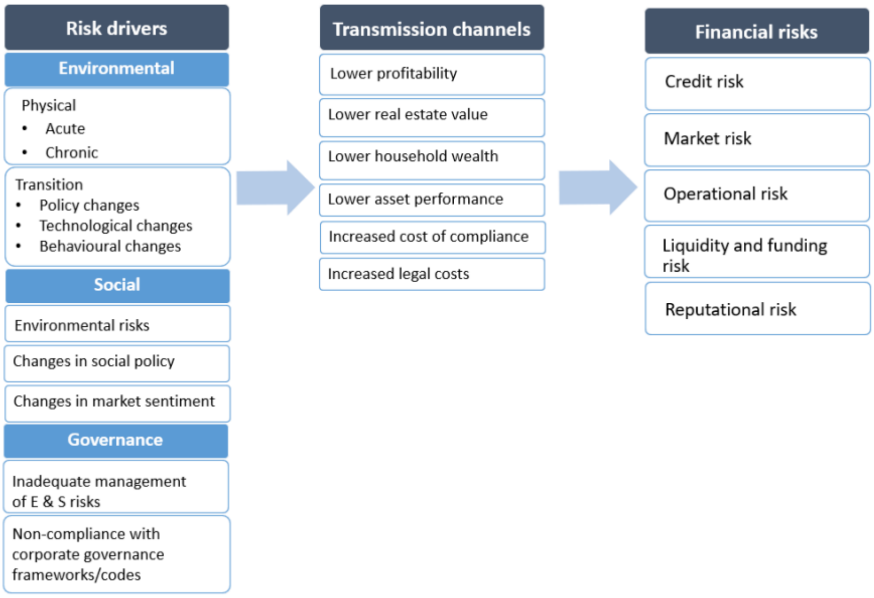
[15] The South African Government. (2022). Treasury on launch of South Africa's first national Green Finance Taxonomy. [Online]. Available: https://www.gov.za/ts/speeches/south-africa%E2%80%99s-first-national-green-finance-taxonomy-launched-assist-financial-sector. [March 2023].

[16] Financial Stability Board. (2021). Task Force on Climate-related Financial Disclosures (TCFD). [Online]. Available: https://www.fsb-tcfd.org/. [March 2023].

[17] Stewart & Deschryver. (2020). Overheating pension pots: How resilient are pension systems to climate change?. [Online]. Available: https://blogs.worldbank.org/psd/overheating-pension-pots-how-resilient-are-pension-systems-climate-change. [February 2023].

[18] ICAEW Insights (2023). ISSB issues first sustainability disclosure standards. Available: https://www.icaew.com/insights/viewpoints-on-the-news/2023/jun-2023/issb-issues-first-sustainability-disclosure-standards [July 2023]

Figure 3: Transmission channels of ESG risks and their impacts on financial markets



Source: European Banking Authority. (2021). [EBA report on management and supervision of ESG risks for credit institutions and investment firms](#).

ESG rulemaking in developing markets

While some of the frameworks adopted in the UK and the EU provide a model for aspects of best practice, ESG risks are context specific. Therefore, ESG guidance by regulators should reflect the realities, tools, and context of each economy. The following section reflects on some of the regulatory developments that have been recently drafted in a selection of emerging (or "developing") economies, which are of particular interest to this project.

In emerging economies, pension and financial sector regulators, stock exchanges, central banks, and ministries of treasury - in some cases partnering with international organisations - have been developing their own guidelines and supervisory requirements. They aim to enhance transparency and encourage action toward greater sustainability in their own markets, enhance market stability and facilitate economic and social development. Enforcing these guidelines and requirements will be key to their implementation especially as some companies do not yet consider ESG in their strategies.[19] However, some countries in Sub-Saharan Africa (e.g. Nigeria, South Africa, and Kenya) are already experiencing the fruit of these policies with investors increasingly looking for ESG-related investment opportunities; and different sectors are incorporating ESG risks into their decision making.[20, 21] South Africa is an example of where the pension regulators have strived to increase their understanding of market practice on sustainable issues.

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[19] PWC. (2023). *Africa Business Agenda: ESG Perspective 2023.* [Online]. Available: https://www.pwc.co.za/en/assets/pdf/africa-business-agenda-esg-perspective-2023.pdf. [April 2023].

[20] Savage, R. (2022). *More African countries implementing ESG finance policies - study.* [Online]. Available: https://www.reuters.com/business/finance/more-african-countries-implementing-esg-finance-policies-study-2022-10-13/. [April 2023].

[21] ESG Enterprise (2020). *The State of ESG in Africa.* [Online]. Available: https://www.esgenterprise.com/esg-news/esg-africa/. [April 2023].

Their actions reveal that a crucial first step is to conduct deep surveys and/or discuss roadmaps before drafting prescriptive regulation.[22]

Another interesting aspect of developing country pension fund ESG interventions is that ESG language is used to refer to responsible investment as well as disclosure and reporting. This is consistent with the approach taken by developed countries. This can be seen for listed companies that address investors through periodic reporting.

This is most clear in considering the "environmental" aspect of ESG where a few countries have started to draft their own green taxonomies defining the activities that count as "green" in their context. Some of the countries that have already implemented green taxonomies include: South Africa, Malaysia, Indonesia, Colombia, Georgia and Bangladesh, with many countries currently in the process of developing such taxonomies.[23] Lastly, understanding the exposure and potential impacts of climate risks in the financial markets as a whole (systemic analysis) is becoming increasingly common, as evidenced by the recent actions of Chile (2021 Financial Market Commission's strategy for addressing climate change), Singapore (2021 system-wide consultation on environmental risks guidelines), Mexico (2021 system-wide consultation on environmental issues into risk assessment), Brazil (2016 insurance market survey), and Malaysia (2021 climate change and principle based taxonomy).

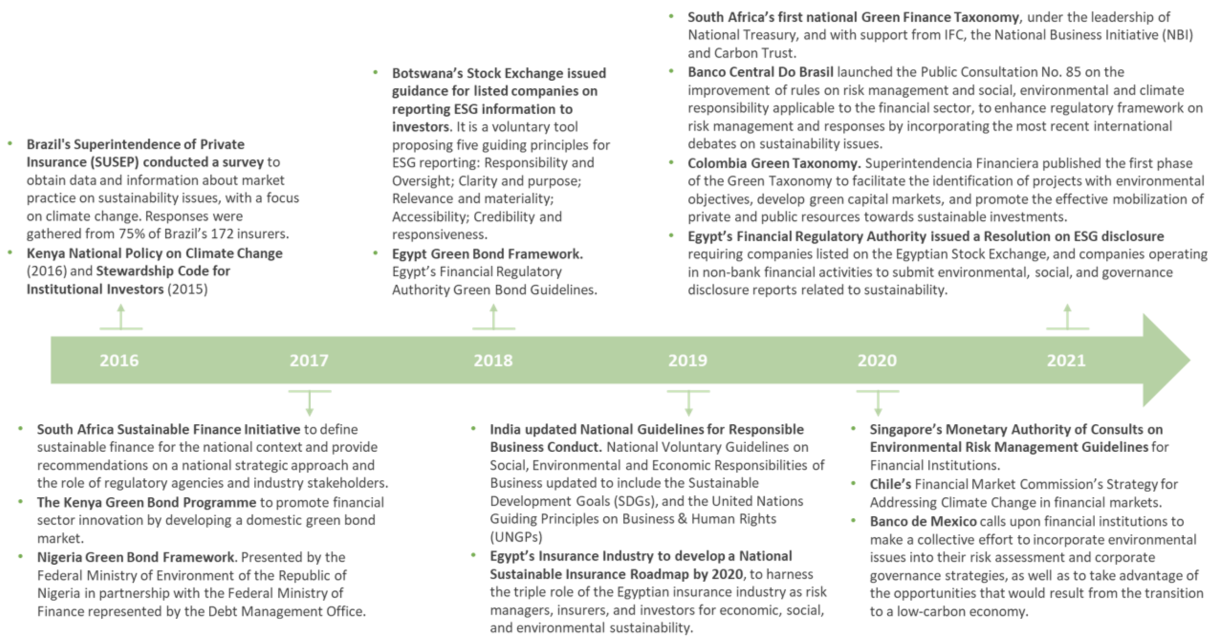
Corporate governance and stewardship codes are an established tool to regulate decision making and protect the interest of policy holders in both developed and developing countries. In many developing countries, these policies are being updated to reflect ESG factors considering contextual concerns. An example is the King report on corporate governance in **South Africa**. King I was published for the first time in 1994, recommending standards of conduct for boards and directors of listed companies, banks, and certain state-owned enterprises. King III (the 2009 update) integrated - for the first time - governance, strategy, and sustainability. The latest update, King IV (published in 2016), acknowledged that stakeholders have greater expectations than ever before and stated that millennials are increasingly concerned about environmental issues. Its recommendations acknowledge *three key shifts in the corporate world*:

1. A shift from financial capitalism to inclusive capitalism;
2. A shift from short-term capital markets to long-term, sustainable markets; and
3. A shift from siloed reporting to integrated reporting.

[22] The World Bank. (2021). *African Pension Funds.* [Online]. Available: https://thedocs.worldbank.org/en/doc/2c14fd5a74200c20d9fa48887ac7889b-0430012022/original/Africa-pension-funds-ESG-landscape-V2.pptx. [March 2023].

[23] EcoFact. (2022). Green Taxonomies Around the World: Where Do We Stand?. [Online] Available: https://www.ecofact.com/blog/green-taxonomies-around-the-world-where-do-we-stand/. [March 2023].

Figure 4: "ESG" rulemaking in selected emerging market economies



Source: Genesis Analytics. (2022). Information from: Green Finance Forum. (2022). [Policies and Regulations](). Note: The scheme limits to recent developments and it is not an exhaustive depiction of all regulatory developments in all emerging market economies

Prudential Regulation, Supervision, and Enforcement

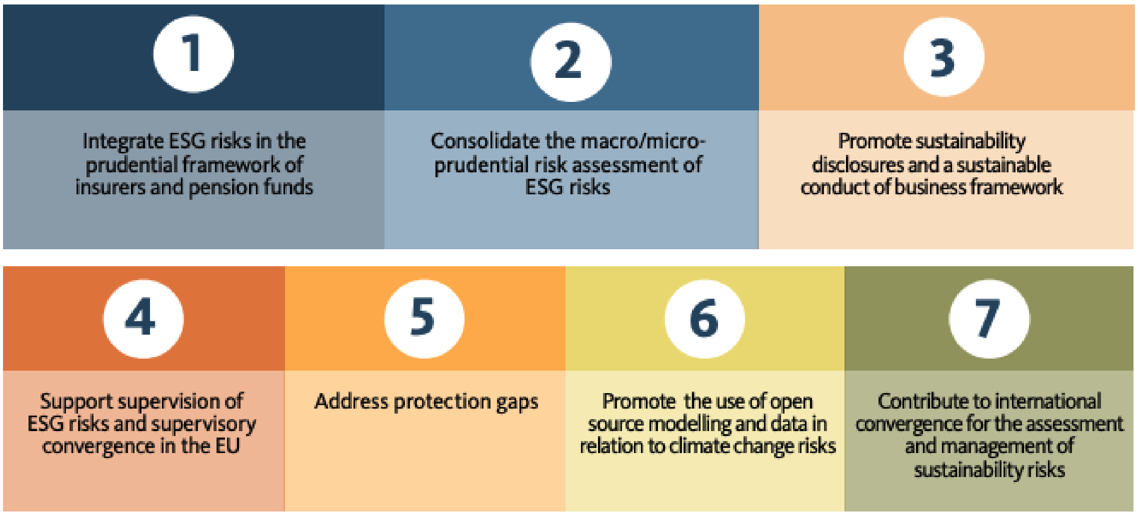
An initial assessment on global pension funds' prudential supervision shows that, up to now, it has taken the form of high-level guidance, recommendations, and expectations - rather than specific enforceable measures. Consequently, the understanding of climate-related risks is continuously evolving and improving over time, and supervisory practices are to be seen as iterative and dynamic processes.

In April 2019, the Bank of England (BoE) became the first central bank and supervisor to set supervisory expectations through the Supervisory Statement 3/19 for banks and insurers on the management of climate-related financial risks, covering governance, risk management, scenario analysis, and disclosure. So far, the BoE has been concerned with improving the understanding of the potential transmission mechanisms, providing observations on good practice, and facilitating robust and accessible tools for the industry to meet its prudential expectations (see below). Currently, most pension funds do not use climate stress-testing or scenario analysis results when assessing the capital, asset and solvency requirements of their portfolios.[24] For example, the BoE explicitly states that it will undertake further analysis over 2022 to explore whether enhancements to the regulatory capital frameworks are needed.[25] Crucially, this might have material implications in pricing, and consequently in the overall social objective of closing the current insurance gap and enhancing financial inclusion. In 2021, the UK Pension Regulator amended the guidelines on Defined Contribution (DC) investment governance to clarify that pension funds should show that they incorporate ESG factors in risk assessment and investment decision making processes in their Statement of Investment Principles and Implementation Statement.[26,27] Similarly, the

[24] BIS. (2019). *Turning up the heat – climate risk assessment in the insurance sector*. [Online]. Available: https://www.bis.org/fsi/publ/insights20.pdf. [March 2022].
[25] BoE. (2021). *Climate Change Adaptation Report 2021*. [Online]. Available: https://www.bankofengland.co.uk/prudential-regulation/publication/2021/october/climate-change-adaptation-report-2021. [March 2022].
[26] Osborne Clark. (2023). *UK Pensions Regulator steps up focus on ESG and climate-change reporting rules*. [Online]. Available: https://www.osborneclarke.com/insights/uk-pensions-regulator-steps-focus-esg-and-climate-change-reporting-rules. [April 2023].
[27] The Pensions Regulator UK. (2021). *DC investment guidance*. [Online]. Available: https://www.thepensionsregulator.gov.uk/en/document-library/scheme-management-detailed-guidance/funding-and-investment-detailed-guidance/investment-guide-for-dc-pension-schemes. [April 2023].

European Insurance and Pensions Authority (EIOPA) is currently integrating sustainability into the supervisory framework through seven key areas of activity on sustainable finance for 2022-2024 spanning the integration of ESG risks in the prudential framework, addressing disclosure and protection gaps.[28]

Figure 5: EIPOA's Priorities to Address Sustainable Risk



Source: EIPOA's Sustainable Finance Activities 2022-2024

Common themes and recommendations

As stated above, both climate-risk prudential supervision as well as sustainability standards and measurement mechanisms are being steered and refined globally. Efforts by the ISSB to develop a universal sustainability and ESG reporting framework (the first of which were launched in 2023) signify a movement towards a universally accepted set of ESG principles. However, even outside of the ISSB standards, common themes are evident from the expectations and regulatory developments advancing in the UK (PRA), EU (EIOPA), Ireland (CIB), United States (NIPA), Netherlands, South Africa, India, and Brazil**.** The following table summarises common areas of best practice recommendations. These are areas where greater convergence of standards and prudential regulation is expected in the future.

[28] EIOPA. (2021). *EIOPA's priorities to address sustainability risk.* [Online]. Available:https://www.eiopa.europa.eu/document-library/annual-work-programme/sustainable-finance-activities-2022-2024_en. [March 2023].

Table 2: Common themes from expectations and regulatory developments in the pension industry

Key theme	Common supervisory expectation	Existing
Governance	• Pension funds should **embed ESG issues in decision making in investment analysis and decision making** (Principle 1 of UN's Principles for Responsible Investment PRI). • **Boards need to demonstrate clear knowledge and ownership of climate risks**, while also **promoting an internal culture that emphasises the importance of climate and other ESG issues**. • Pension funds are expected to have **clear roles and responsibilities for the board and its relevant sub-committees in managing the financial risks from climate change**. These should be under the responsibility of Senior Management Functions (SMF) and ensure that these responsibilities are included in the SMF's Statement of Responsibilities.	Netherlands, Brazil, South Africa, UK, Canada
Risk management framework	• Pension funds are expected to understand the impact of climate change on their risk profiles and **ensure that existing risk management frameworks are** appropriately **robust to identify, monitor, measure and mitigate climate risks**. • **Risk appetite statements should include the risk exposure limits and thresholds for the financial risks** that the firm is willing to bear. • **Risk identification and measurement:** Use scenario analysis and stress-testing. (See below) • **Risk monitoring:** consider a range of quantitative and qualitative tools and metrics to monitor exposure. Monitor progress against their overall business strategy and risk appetite. • **Risk management and mitigation:** provide evidence how the investment decisions mitigates financial risks arising from climate-related risks and have a credible plan or policies in place for managing exposures. • Initial efforts to conduct risk assessment for the entire financial sector.	UK, Ireland, European Union, Brazil, Mexico, Chile.
Scenario analysis and stress testing	• Use **scenario analysis to understand the impact of the financial risks from climate change financial sectors and investments** . • Consider both s**hort term and long-term risk under different scenarios** (orderly and disorderly scenarios). • When using **scenario analysis and stress-testing and go beyond using only historical data to inform their risk assessment,** e.g., consider future trends in catastrophe modelling. • Promote the **use of open-source modelling and data in relation to climate change risks.** (EIOPA) • Supervisors have a **growing interest in including climate-related events in system-wide stress tests** exercises.[29] The BoE already does.	UK, Ireland, European Union
Disclosures	• **Pensions funds will demonstrate accountability and transparency in regularly disclosing publicly our progress** in implementing the Principles. (Principle 3 of UN's Principles for Responsible Investing) • **Transparent disclosures to consumers and investors** will be key with authorities stressing the importance of not engaging in greenwashing. • **Consider whether further disclosures are necessary to enhance transparency** on their approach to managing the financial risks from climate change, in line with the expectations set out in the overarching supervisory statement (i.e., existing requirements to disclose information on material risks and on principal risks and uncertainties in their Strategic Report. • Under UK regulation, firms with over 500 employees should **comply with TCFD.** TCFD requirements comprise climate-related disclosure in 4 areas: Governance, Strategy, Risk Management and Targets and metrics.	UK, Ireland, European Union, Brazil
Investment	• Pension funds should **adopt a sustainable approach to their investments based on principles of stewardship**.	UK, Ireland,

[29] BIS. (2019). *Turning up the heat – climate risk assessment in the insurance sector*. [Online]. Available: https://www.bis.org/fsi/publ/insights20.pdf. [March 2023].

Key theme	Common supervisory expectation	Existing
	(EIOPA) • Pension funds must **diversify their assets to avoid excessive accumulation of risk** in the investment portfolio. • Use the **"prudent person principle" in assessing investment exposures** (i.e., ensuring that insurers only invest in assets that they can properly identify, measure, monitor, manage, control and report) • Supervisors will **focus on inconsistencies between the management of assets and liabilities, resulting in a "cognitive dissonance"** (i.e., when careful management of climate change risks on the liability side of their balance sheet is not always matched by similar considerations on the asset side)[30]	European Union, South Africa
Strategy and business model	• Appropriate **business model analysis should be undertaken to determine the impacts (and potential opportunities) of climate risks** on insurers' overall risk profile, business strategy and sustainability. • France has adopted the "PACTE" law on companies' growth and transformation. It integrates the need for consideration of social and environmental issues in a company's strategic activities.[31]	UK, Ireland, European Union, United States

[30]Deloitte. (2020). *Climate change and insurance How boards can respond to emerging supervisory expectations.* [Online]. Available: https://www2.deloitte.com/content/dam/Deloitte/pt/Documents/risk/Deloitte-UK-climate-change-and-insurance.pdf. [March 2023].

[31] Green Finance Platform. (2019).France's Law on Business Growth and Transformation (PACTE Law). [Online]. Available: https://www.greenfinanceplatform.org/policies-and-regulations/frances-law-business-growth-and-transformation-pacte-law [March 2023].

2.2 Best practice in the pension industry

The World Bank Group created a sustainability scoring checklist for the pension industry which identified that the industry typically has governance policies in place and many countries also have published an approach to sustainable investments. However, more work is needed to create policies that align pension fund investment and risk management with climate-related concerns.[32]

This checklist was also applied to pension disclosures in African countries.[33,34] According to this study, Ghana, Kenya and Nigeria do have some disclosures that refer to ESG integration and reporting, human rights and anti-corruption measures, but lack disclosures that refer to specific ESG and TCFD indicators.[35] Across all the countries in the study (South Africa, Namibia, Botswana, Nigeria, Ghana, Kenya, Uganda, Tanzania), on average only 20% of the TCFD-related information was found whilst on average 65% of ESG Integration information in the checklist was found.[36]

A key finding is that "peer to peer learning [is needed] between African pension fund [supervisors] on ESG best practices" and that a "coordinated regional approach" is recommended.[37] Whilst no specific recommendations are provided for how this peer to peer learning is to take place; sharing experiences on creating, implementing and enforcing guidelines may be valuable. Within South Africa, peer pressure from competitors that are implementing these guidelines increased reporting on ESG indicators.[38] In support of the above findings, an international survey of institutional investors found that the investors tended to prioritise governance and social risks over environmental ones.[39] This could be because pricing and hedging climate risks is complex because of the lack of data relating to risks and the complexity of predicting when these risks will materialise.[40] To support the pension industry in understanding these risks, the World Bank Group conducted research to quantify climate change risks and regulatory risks of pension industries around the world. The results are presented in the next section.

Climate-related supervision

Climate change affects economies and industries across the world. The pension industry is no exception and is particularly impacted by the physical appreciation or depreciation of asset values, the transition away from (and thus change in growth projections of) certain industries, the impact of changing technologies on invested companies and regulatory risk.[41,42] These impacts are not evenly distributed, with

[32] The World Bank Group. (2020). *Sustainable Investment: Best Practice Disclosure Checklist for Pension Funds.* [Online]. Available: https://openknowledge.worldbank.org/entities/publication/96739f70-fa91-5bad-bc37-f4c45458758f. [April 2023].

[33] The World Bank Group. (2021). *African Pension Funds - Environmental, Social and Governance Factors.* [Online]. Available: https://thedocs.worldbank.org/en/doc/2c14fd5a74200c20d9fa48887ac7889b-0430012022/original/Africa-pension-funds-ESG-landscape-V2.pptx. [April 2023].

[34] The World Bank Group. (2020). *Sustainable Investment: Best Practice Disclosure Checklist for Pension Funds.* [Online]. Available: https://openknowledge.worldbank.org/entities/publication/96739f70-fa91-5bad-bc37-f4c45458758f. [April 2023].

[35] The World Bank Group. (2021). *African Pension Funds - Environmental, Social and Governance Factors.* [Online]. Available: https://thedocs.worldbank.org/en/doc/2c14fd5a74200c20d9fa48887ac7889b-0430012022/original/Africa-pension-funds-ESG-landscape-V2.pptx. [April 2023].

[36] The World Bank Group. (2021). *African Pension Funds - Environmental, Social and Governance Factors.* [Online]. Available: https://thedocs.worldbank.org/en/doc/2c14fd5a74200c20d9fa48887ac7889b-0430012022/original/Africa-pension-funds-ESG-landscape-V2.pptx. [April 2023].

[37] The World Bank Group. (2021). *African Pension Funds - Environmental, Social and Governance Factors.* [Online]. Available: https://thedocs.worldbank.org/en/doc/2c14fd5a74200c20d9fa48887ac7889b-0430012022/original/Africa-pension-funds-ESG-landscape-V2.pptx. [April 2023].

[38] *The World Bank Group. (2021). African Pension Funds - Environmental, Social and Governance Factors. [Online]. Available: https://thedocs.worldbank.org/en/doc/2c14fd5a74200c20d9fa48887ac7889b-0430012022/original/Africa-pension-funds-ESG-landscape-V2.pptx. [April 2023].The World Bank Group. (2021). African Pension Funds - Environmental, Social and Governance Factors.*

[39] Krueger, P., Sautner, Z. and Starks, L. (2019). *The Importance of Climate Risks for Institutional Investors.* [Online]. Available: https://www.ecgi.global/sites/default/files/working_papers/documents/finalkruegersautnerstarks.pdf. [April 2023].

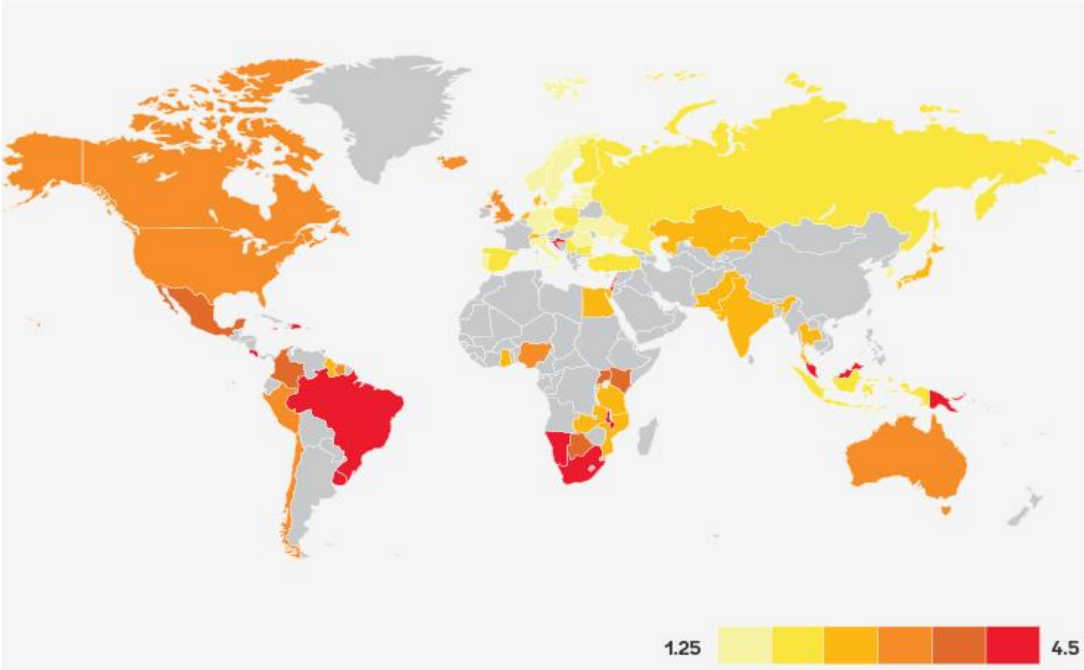
[40] Krueger, P., Sautner, Z. and Starks, L. (2019). *The Importance of Climate Risks for Institutional Investors.* [Online]. Available: at: https://www.ecgi.global/sites/default/files/working_papers/documents/finalkruegersautnerstarks.pdf. [April 2023].

[41] World Bank Group, IOPS, Columbia School of International and Public Affairs. (2020). *Pension Systems + Climate Risk: Measurement and Mitigation.* [Online]. Available: https://documents1.worldbank.org/curated/en/143231601016562164/pdf/Pension-Systems-Plus-Climate-Risk-Measurement-Plus-Mitigation.pdf. [April 2023].

[42] Krueger, P., Sautner, Z. and Starks, L. (2019). *The Importance of Climate Risks for Institutional Investors.* [Online]. Available: at: https://www.ecgi.global/sites/default/files/working_papers/documents/finalkruegersautnerstarks.pdff. [April 2023].

some countries, including in Africa, experiencing high levels of risk, as shown in the World Bank graphic below, which uses darker colours such as orange and red to show countries that face higher levels of climate risk.[43]

Figure 6: Heatmap showing the climate risk facing the pension industries in various countries



Source: World Bank Group, IOPS, Columbia School of International and Public Affairs. (2020). Pension Systems + Climate Risk: Measurement and Mitigation. (p.8)

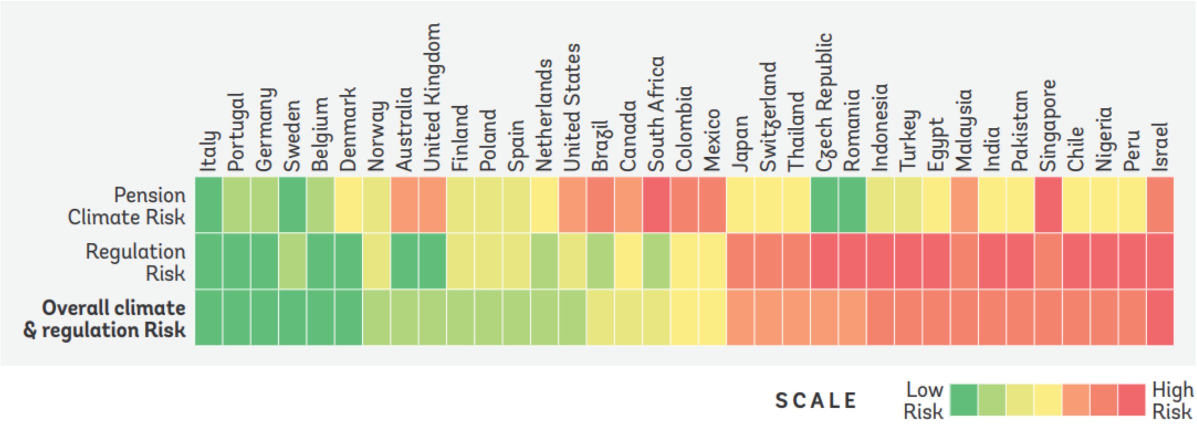
As this shows, African countries that were studied tend to face higher levels of climate risk relative to those in Western Europe. Thus, African countries need to prepare to protect their pension industries from climate risk. One way of equipping the pension industry to face this climate risk is by providing regulations that guide the industry in how to consider climate change, or ESG.

In the same study, theWorld Bank Group reviewed the available ESG regulations that had been put in place to mitigate this risk, including those that are voluntary, mandatory and comply-or-explain. Based on this, they gave each country a regulatory risk score.[44] If a country has a low regulatory risk score this indicates that the country has put regulation in place to mitigate the potential impacts of climate change. As such, a low regulatory risk score would help a country with a high climate risk score to mitigate that risk and achieve a lower overall climate and regulatory risk score.

[43] World Bank Group, IOPS, Columbia School of International and Public Affairs. (2020). *Pension Systems + Climate Risk: Measurement and Mitigation.* [Online]. Available: https://documents1.worldbank.org/curated/en/143231601016562164/pdf/Pension-Systems-Plus-Climate-Risk-Measurement-Plus-Mitigation.pdf. [March 2023].

[44] World Bank Group, IOPS, Columbia School of International and Public Affairs. (2020). *Pension Systems + Climate Risk: Measurement and Mitigation.* [Online]. Available: https://documents1.worldbank.org/curated/en/143231601016562164/pdf/Pension-Systems-Plus-Climate-Risk-Measurement-Plus-Mitigation.pdf. [March 2023].

Figure 7: Composition of the overall climate and regulatory risk score



Source: World Bank Group, IOPS, Columbia School of International and Public Affairs. (2020). [Pension Systems + Climate Risk: Measurement and Mitigation](). (p.8)

As this analysis shows, the presence of ESG regulation for the pension industry reduces the country's overall climate and regulation risk score. As such, it is important to equip pension regulators with the knowledge on ESG and ESG regulation/policy guidelines or guidance - precisely the aim of this project.

The next section will review the Organisation for Economic Cooperation and Development's standards for pension supervision to identify best practice for ESG guidance.

Global standards for pension supervision

In 2009, the OECD developed a list of core principles for private pension management which was later linked to the guidelines produced by the International Organisation of Pension Supervisors (IOPS).[45,46] Since these guidelines were produced with input from regulators around the world, they serve as best practice for pension supervision.[47,48] These core principles, which were updated in 2016, can be divided into Environmental, Social and Governance "ESG" themes as below.

Table 3: OECD Core Principles for Private Pension Regulation and Environmental, Social, and Governance "ESG" themes

Key theme	Sub-aspects[49]	Core Principle (CP) directly related
Environmental:	Climate change risks, carbon emissions, air and water pollution, biodiversity, deforestation, energy efficiency, waste management and water scarcity	**No CPs explicitly address environmental concerns. However, climate-risk related issues are increasingly being considered through the following principles. Supervisors should identify how climate-related risks are relevant to their supervisory objectives.** CP 3: Governance ● Business objectives and investment strategies CP 4: Investment and risk management

[45] OECD. (2016). *OECD Core Principles of Private Pension Regulation.* [Online]. Available: https://www.oecd.org/daf/fin/private-pensions/Core-Principles-Private-Pension-Regulation.pdf. [April 2023].
[46] OECD and the International Organisation of Pension Supervisors. (2009). *OECD Consolidated Core Principles of Occupational Pension Regulation.* [Online]. Available : http://www.iopsweb.org/principlesguidelines/42153269.pdf. [April 2023].
[47] Note that the pension regulators of Ghana, Kenya and Nigeria are governing members of IOPS.
[48] International Organisation of Pension Supervisors. (n.d.). *IOPS Members and Observers.* [Online]. Available: http://www.iopsweb.org/membership/iops-members-observers.htm. [April 2023].
[49] CFA. (2022). *ESG Investing and Analysis*. [Online]. Available: https://www.cfainstitute.org/en/research/esg-investing#:~:text=ESG%20stands%20for%20Environmental%2C%20Social,material%20risks%20and%20growth%20opportunities. [March 2022].

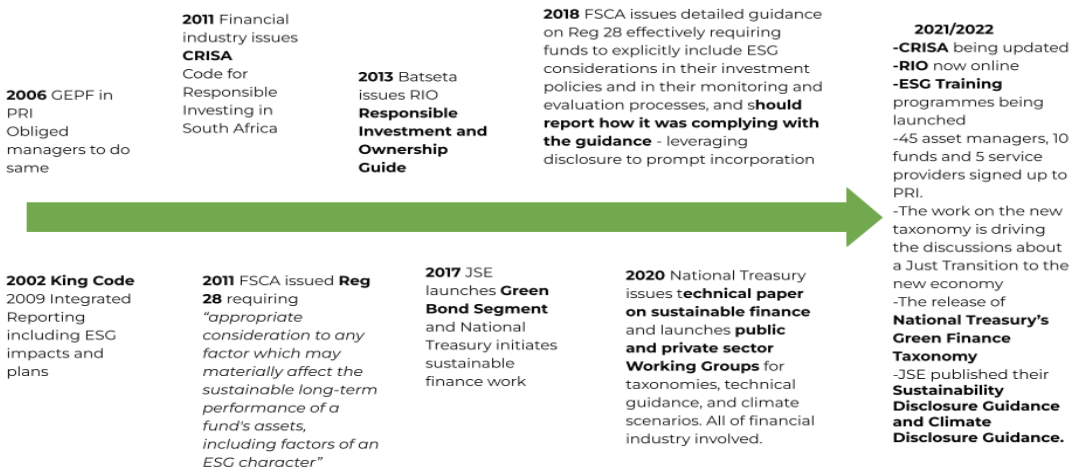
Key theme	Sub-aspects[49]	Core Principle (CP) directly related
		• Integrating climate-related risks into the scope of the risk management system • Climate-related risks for investments • Impact of investments on climate change • Stress testing and scenario analysis of climate-related risks CP 5: Plan design, pension benefits, disclosure, redress • General disclosure requirements CP 6: Supervision • Information gathering and sharing • Supervisory guidelines on environmental considerations
Social:	Customer satisfaction, data protection and privacy, gender and diversity, employee engagement, community relations, human rights and labour standard, cybersecurity	CP 5: Plan design, pension benefits, disclosure, redress CP 8: Access, vesting, and portability, and portability of occupational pension plans CP 10: Equal treatment, business conduct, competition and portability of personal pension plans **Related to specific sections within the following core principles:** CP 2: Establishment of pension plans, pension funds, and pension entities • Capital requirements CP 4: Investment and risk management • Valuation requirements
Governance:	Board composition, audit committee structure, bribery and corruption, executive compensation, lobbying, political contributions, and whistleblowing	CP 1: Conditions for effective regulation and supervision CP 2: Establishment of pension plans, pension funds, and pension entities CP 3: Governance CP 4: Investment and risk management CP 6: Supervision CP 7: Occupational pension plan liabilities, funding rules, winding up, and insurance CP 9: Funding of personal pension plans, wind-up and insolvency
Source: Genesis Analytics, based on OECD. (2016) Core Principles of Private Pension Regulation. [50]		

The South African case study

South Africa has an advanced pension system and was an early adopter of ESG regulation, which makes it a key country to consider when it comes to assessing the implementation framework of ESG in emerging market (EM) countries. The Code for Responsible Investing in South Africa (CRISA) was first introduced in South Africa in 2011. Figure 8 below provides a detailed timeline of the different regulations, working groups and guidance on ESG in South Africa since 2002.

[50] OECD. (2016). *Core Principles of Private Pension Regulation.* [Online]. Available: https://www.oecd.org/daf/fin/private-pensions/Core-Principles-Private-Pension-Regulation.pdf. [April 2023].

Figure 8: Timeline of ESG regulation in South Africa



Source: Adapted from World Bank (2021). African Pension Funds - Environmental, Social & Governance Factors.

South Africa has spent over 15 years building awareness in climate related risk in the financial sector, and is one of the most advanced countries when it comes to the implementation of ESG in the pension industry.[51]

There are currently 3 key ESG reporting requirements in South Africa, namely:

1. **Regulation 28 of the South Africa Pension Funds Act** which outlines the fiduciary duty of a pension fund and provides principles in which these funds should act in accordance with. This regulation is mandatory for all pension funds;
2. **Code for Responsible Investing in South Africa** which provides 5 principles for responsible investment; and
3. **Circular PF 130 Good Governance of Retirement Funds** which is a voluntary guidance on improving governance structures within pension funds.

These requirements, alongside other international examples of ESG integration in the Pensions industry, provide a firm foundation on which to provide guidance in new markets.

2.3 Institutions and tools to watch

For reference, both for the purposes of this project and for future potential work, it is important to be aware of some of the main institutional actors in the ESG space that are relevant for pension regulators.

Table 4: Main institutional actors in the ESG space

Institution	Mission and resources
International Organisation of Pension Supervisors http://www.iopsweb.org/	International organisation that provides resources to equip pension regulators to supervise the pension industry. Members include: Ghana's National Pensions Regulatory Authority (NPRA), Kenya's Retirement Benefit Authority (RBA) and Nigeria's National Pension Commission (PENCOM). Resources are available: http://www.iopsweb.org/resources/

[51] World Bank. (2021). African Pension Funds - Environmental, Social & Governance Factors. [Online]. Available: https://thedocs.worldbank.org/en/doc/2c14fd5a74200c20d9fa48887ac7889b-0430012022/original/Africa-pension-funds-ESG-landscape-V2.pptx. [February 2023].

Institution	Mission and resources
African Pensions Supervisors Network Programme https://fsdafrica.org/projects/african-pensions-supervisors-network-programme/	FSD Africa project that facilitates the collaboration of pension supervisors across Africa to tackle challenges faced by regulators and share knowledge.
African Securities Exchanges Association https://african-exchanges.org/	African body composed of 25 security exchanges with a working group on sustainability. Produces progress reports on sustainability: https://african-exchanges.org/asea-sustainability-progress-report-2020/
Sustainable Stock Exchanges Initiative https://sseinitiative.org/	International body of stock exchanges that provides resources on sustainable reporting and disclosures. Database of stock exchanges that have met criteria such as providing ESG reporting guidance: https://sseinitiative.org/esg-disclosure/
UN - Principles for Responsible Investment https://www.unpri.org	Strategic approach to integrating ESG factors into the investment decision making processes. Responsible investment aims at facilitating sustainable businesses, improving business performance, reducing risk and contributing to environmental, social, and economic security. Resources are available: https://www.unpri.org/investment-tools
International Sustainability Standards Board (ISSB) https://www.ifrs.org/groups/international-sustainability-standards-board/	The International Sustainability Standards Board (ISSB) is an independent, private-sector body that develops and approves IFRS Sustainability Disclosure Standards (IFRS SDS). The ISSB operates under the oversight of the IFRS Foundation. Resources are available: https://www.ifrs.org/groups/international-sustainability-standards-board/#resources

In addition, there are a range of international frameworks that refer to ESG which are important to be aware of and to follow the progress of over time. These can serve as useful guides for pension supervisors.

Table 5: ESG related international frameworks

Framework / Link	Use	Description
UN Global Compact – Sustainable Development Goals ('SDGs') https://www.unglobalcompact.org/sdgs/about	**High-level guiding principles**	Sustainable Development Goals are 17 goals providing a global aspiration for improving the world, laying out where we collectively need to go and how to get there.
Sustainability Accounting Standards Board (SASB) Standards https://www.sasb.org/	**Framework for sustainability disclosure**	SASB Standards provide industry specific guidance on sustainability disclosures.
EU Corporate Sustainability Reporting Directive (CSRD) https://eur-lex.europa.eu/eli/dir/2022/2464/oj	**Rules guiding the reporting of environmental and social impact and risks**	EU Corporate Sustainability Reporting Directive outlines how companies should report on their social and environmental impact and risks so that investors can assess these before investing.
EU Corporate Sustainability Due Diligence (CSDD) https://commission.europa.eu/business-economy-euro/doing-business-eu/corporate-sustainability-due-diligence_en	**Rules governing the process of identifying environmental, social, and governance risks and impact and mitigating or adapting based on this**	EU Corporate Sustainability Due Diligence requires corporates to do the due diligence of the environmental, social and governance impacts they create or risks that they are faced with and to mitigate the negative impacts.

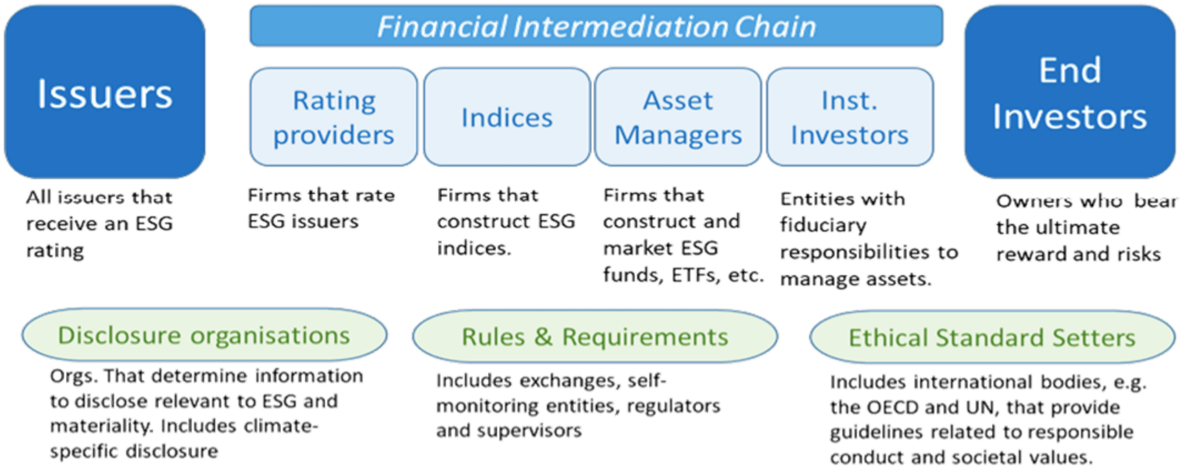
Framework / Link	Use	Description
UN Guiding Principles Reporting Framework ('UNGPRF') https://www.ungpreporting.org/	**Framework for reporting human rights compliance**	The world's first comprehensive guidance for companies to report on how they respect human rights. It is a tool that enables investors to review companies' understanding and management of human rights risks.
Task Force on Climate-Related Financial Disclosures (TCFD) https://www.fsb-tcfd.org/	**Framework for disclosure on climate risks**	Framework to help public companies and other organizations more effectively disclose climate-related risks and opportunities through their existing reporting processes. (Mandatory in the UK)
The Taskforce on Nature-related Financial Disclosures (TNFD) https://tnfd.global/	**Framework for disclosure on nature risks**	A voluntary risk management and disclosure framework for firms to report and act on evolving nature-related risks.
Greenhouse Gas Protocol https://ghgprotocol.org /	**Standards for greenhouse gas accounting**	The world's most widely used greenhouse gas accounting standards.
Global Reporting Initiative ('GRI') https://www.globalreporting.org/	**Standards for sustainability reporting**	Provider of the global best practice for impact reporting
World Economic Forum ('WEF') metrics https://www.weforum.org/stakeholdercapitalism	**Initiative to provide common metrics for measuring stakeholder capitalism**	The initiative identified a set of universal metrics and disclosures, deliberately drawn from existing standards. These metrics and disclosures focus on four themes: Principles of Governance, Planet, People and Prosperity and reflect a six-month consultation process with more than 200 companies, investors, and other interested parties.
Impact Reporting and Investment Standards ('IRIS') https://iris.thegiin.org/	**System to integrate social and environmental factors into investment decisions**	Generally accepted system for measuring, managing, and optimizing impact. It is a free, publicly available resource that is managed by the Global Impact Investing Network (GIIN).
Global Impact Investing Network ('GIIN') https://thegiin.org/	**Global champion of impact investing**	A global champion of impact investing, dedicated to increasing its scale and effectiveness around the world.
Global Steering Group for Impact Investment ('GSG') https://gsgii.org/	**Independent organisation catalysing impact investment**	The Global Steering Group for Impact Investment (GSG) is an independent organisation catalysing impact investment. We want societal and environmental impact to be at the heart of investment and business decisions. A registered UK charity it currently has 33 member countries plus the EU
International Sustainability Standards Board (ISSB) Sustainability Disclosure Standards https://www.ifrs.org/issued-standards/ifrs-sustainability-standards-navigator/	**Standards for sustainability reporting**	IFRS S1 provides a set of disclosure requirements designed to enable companies to communicate to investors about the sustainability-related risks and opportunities they face over the short, medium and long term. IFRS S2 sets out specific climate-related disclosures and is designed to be used with IFRS S1.

The ESG Financial Ecosystem

Across the ESG financial ecosystem, pensions are categorised as ESG users. As portrayed in figure 9, pensions lie at the end of the financial intermediation chain as well as categorised in-between rules and requirements and ethical standard setters categories. This highlights the role of pensions in the ESG financial ecosystem as users of ESG ratings and information who perform overall assessment of their investments using their own due diligence and ESG integration with the use of external scores.[52]

[52] Boffo, R., & Patalano, R. (2020), ESG Investing: Practices, Progress and Challenges. OECD Paris. Retrieved from www.oecd.org/finance/ESG-Investing-Practices-Progress-and-Challenges.pdf. [April 2023].

Figure 9: The ESG Financial Ecosystem



Source: Adapted from Boffo, R., and R. Patalano (2020). ESG Investing: Practices, Progress and Challenges. OECD Paris. Retrieved from www.oecd.org/finance/ESG-Investing-Practices-Progress-and-Challenges.pdf [May 2023]

Across the pensions industry, asset managers and pension funds are categorised as users of ESG ratings and information. Asset managers use ESG data to create segregated portfolios and investment products as a guide for their portfolio composition decisions. On the other hand, pension funds use ESG ratings and information for portfolio management, as well as alignment of their fiduciary duty to incorporate forward-looking assessments in their investment process.[53]

Figure 9 also shows that ESG guidance, framing and oversight for asset managers is based on rules and requirements perspective while pension funds is based on ethical standard setters. Rules and requirements are provided by oversight bodies such as market regulators, pension supervisors and self-regulatory bodies. These oversight bodies consider ESG rules and requirements relevant with guidance from ESG taxonomies and disclosure frameworks. Ethical standard setters are mainly international organisations such as GRI who have increasingly incorporated ethical standards from several international organisations and NGOs into its reporting frameworks.[54]

[53] Fama, E. & French, K. (2013), A Four-Factor Model for the Size, Value, and Profitability Patterns in Stock Returns. SSRN Electronic Journal. http://dx.doi.org/10.2139/ssrn.2287202
[54] Ops cit.

3. ESG DIAGNOSTIC ASSESSMENT - KENYA

This section provides a desktop review of ESG developments across the financial sector, capital markets and pension industry in Kenya. The research shows that there is growing interest around the implementation of ESG principles and a willingness for the integration of these principles among key actors in the industry.
[To be augmented after we receive survey responses]

3.1 ESG integration at a national level

Kenya has been a regional leader in ESG integration, especially from the environmental angle. The "E" in ESG is defined and supported by several regulations, policies, and institutional arrangements in the country. The Constitution of Kenya (2010) encompasses all environmental and climate change policies and action. For example, Article 42 of the Constitution describes the right to a clean and healthy environment for every person to be a fundamental right within Kenya, while Article 69 places obligations on the State with respect to the environment, including sustainable management of natural resources, maintaining a minimum tree cover, and protecting biodiversity.[55] Climate change policies and actions are a focus of the Climate Change Act (2016) which provides the overall legal framework for the achievement of a low-carbon future and serves as the country's blueprint for mainstreaming environmental and climate change.

Policy initiatives under the Climate Change Act necessitated the formulation of a National Climate Change Action Plan (NCCAP) as a way of providing a framework for Kenya to deliver on its nationally determined contributions (NDCs) under the Paris Agreement.[56] The current NCCAP (2018–2022; now due for review) aims to *'further Kenya's development goals by providing mechanisms and measures to achieve low carbon climate resilient development'*. The NCCAP is aligned with the Kenyan government's developmental policy road map, comprising Vision 2030 and the UN's Sustainable Development Goals (SDGs), all of which reflect the commitment by the Kenyan government to achieve low-carbon, climate-resilient development.

As an example of Kenya's commitment to NCCAP 2018-2022 and Vision 2030, the Kenyan government has often taken radical conservation measures such as involuntary relocation of rural communities from ecologically sensitive areas like the Mau Forest[57], as part of a larger plan to rehabilitate the degraded ecosystem and achieve 10% forest cover nationally. Other measures include the ban on all plastic containers, straws and other related products at national parks, national reserves or conservation areas, effective June 2020.[58] Despite this measure, there have been efforts to introduce corresponding fiscal incentives for corporations that invest in recycling.[59]

Other environmental legislative frameworks for the country, at the macro level, are summarised in table 6.

Table 6: Environmental legislative framework for Kenya

Legislation	Environmental regulation
Environment and Management Co-ordination Act (EMCA) 1999	This was Kenya's first framework on environmental law. It sets out the principles and guidelines for ensuring environmental quality as well as enforcement on the same. It complements other sectoral laws such as those on water, land, forest, mining, and wildlife. Currently, the law is expected to be superseded by the Environment and Management Co-ordination Bill 2022, that seeks to introduce guidelines for integrating climate risk and

[55] Republic of Kenya. Constitution of Kenya 2010. http://kenyalaw.org/lex/actview.xql?actid=Const2010 [March 2023]

[56] Ministry of Environment and Forestry, National Climate Change Action Plan (Kenya): 2018–2022 (2018).

[57] Ministry of Environment and Forestry. (2020). Second phase of Mau evictions to kick off soon. Available at www.environment.go.ke/?p=6844 [March 2023]

[58] Ministry of Environment and Forestry. (2020) Implementation Plan for the Ban of Single Use Plastics in Protected Areas. Available at www.environment.go.ke/wp-content/uploads/2020/03/action-plan.pdf [March 2023]

[59] 15% corporate tax incentive for the first five years of operation and VAT exemption for the supply of machinery and equipment used in constructing plastic recycling plants and services to those plants

Legislation	Environmental regulation
	vulnerability assessments as part of the environmental assessment study process by National Environment Management Authority (NEMA).[60]
Climate Change Act, 2016	Several draft regulations and policies are currently underway in the implementation of the Climate Change Act, 2016: ● Draft Climate Change (Public Participation and Access to Information) Regulations 2021, according to Section 24(3) of the Climate Change Act. These will also provide guidelines on access to climate information in line with the Access to Information Act No. 31, 2016.[61] ● Draft Climate Change (Duties and Incentives) Regulations 2021, to impose climate change duties on public entities in the national and county governments.[62] ● Draft Climate Change (Monitoring, Reporting and Verification) Regulations 2021, to provide a framework for monitoring, reporting and verifying greenhouse gas (GHG) emissions; mitigation and adaptation actions; and climate change enablers such as climate finance, technology development, and transfer and capacity building.[63] ● Draft Climate Change (Code of Conduct and Conduct for Doing Business) Regulations 2020, to guide the conduct of the members of the National Climate Change Council[64]; and ● Draft National Climate Change Learning Strategy 2021–2031, as the framework for promoting public awareness to enhance knowledge and participation of the general public in climate change actions.[65] The Act is currently under amendment - The Climate Change (Amendment) Bill, 2023 to include provisions for mitigation mechanisms including carbon budgets, markets, standards and trading, national carbon registry, nature based solutions, non-market approaches as well as Reduced Emissions from Deforestation and Forest Degradation (REDD+).[66]
Energy Act 2019	Mandates the Kenyan government to promote the development and use of renewable energy, including biodiesel, bioethanol, biomass, solar, wind and hydropower, as well as providing the supporting framework for the transition to a green economy with likely gains in environmental protection and climate change.[67]
Green Fiscal Incentives Policy Framework 2022 (pending)	Currently, this framework is pending public review. It seeks to steer Kenya's economy onto the desired low-carbon, climate-resilient, green development pathway through a variety of fiscal and economic mechanisms It also defines how the government Ministries, Departments and Agencies (MDAs) can enhance mobilization of climate finance from all sources: private, public, multilateral agencies, bilateral, philanthropic, and others to finance Kenya's updated NDC and NCCAPs.[68]

[60] Section 101(12) of the Environment and Management Co-ordination Bill 2022

[61] Public Participation Consultations and Access to Climate Change Information Regulations 2021. Available at http://www.environment.go.ke/wp-content/uploads/2021/01/Public-Participation-Draft-Regulations.pdf [March 2023]

[62] Climate Change (Duties and Incentives) Regulations 2021. Available at http://www.environment.go.ke/wp-content/uploads/2021/03/FINAL-Public-Consultation-Draft-The-Climate-Change-Act-Duties-and-Incentives-Regulations-2021.pdf. [March 2023]

[63] Draft Climate Change (Monitoring, Reporting and Verification) Regulations 2021. Available at http://www.environment.go.ke/wp-content/uploads/2021/03/FINAL-Public-Consultation-Draft-The-Climate-Change-Act-Monitoring-Reporting-and-Verification-Regulations-2021-1.pdf [March 2023]

[64] Draft Climate Change (Code of Conduct and Conduct for Doing Business) Regulations 2020. Available at http://www.environment.go.ke/wp-content/uploads/2021/01/Final-1st-Draft-Regulations.pdf

[65] Draft National Climate Change Learning Strategy 2021–2031. Available at http://www.environment.go.ke/wp-content/uploads/2021/05/DRAFT-NATIONAL-CLIMATE-CHANGE-LEARNING-STRATEGY-.pdf [March 2023]

[66] Climate Change Amendment Bill 2023. Available at https://www.environment.go.ke/wp-content/uploads/2023/03/26.3.23-CLIMATE-CHANGE-AMENDMENT-BILL-2023.pdf [July 2023]

[67] Republic of Kenya. Energy Act 2019 https://www.epra.go.ke/download/the-energy-act-2019/ [March 2023]

[68] Draft Green Fiscal Incentives Policy Framework 2022. AVailable at https://www.treasury.go.ke/wp-content/uploads/2023/01/Draft-Green-Fiscal-Incentives-Policy-Framework.pdf [March 2023]

Legislation	Environmental regulation
National REDD + Strategy 2021	Outlines Kenya's proposed approach for implementing the UN's Collaborative Programme on Reducing emissions from deforestation and forest degradation (REDD+) by outlining inter alia strategic options that can be adopted to allow for inclusivity while reducing emissions from the forest sector and specifying the roles of the key stakeholders to implement those strategic options.[69]
Source: Author based on linked sources	

Kenya has been an active participant in the United Nations Climate Change Conference, or Conference of the Parties of the UNFCCC (COP). During the 2022 COP (COP27), Kenya pledged to:

- Increase tree cover to more than 30% by 2032 and grow 5 billion trees in the next five years;
- Rehabilitate and restore all degraded water towers and other forest ecosystems;
- Establish the Climate Change Council (Council) under the Climate Change Act, 2016 to be chaired by the President, and
- Steer Kenya's climate action through stakeholder engagement.

Previously, during the 2021 COP (COP26), Kenya pledged to end deforestation by 2030, continue to invest in renewable energy to achieve 100% renewable energy by 2030, and ensure 100% clean cooking by 2028. All these initiatives are part of Kenya's move towards achievement of the global net zero emission target by 2050.

Kenya's Finance Act 2022[70] was introduced with the goal of increasing revenue streams for the government as well as to align tax legislations with the country's government developmental priorities. Environment-related provisions in the Finance Act mainly relate to the operations of the Nairobi International Financial Centre (NIFC), Kenya's first carbon market exchange. These include corporate tax incentives for carbon credit projects certified by NIFC. NIFC was established in 2022 following the NIFC Act, 2017[71] with the aim of developing a predictable and efficient business environment aimed at encouraging domestic and foreign investors to contribute to sustainable economic growth and to promote green finance. An early initiative by the NIFC was a tripartite collaboration agreement signed between AirCarbon Exchange (ACX), a Singapore-based global carbon exchange, the Nairobi Stock Exchange (NSE) and the NIFC to develop the first carbon exchange within East Africa.[72] If operationalised, the carbon exchange will provide further impetus for the growth of climate finance in Kenya because it will provide a locally accessible marketplace for carbon offsets, further develop carbon trade, and attract investments in carbon markets.

Further developments around carbon credits include the launch of the Kenya Carbon Emission Reduction Tool (KCERT 2050)[73], by Kenya's Ministry of Energy, the British High Commission in Nairobi, and Strathmore University. KCERT 2050 is a data-driven policy-making tool allowing users to trial project emissions generated from various sectors as well as provide government MDAs with an opportunity to develop action plans and long-term energy strategies on emissions reductions. The tool is expected to enable an innovative and instrumental approach to ensuring decisions made by policymakers are backed by data when planning the country's low-carbon transition and climate mitigation approaches. Kenya is also amending the Climate Change Act 2016 to include provisions for mitigation mechanisms including carbon

[69] UN-REDD (2022). National REDD+ Strategy. Available at https://www.un-redd.org/sites/default/files/2022-05/NATIONAL%20REDD%2B%20STRATEGY%202022.pdf [March 2023]

[70] Republic of Kenya (2012) Finance Act 2022. http://kenyalaw.org/kl/fileadmin/pdfdownloads/Acts/2022/TheFinanceAct_2022.pdf [March 2023]

[71] Republic of Kenya (2017) Nairobi International Finance Centre (NIFC) Act, 2017 http://kenyalaw.org:8181/exist/kenyalex/actview.xql?actid=No.%2025%20of%202017 [March 2023]

[72] Nairobi International Finance Centre. (2022, July 4). Kenya announces the official launch of the Nairobi International Financial Centre (NIFC) https://nifc.ke/pressrelease/kenya-announces-the-official-launch-of-the-nairobi-international-financial-centre-nifc/

[73] Kenya News Agency. (2022, July 21). Kenya launches 2050 Calculator to mitigate climate change. https://www.kenyanews.go.ke/kenya-launches-2050-calculator-to-mitigate-climate-change/ [March 2023]

budgets, markets, standards and trading, national carbon registry, nature-based solutions, non-market approaches as well as Reduced Emissions from Deforestation and Forest Degradation (REDD+).[74]

Kenya's private sector have followed suite and developed a Kenya Private Sector Strategy on Climate Change Solutions (2022-2030)[75], launched by the Kenya Private Sector Alliance (KEPSA) to guide the private sector in implementing climate change-oriented solutions towards a low-carbon development pathway.

Like the environmental perspectives, Kenya's "S" in ESG is underpinned by the Constitution of Kenya, 2010 as well as Vision 2030. Under the social pillar of Vision 2030, Kenya seeks to build "a just and cohesive society with social equity in a clean and secure environment". Social integrations is provided for under Kenya's National Cohesion and Integration Act 2009, amended in 2019[76], that seeks to "encourage national cohesion and integration by outlawing discrimination on ethnic grounds; to provide for the establishment, powers and functions of the National Cohesion and Integration Commission, and for connected purposes". Further to this, the National Social Protection Policy (NSPP)[77] was introduced in 2011 to ensure that "all Kenyans live in dignity and exploit their human capabilities for their own social and economic development". Key challenges on social inclusion, as outlined in the policy, are the significant gaps in coverage of social protection and the fragmentation of existing social systems. Other social-related regulations and policies include the National Policy on Gender and Development (NPGD) 2019[78] outlining the national agenda for gender equality with a series of principles to be adopted and integrated into the national and local government sectoral policies, practices and programmes, as well as the private sector.

In recognition of new labour trends, Kenya's parliament is seeking to amend employment laws through the Employment (Amendment) Act 2022.[79] The amendment includes the safeguarding of employees in the workplace, including an employee's right to disconnect. Other social-related regulation includes the Data Protection Act 2019[80] that is steadily being implemented with the release of various data protection policies in 2021. The Act impacts mainly the legal and compliance, technology, and data areas of an organisation. It defines how organisations in Kenya manage the data that they collect, as well as considerations on the purpose, openness, participation, constraints on usage, and collection limitations of personal data.

The "G" in ESG is mainly driven by the Companies Act, 2015 (Companies Act), that places personal liability on directors of companies to ensure compliance. For publicly-listed companies, Kenya's Guidelines on Corporate Governance Practices by Public Listed Companies in Kenya 2012 (the Guidelines) provides the governance codes. Its guidelines are guided by best practices from the United Kingdom, Malaysia, South Africa, the Organisation for Economic Co-operation, and Development (OECD) and the Commonwealth Association for Corporate Governance. Other regulations aimed at ensuring disclosure of listed companies are NSE Listing Manual, Capital Markets Authority (CMA) (Licensing Requirements) (General) Regulations 2002, CMA (Securities) and the (Public Offers, Listing and Disclosures) Regulations 2002. Several Kenyan companies are choosing to follow global industry best practices and opting into standards and reporting indexes such as the IFC Performance Standards, Sustainability Accounting Standards Board (SASB) and the Global Reporting Initiative (GRI).

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[74] Ibid

[75] KEPSA (2022, June 11). KEPSA Launches a Strategy to Promote Coordinated and Inclusive Implementation of Business Climate Change Solutions. Retrieved from https://kepsa.or.ke/kepsanews/kepsa-launches-a-strategy-to-promote-coordinated-and-inclusive-implementation-of-business-climate-change-solutions [March 2023]

[76] Republic of Kenya (2008) National Cohesion and Integration Act 2009 http://kenyalaw.org/kl/fileadmin/pdfdownloads/Acts/NationalCohesionandIntegrationAct_No12of2008.pdf

[77] Government of Kenya: Ministry of Gender, Children and Social Development (2011). National Social Protection Policy (NSPP) https://www.socialprotection.or.ke/images/downloads/kenya-national-social-protection-policy.pdf [March 2023]

[78] Government of Kenya: Ministry of Public Service, Youth and Gender (2019). National Policy on Gender and Development (NPGD) 2019. Retrieved from http://psyg.go.ke/wp-content/uploads/2019/12/NATIONAL-POLICY-ON-GENDER-AND-DEVELOPMENT.pdf [March 2023]

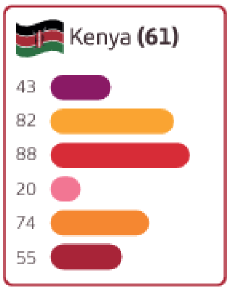
[79] Bowmans (2021) Kenya: The Employment (Amendment) Bill 2021. https://www.bowmanslaw.com/insights/employment/kenya-the-employment-amendment-bill-2021/ [March 2023]

[80] Republic of Kenya (2019) Data Protection Act 2019 http://kenyalaw.org/kl/fileadmin/pdfdownloads/Acts/2019/TheDataProtectionAct__No24of2019.pdf [March 2023]

3.2 ESG integration in the financial sector

ESG in the financial sector in Kenya is commonly understood as Sustainable Finance, which took root in Kenya following the launch of Kenya's development plan, Vision 2030. The Sustainable Finance Initiative (SFI) was led by the Kenya Bankers' Association (KBA) who developed SFI Principles in 2013, a set of Kenya-specific harmonised guidelines for adoption of sustainable development across the banking industry as a means of contributing to Vision 2030. Thus, Kenya has had a decade to firmly establish sustainable finance across the country, which is highlighted across the various financial sectors.

According to the Absa Africa Financial Markets Index[81], which evaluates countries' financial development by market accessibility, openness, and transparency, Kenya ranks 8th (out of 26 countries) with a score of 61 in 2022, an improvement from ranking 10th in 2021 with a score of 55. While it does not directly measure ESG, it provides useful context for the financial sector which does impact the ability to deliver against ESG requirements. Across the indices assessed in the Index, Kenya scored highest in market accessibility (score of 88) with a maximum score for integration of sustainability in financial frameworks, incorporation of climate stress testing, incentives for ESG asset issuances, and market standards in financial policies. Kenya's 2nd highest score was on the access to foreign exchange indices (score of 82) with Absa Africa Financial Markets Index highlighting the adequacy of foreign reserves and interbank foreign exchange liquidity as areas where Kenya scored highest. Kenya's 3rd highest score was on the macroeconomic environment and transparency indices (score of 74) with increased market transparency in credit ratings as a proxy. Kenya's lowest score was on the capacity of local investors, measured by pension holdings by capita, indices (score of 20) mainly due to limited pension assets that focus highly on government securities reducing diversification gains of assets under management.[82]



3.2.1 ESG integration in the capital markets

Capital markets in Kenya have championed the development of green finance channels through the Kenya Green Bond Programme (KGBP)[83] that was launched in 2017. KGBP is a way of promoting financial sector innovation through a domestic green bond market to enhance green investments. The KGBP initiative was developed through a collaboration with the Kenya Bankers Association (KBA), NSE, Climate Bonds Initiative (CBI), FSD Africa and the FMO (the Dutch Entrepreneurial Development Bank).

Following the launch of the KGBP initiative, the Capital Markets Authority (CMA), the capital markets regulator in Kenya, as well as the Nairobi Securities Exchange (NSE) issued a Policy Guidance Note on Green Bonds[84] in 2019. This was subsequently followed by the launch of the first local currency-denominated green bond in East and Central Africa dually listed on the London Stock Exchange and NSE.[85] The bond was issued by a Kenyan property developer, Acorn Holdings, with a guarantee from the development agency, GuarantCo, with funds geared to build 5,000 environmentally friendly student housing units - more information on the green bond issuance is presented in Box 1.

Box 1: Kenya as a pace setter for green capital markets
Kenya's capital market became the regional pacesetter in the uptake of environment-friendly financing options in 2020 as a way of ensuring sustainable development. Acorn Holdings, a real estate developer, successfully issued Kenya's first green bond, certified by CBI. The KES 4.3 billion issuance was geared towards financing green and environmentally friendly student accommodation for 5,000 students in Nairobi. According to Moody's, a global ratings

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81 Official Monetary and Financial Institutions Forum (OMFIF) (2023) Absa Africa Financial Markets Index 2022. Retrieved from https://www.omfif.org/wp-content/uploads/2022/10/Absa-Africa-Financial-Markets-Index-2022.pdf [March 2023]

82 Ibid

83 https://www.greenbondskenya.co.ke/

84 CMA (2021) Policy Guidance Note on Green Bonds https://www.cma.or.ke/index.php/regulatory-frame-work/policy-guidance-notes [March 2023]

85 Euromoney. (2020, January 20). First Kenyan shilling green bond lists on London Stock Exchange. https://www.euromoney.com/article/b1jzjd4d7m9jkc/first-kenyan-shilling-green-bond-lists-on-london-stock-exchange [March 2023]

agency, Acorn's medium-term note programme B1 is a level higher than Kenya's sovereign rating of B2. This issuance became the first non-governmental green bond rated by Moody's in Africa.

Following this issue, Acorn Holdings further quoted two Income and Development Real Estate Investment Trust (REIT) products - Acorn Student Accommodation Development REIT (ASA D-REIT) and Acorn Student Accommodation Income REIT (ASA I-REIT). Both issues were issued at a total minimum subscription of KES 852 million and up to a maximum of KES 8.5 billion, respectively in December 2020. ASA D-REIT and ASA I-REIT are ESG aligned and listed on NSE's unquoted securities platform.

Source: Authority, C. M. (2023, January 24). The role of capital markets in supporting Sustainable Investments. Business Daily. Retrieved from https://www.businessdailyafrica.com/bd/sponsored/role-of-capital-markets-in-supporting-sustainable-investments-4096578 [March 2023]

ESG in capital markets is detailed in the NSE ESG disclosure manual (ESG Manual)[86], issued in November 2021, directs listed companies to integrate and comply with the ESG reporting requirements with mandatory reporting expected from November 2022. The ESG Manual follows the GRI standards. This made Kenya the 4th African Exchange to launch an ESG Guidance Manual. It was issued following investor demand for comprehensive ESG disclosures and reporting and the need to improve and standardise ESG disclosures. The ESG Manual is compulsory for listed companies but can be used by non-listed entities as well.

Over and above the ESG Manual, the NSE and the Central Bank of Kenya (CBK) jointly issued guidelines that oblige listed companies, boards of directors, and senior management to take an active role in formulating and implementing ESG strategies, policies and reporting requirements.[87] These NSE guidelines, coupled with the Companies Act, assign the responsibility of reporting on matters related to ESG issues with the directors of companies.

In terms of guidance on social elements in capital markets, the CMA issued Guidelines on Corporate Governance Code for Listed Companies (the Code) in 2015.[88] These guidelines require Boards in Listed Companies to implement policies that assure diversity, including female diversity, in their composition. The CMA supplemented the Code with the Stewardship Code for Institutional Investors in 2017. This encourages listed companies to carry out their operations with a positive social impact while encouraging investors to incorporate social, environmental, and ethical initiatives into their investment processes.

Box 2: Focus on Kenya's Stewardship Code for Institutional Investors

In Kenya, the Capital Markets Authority (CMA) enacted the Stewardship Code for Institutional Investors in 2017 (Stewardship Code), the second of its kind in Africa after South Africa. The goal is to allow institutional investors (asset owners and asset managers) investing in securities listed at the Nairobi Securities Exchange (NSE) to take up a stewardship role. Thus, institutional investors act as their client's or investor's representatives while encouraging continuous improvement in corporate governance practices in listed companies and other approved products. The Stewardship Code has seven core principles:

1. stewardship or responsible investment policies;
2. monitoring companies held in investment policies;
3. active and informed voting practices;
4. engagement, escalation and collaboration with other institutional investors;
5. conflicts of interest;
6. **focus on sustainability issues including environmental, social and ethical factors**; and
7. public disclosures and client reporting

Under Principle 6: Focus on sustainability issues including environmental, social and ethical factors; reference is made to the CMA's Corporate Governance Code section on Ethics and Social Responsibility relating to the role of listed companies in contributing to social outcomes as a component of corporate governance, as well as

[86] NSE ESG Disclosures Guidance Manual (2021) https://www.nse.co.ke/wp-content/uploads/NSE-ESG-Disclosures-Guidance-Manual.pdf [March 2023]

[87] Ibid

[88] CMA (n.d.) CMA releases Corporate Governance Code for Listed Companies. Retrieved from https://www.cma.or.ke/index.php/news-publications/press-center/376-cma-releases-corporate-governance-code-for-listed-companies [March 2023]

stakeholder engagement activity. Materiality of commercial risks arising across the investment process is considered an institutional investor fiduciary responsibility. Furthermore, full consideration of non-financial risks that issuers face need to be factored by institutional investors in their monitoring, voting and engagement activities. While relevance of ES and ethical factors need to be aligned to investment policy processes, integrated reporting as a way of engaging stakeholders can be used to allow for material ES and ethical factors to be linked to the performance of institutional investors' assets. Finally, a call for robust materiality ES and ethical disclosures can be raised by institutional investors including how the listed company is addressing these risks.

Source: Author based on CMA (2017) Stewardship Code for Institutional Investors in 2017 (Stewardship Code) Available: https://cma.or.ke/wp-content/uploads/2023/03/Stewardship-Code.pdf [July 2023]

The NSE, Kenya's Securities Exchange, which is regulated by the CMA, has set a goal for the listed companies on its Exchange to have at least a third of the board representation to be female. The NSE further promotes gender equality by hosting a Leadership and Diversity Dialogue series that aims to sensitize listed companies on various aspects of leadership and diversity and how it relates to firm performance.[89] NSE are also members of the 30% Club[90], a global campaign to increase gender diversity in boards and senior management. Other developments made by NSE to promote social aspects of ESG include setting up an electronic trading system for securities transactions, an exchange-traded products system and a digital academy to increase the public's participation in the stock exchange.[91]

The NSE also requires listed entities to abide by the Management, Supervision, and Internal Control Standards for entities[92], issued by the CMA, as a way to assist licensed persons to understand what is expected of them when meeting the required level of internal control standards.

Kenya's Companies Act of 2017 mandates company directors to review ESG issues that may affect the future performance of the company. The board of directors have been tasked to provide oversight on ESG reporting, with proposed endorsement by the CEO and driven by the Sustainability Manager[93].

The CMA and the NSE are also in discussions to introduce an ESG index in future which would track the performance of companies with superior ESG practices[94].

With the increase in trading of cryptocurrencies – Kenya ranks 1st globally for peer-to-peer trading volume and 5th globally for cumulative cryptocurrency activity, holding more than US$ 1.5 billion of Bitcoin[95]; the CMA developed a policy framework on crypto assets and tokenized securities[96], in alignment with other cryptocurrency-related regulations - the National Payments Systems Act (NPSA), and the Kenya Information and Communication Act (KICA). This was done as a way of promoting financial stability as well as mitigating the risk of terrorism financing and money laundering. Cybersecurity is a tangible

[89] Gender Equality - Nairobi Securities Exchange PLC. (2022, January 15). Nairobi Securities Exchange PLC. https://www.nse.co.ke/gender-equality/ [March 2023]

[90] Sustainable Stock Exchanges (n.d.) Exchange in Focus: NSE joins the 30% club to promote gender equality within the Capital Markets. Retrieved from https://sseinitiative.org/all-news/exchange-in-focus-nse-joins-the-30-club-to-promote-gender-equality-within-the-capital-markets/ [March 2023]

[91] https://academy.nse.co.ke/

[92] NSE Management, Supervision, and Internal Control Standards for entities (2012) https://www.cma.or.ke/index.php/regulatory-frame-work/guidelines?download=44:management-supervision-internal-control-guidelines-may-2012 [March 2023]

[93] Republic of Kenya. Companies Act of 2017 http://kenyalaw.org:8181/exist/rest/db/kenyalex/Kenya/Legislation/English/Acts%20and%20Regulations/C/Companies%20Act%20-%20No.%2017%20of%202015/docs/CompaniesAct17of2015.pdf [March 2023]

[94] Ombok, E. (2021, November 29). Kenya's Bourse Gives Companies One Year to Grasp ESG Reporting. Bloomberg.Com. https://www.bloomberg.com/news/articles/2021-11-29/kenya-s-bourse-gives-companies-one-year-to-grasp-esg-reporting [March 2023]

[95] Blockchaincenter. (2021, December 10). Cryptocurrency World Map - Blockchaincenter.net. https://www.blockchaincenter.net/cryptocurrency-world-map/?crypto=BTC;ETH;XRP;BCH;LTC;ADA;XMR;TRX;MIOTA;DOGE [March 2023]

[96] CMA (2017). Stakeholders' Consultative Paper on Policy Framework for Implementation of a Regulatory Sandbox to Support Financial Technology (Fintech) Innovation in the Capital Markets in Kenya. Retrieved from https://cma.or.ke/index.php/cma-study-on-low-uptake-of-capital-markets-products?download=100:stakeholders-consultative-paper-on-policy-framework-for-implementation-of-regulatory-sandbox-to-support-financial-technology-fintech-innovation-in-the-capital-markets-in-kenya [March 2023]

component of ESG by providing insights on cyber behaviours and risks capital markets face as a social and ethical factor of ESG.[97]

3.2.2 ESG integration in the banking sector

Kenya's banking sector is regulated by the Central Bank of Kenya (CBK), who in 2021 issued a guidance on climate related risk management (the Guidance[98]) directed to financial institutions, specifically commercial banks and mortgage finance companies. The Guidance informs these institutions on how to manage their climate-related risks in their business decisions and activities. The institutions themselves were tasked with providing the CBK with a plan on how they will implement the Guidance by June 2022 and reporting is expected between January to June 2023.

On the social and governance aspects of banking, the CBK, similarly to the CMA, issued a discussion paper on examining the applicability of Central Bank Digital Currencies (CBDCs) in February 2022.[99] Since Kenya is a global leader on mobile money, the additionality of CBDC is expected to be a significant one. This is because the CBDC will offer opportunities to enhance cross-border payments, innovation as well as regional and global cooperation. Kenya joins 12 other countries in Africa exploring CBDCs.[100] The CBK is currently regulating cryptocurrency through the NPSA as well as related money remittance regulations as provisions towards social and ethical considerations on digital protection.

According to the KBA Environmental Risk Exposure in Kenya's banking sector report,[101] most banks take a precautionary approach in their credit risk assessment process focusing on meeting the minimum legal requirements. The report also concludes that there is limited understanding by the banks on requirements of an environmental and social framework over the apparent physical environmental risks. Furthermore, the report recommends banks to not undermine the adverse impacts of their operations on the environment and surrounding communities over their clients' financial and operational sustainability. The report also found that Kenyan banks rely more on NEMA's Environmental Impact Assessment (EIA) licence and County Government project approvals as proof of compliance for the projects they finance. However, this compliance has been found inadequate in projects that require more environmental due diligence due to the many gaps that exist in the licensing process in Kenya. The report further recommends the development and adoption of an environmental/ESG risk management regulatory framework that specifically applies across the banking sector. Other recommendations made include internal and external training capacity building and embedding of ESG reporting and disclosure requirements into credit documentation.[102] An extract of case studies taken as-is from the KBA Environmental Risk Exposure in Kenya's banking sector report is presented in figure 9.

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[97] Yirrel, S. (2023, April). Security and Ethics: Why Cybersecurity Is a Core Part of ESG. CompTIA Blog. Available at https://connect.comptia.org/blog/security-and-ethics-why-cybersecurity-is-a-core-part-of-esg#:~:text=%E2%80%9CESG%20frameworks%20are%20a%20tangible,ESG%20picture%2C%E2%80%9D%20he%20read [July 2023]

[98] CBK (2021) Guidance on Climate-Related Risk Management | CBK. Retrieved from https://www.centralbank.go.ke/2021/10/15/guidance-on-climate-related-risk-management/ [March 2023]

[99] CBK (2022) Discussion Paper on Central Bank Digital Currency | CBK. Retrieved from https://www.centralbank.go.ke/2022/02/10/discussion-paper-on-central-bank-digital-currency/ [March 2023]

[100] Atlantic Council. (2022). CBDC Tracker. Atlantic Council. https://www.atlanticcouncil.org/cbdctracker/ [March 2023]

[101] KBA (2022) Environmental Risk Exposure in Kenya's banking sector report. Retrieved from https://www.kba.co.ke/wp-content/uploads/2022/05/KBA Environment Report-Final.pdf [March 2023]

[102] Ops. cit.

Figure 9: Case study of 2 Kenyan bank's Environmental Risk Exposure

Bank A	Bank B
Bank A is a Tier 1 commercial bank in Kenya. Of the Bank's total portfolio, 20 percent is in the Manufacturing sector and 4 percent in the Real estate sector. The Bank has an Environmental and Social Risk Management Policy that guides the environmental and social risk assessment process and an Environmental and Social Risk Categorisation Tool. Environmental and social risk governance is well defined from the role of the Board, the senior management, the credit department, and the Environment and Social Risk team that is part of the risk management team as well as the environment and social risk champions that are trained on the KBA Sustainable Finance Initiatives. In the credit origination, appraisal processes, documentation, and ongoing monitoring process, the bank has embedded the following specific environmental and social risk management processes. Screening process: i) E&S risk categorisation - Categorisations are undertaken for each project based on the magnitude of its potential environmental and social risks and impacts. Bank A performs an environmental and social due diligence commensurate with the nature, scale, and stage of the projects. ii) E&S Due diligence - Compliance to National regulatory requirements, NEMA Environment Impact Assessment (EIA), and/ or Directorate of Occupational Safety and Health Services (DOSHS) Occupational Safety Health Audit (OSHA) reports for project activities in the Medium & High E&S Risk categories. iii) E&S covenants - Environmental Social Risk Management Plan (ESMP) recommendations from EIA and/or OSHA reports compliance is embedded in contracts iv) ISO certification if available (i.e., 14000 series on Environmental Management Systems & 18000 series on Occupational Health and Safety Management Systems) v) E&S Monitoring - Bank A carries out E&S risk monitoring by reviewing client performance on the agreed-upon action plans.	Bank B is a Tier 3 Commercial Bank in Kenya. Of the Bank's total lending, 20 percent is in the Manufacturing sector and 4 percent in the Real estate sector. The Bank does not have a formal policy on environmental and social risk management. Aspects of E&S risks are however included in the Credit risk management policy. The responsibility for the management of the environmental and social risks largely lies with the Credit Risk Management Team and credit analysts. In the credit origination, appraisal processes, and documentation process, E&S risks are identified by the credit analysts. Factors for consideration in the credit origination process include environmental impacts of the projects, health, and safety impacts to individuals and communities. As part of the credit appraisal process, the Bank ensures compliance with the stipulated laws of the country and county, and relevant approvals, permits, and certificates have been received from the regulators (e.g., NEMA approvals). Monitoring involves the review of reports submitted by the clients such as building inspection reports.

Source: Screenshot directly from KBA (2022) Environmental Risk Exposure in Kenya's banking sector report. Retrieved from https://www.kba.co.ke/wp-content/uploads/2022/05/KBA Environment Report-Final.pdf [March 2023]

3.2.3 ESG integration in the insurance sector

In 2022, FSD Africa and Genesis Analytics worked with the insurance regulator in the country to work towards a toolkit and guidelines for the integration of ESG considerations into insurance regulation. That work included a detailed diagnostic of the insurance industry, which we encourage you to refer to for information on that sector.

3.2.4 ESG integration in the pension industry

Retirement schemes in Kenya are categorized by contributions, mode of payment at retirement, membership and mode of investment as shown in table 7.

Table 7: Categorisation of retirement schemes in Kenya

Categorisation	Description
Based on Contributions	**Defined Benefits Schemes** funded either exclusively by employer contributions or partly by employee contributions.
	Defined Contribution Scheme where member' and employer' contributions are fixed either as a percentage of pensionable earnings or as fixed amount. However, members have the freedom to contribute more than the defined rate (Additional Voluntary Contribution).
Based on Mode of Payment at Retirement	**Pension Scheme** that provides access to up to 1/3 of cumulative contributions plus accrued interest on the lump sum at retirement. The remaining amount is used to purchase an annuity that pays a periodic income to the pensioner.

Categorisation	Description
	Provident Fund that a member receives their contributions and those made on their behalf plus accrued interest.
Type of Membership	**Occupational Retirement Benefits Scheme** set up by an employer where only members of their staff are eligible to join.
	Umbrella Retirement Benefits Scheme that pools the retirement contributions of multiple employers on behalf of their employees. This reduces the average cost per member and enhances the returns of both the employer and the employees' contributions. Notable Umbrella schemes include the **Public Service Pension Schemes** for all public service employees, including civil servants, teachers and disciplined forces, with a separate scheme for armed forces; and **National Social Security Fund (NSSF)** for employees in formal sector establishments with 5+employees excluding public service employees.
	Individual Retirement Benefits Scheme where individuals contribute directly into the scheme of their choice, voluntarily, towards saving for their retirement.
Mode of Investment	**Segregated Funds** where members' contributions are invested directly by the Trustees, via an appropriate Investment Policy, is then implemented by the Fund Manager, appointed by the Trustees.
	Guaranteed Funds are offered by insurance companies where members' contributions are pooled together and the insurer guarantees a minimum rate of return. If the actual return surpasses the minimum guaranteed rate, the insurer may either top up the minimum rate with a bonus rate of return or reserve the extra return.
Source: Author, based on Cytonn Investments (n.d.) Progress of Kenyan Pension Schemes-2022. Retrieved from https://www.cytonn.com/topicals/progress-of-kenyan-1 [March 2023]	

The retirement industry is regulated by the Retirement Benefits Authority (RBA), established under the Retirement Benefits Act (amended in 2006 and 2007). The Retirement Benefits Act was enacted as part of an on-going reform process in the financial sector to bring the retirement benefits industry under a harmonized legislation. This Act filled a regulatory gap which had existed in Kenya, where retirement benefits schemes were regulated by fragmented legislation under Trust and Income Tax Laws. The absence of specific retirement benefits regulations allowed schemes to adopt different styles of operation. RBA employs a risk-based supervisory approach adapted from the Australian model. This supervisory approach measures solvency of defined benefit schemes and the investment risk of defined contribution schemes by applying a risk score to each scheme determining RBA's supervisory response. The RBA conducts a risk profiling exercise annually aimed at identifying schemes with high levels of risk.

Other regulations in the pensions industry include the Retirement Benefits (Good Governance Practices Guidelines) 2018[103] aimed at enabling sponsors, members, trustees and service providers to implement and promote proper standards of governance and sound practices; the Retirement Benefits (Forms and Fees) Regulations, 2000[104] that presents the investment guidelines for retirement schemes in Kenya across various asset classes. The RBA regulates and supervises complementary occupational, individual pension plans and the National Social Security Fund (NSSF) and protects the interests of plan members and sponsors.

One of the bases of the Good Governance Practices Guidelines 2018 is that their implementation needs to be in accordance with the general principles of corporate governance. As such, pension schemes in Kenya need to establish governance policies including a Code of Conduct for Schemes, Trustee Remuneration Policy, and Induction and Skills development policy. Furthermore, pension schemes are required to conduct a Governance Audit to ensure conformity to the highest level of governance standards.

103 Retirement Benefits Act (Good Governance Practices) Guidelines (2018). http://kenyalaw.org/kl/index.php?id=8565#jfmulticontent_c26690-2 [March 2023]

104 Retirement Benefits Act (Forms and Fees) Regulations. (2000). https://www.rba.go.ke/investment-regulations-policies/ [March 2023]

NSSF is a mandatory scheme for all employees in the formal sector. It was established under an Act of Parliament in 1965 as a provident fund operating on a defined contribution basis. In 1997, the NSSF Act was amended where it defined the NSSF as a retirement benefits scheme. This brought the NSSF into the regulatory control of the RBA. All employers are obligated to register with the NSSF but only employers with five or more employees are required to contribute to the NSSF.

Recent reforms in this mandatory scheme includes the enactment of the NSSF Act 2013[105] that increased an employee's NSSF contribution to 12% of their monthly earnings (6% from employer and 6% from employee) from KES 400 (KES 200 from employer and KES 200 from employee). Despite these reforms, the NSSF is still not able to adequately overcome the underlying issues faced by retirement schemes - Kenya's largely informal labour market and high levels of poverty and vulnerability. RBA introduced the Mbao Pension Plan as a way of overcoming the issue of the informal labour market by creating a way for workers in small and medium enterprises (SMEs) to make voluntary savings for old age - Box 3.

Box 3: Social pension schemes in Kenya

The Mbao Pension Plan, introduced in 2009, is a type of social pension with a voluntary savings programme aimed at helping Kenyans save for retirement. It is targeted for people working in SMEs and thus aims to expand pension coverage to informal sector workers. It is implemented by the RBA, with membership reaching up to 4 million by 2012, highlighting the need for and demand for such a savings product. However, there are limitations to the scheme:

- Despite the relatively low minimum contribution rates (KES 20 per day), it will still be unaffordable for the most vulnerable Kenyans.
- The low daily contribution and flexibility of the scheme results in little savings.
- The pension benefits are given as a lump sum and not annuities. This means that the plan will not provide a regular income in old age.
- As in the case of most pension schemes in Kenya, flexibility in withdrawal of the savings is provided after 18 months.

The Inua Jamii Senior Citizens' scheme, implemented since 2018, is a social pension scheme that is tax - financed and offers universal pension coverage for all Kenyans once they reach 70 years of age. The programme is Kenya's flagship in social protection by ensuring that all Kenyans are entitled to a minimum income guarantee in their old age. Recipients of the pension scheme are entitled to KES 2,000 per month, payable bi-monthly through one of four commercial payment service providers. The programme is overseen at the national level by Social Assistant Units (SAUs) in the State Department of Social Protection, Pensions and Senior Citizens' Affairs within the Ministry of Labour and Social Protection. However, the programme is implemented at the sub-national level through local officers of the Department of Social Development. A key limitation, over that of lack of SAUs presence at sub-national level, is the lack of a regulatory framework anchoring the scheme. The Constitution of Kenya of 2010 and the NSPP offer a framework for the scheme.

Source: Odera, P. (n.d.) The Role of Labour and Social Assistance Programs - Case Study: Kenya, Mbao Pension Plan. Retrieved from http://web.worldbank.org/archive/website01506/WEB/IMAGES/PENSIO-3.PDF [March 2023]; ILO Social Protection Department (n.d.). Kenya: Inua Jamii Senior Citizens' Scheme. Retrieved from https://www.developmentpathways.co.uk/wp-content/uploads/2019/05/Inua-Jamii-Country-Brief-1.pdf [March 2023]

Other reforms in Kenya's pension industry include the registration of the Kenya National Entrepreneurs Savings Trust (KNEST)[106], a government-backed pension scheme for informal workers. The scheme has been further tailored to include the voluntary savers outside the Hustler Fund programme, thus complementing the current NSSF that also accepts contributions from informal workers. The Hustler Fund programme is a digital financial inclusion initiative aimed at improving financial access to responsible finance for personal, micro, small, and medium-sized enterprises (MSMEs) in Kenya.[107] Borrowers of the Hustler Fund programme have 5% of their borrowings channelled to a savings scheme under KNEST where

[105] NSSF Act 2013 repealed and replaced the NSSF Act (Cap. 258 of the Laws of Kenya). Read more here https://www.nssf.or.ke/nssf-act-2013 [March 2023]

[106] Republic of Kenya. The Kenya Gazette (n.d.). Retrieved from https://gazettes.africa/archive/ke/2021/ke-government-gazette-dated-2021-12-17-no-255.pdf [March 2023]

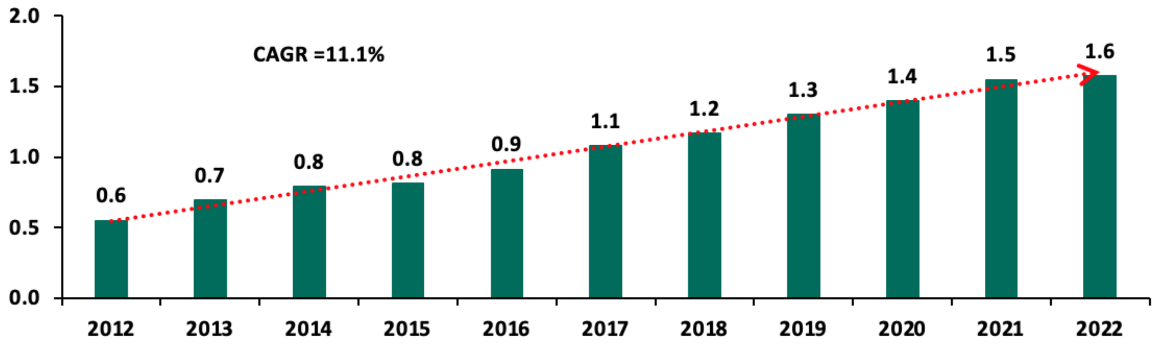
[107] Hustlers Fund. (2022). https://www.hustlerfund.go.ke/

70% of the savings is channelled to a retirement scheme while the remaining 30% is set aside to meet short-term financial needs.[108]

Kenya's pension industry growth has been on an upward trend with assets under management of pension schemes at KES 1.6 trillion billion as at December 2022 and with 3.6 million members enrolled across 1,067 active pension schemes (also shown in figure 10).[109] The number of service providers has also grown with the industry having 31 pension administrators, 24 fund managers, 11 custodians and over 50 qualified actuaries.[110] The percentage of the labour force covered with pension was 22% in 2019 and increased from 15% in 2010 and 13% from 2000.[111] However, despite this growth, pensions uptake is still low with only 12% of the adult population in the labour force saving for their retirement in pension schemes as of 2021[112], with asset growth also increasing at slower rate (1.2% in 2022 against 10.6% growth in 2021)[113]. This is mainly attributed to:

- Market volatility that was further aggravated by the COVID-19 pandemic and global tensions from the war on Ukraine;
- The possibility of members accessing contributions before retirement as a form of savings;
- The general reluctance of Kenyans towards saving;
- A general belief that pensions are for older people hindering young people from joining retirement schemes, and
- Low-income levels with most Kenyans in informal employment[114].

Figure 10: Pension assets growth, in KES trillion



Source: Cytonn Investments (2023, April) Retirement Benefits Schemes have continued to Grow despite Unprecedented Economic Challenges. Retrieved from https://cytonn.com/media/article/retirement-benefits-schemes-continue-to-grow [July 2023]

The pension industry investment portfolio is heavily invested with government securities, accounting for 46% of total assets under management. This is followed closely by guaranteed funds accounting for 19%; and quoted equities and immovable property at 14%. On average, retirement schemes in Kenya allocate 58% of funds to government securities and quoted equities. Figure 11 illustrates the asset allocations between 2013-2022.

[108] Kwama, Joy (2023, March 16). Govt Explains Where 5% Hustler Fund Savings End Up. Kenyans.co.ke. https://www.kenyans.co.ke/news/86943-govt-explains-where-5-hustler-fund-savings-end [March 2023]

[109] Kenya News Agency. (2022, April 22). Kenya's pension industry on an upward trajectory. Kenya News Agency. https://www.kenyanews.go.ke/kenyas-pension-industry-on-upward-trajectory/ [March 2023]

[110] Ibid

[111] Pension funds investment landscape: Market trends and supervisory. (n.d.). Retrieved from https://www.iopsweb.org/Session2-N.Mutuku-IntlConference-Mauritius-2020.pdf [March 2023]

[112] Kenya National Bureau of Statistics (KNBS) (2021) FinAccess Household Survey Report. Retrieved from https://www.knbs.or.ke/wp-content/uploads/2021/12/2021-Finaccess-Household-Survey-Report.pdf [March 2023]

[113] Cytonn Investments (2023, April) Retirement Benefits Schemes have continued to Grow despite Unprecedented Economic Challenges. Retrieved from https://cytonn.com/media/article/retirement-benefits-schemes-continue-to-grow [July 2023]

[114] Cytonn Investments (n.d.) Progress of Kenyan Pension Schemes-2022. Retrieved from https://www.cytonn.com/topicals/progress-of-kenyan-1 [March 2023]

Figure 11: Pension Industry Assets Allocation between 2013 - 2022

Asset Class	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Average	Limit
Government Securities	33.8%	31.0%	29.8%	38.3%	36.5%	39.4%	42.0%	44.7%	45.7%	45.8%	39.2%	90.0%
Quoted Equities	25.5%	26.0%	23.0%	17.4%	19.5%	17.3%	17.6%	15.6%	16.5%	13.7%	19.0%	70.0%
Immovable Property	17.2%	17.0%	18.5%	19.5%	21.0%	19.7%	18.5%	18.0%	16.5%	15.8%	18.0%	30.0%
Guaranteed Funds	10.3%	11.0%	12.2%	14.2%	13.2%	14.4%	15.5%	16.5%	16.8%	18.9%	14.5%	100.0%
Listed Corporate Bonds	4.4%	6.0%	5.9%	5.1%	3.9%	3.5%	1.4%	0.4%	0.4%	0.5%	3.1%	20.0%
Fixed Deposits	4.9%	5.0%	6.8%	2.7%	3.0%	3.1%	3.0%	2.8%	1.8%	2.7%	3.3%	30.0%
Offshore	2.2%	2.0%	0.9%	0.8%	1.2%	1.1%	0.5%	0.8%	1.3%	0.9%	1.2%	15.0%
Cash	1.3%	1.0%	1.4%	1.4%	1.2%	1.1%	1.2%	0.9%	0.6%	1.1%	1.1%	5.0%
Unquoted Equities	0.6%	0.0%	0.4%	0.4%	0.4%	0.3%	0.3%	0.2%	0.2%	0.3%	0.4%	5.0%
Private Equity	0.0%	0.0%	0.0%	0.0%	0.0%	0.1%	0.1%	0.1%	0.2%	0.2%	0.1%	10.0%
REITs	0.0%	0.0%	0.0%	0.1%	0.1%	0.1%	0.0%	0.0%	0.0%	0.0%	0.0%	30.0%
Commercial Paper, non-listed bonds by private companies	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	10.0%
Others e.g. unlisted commercial papers	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.1%	0.2%	0.0%	10.0%
	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	

Source: Cytonn Investments (2023, April) Retirement Benefits Schemes have continued to Grow despite Unprecedented Economic Challenges. Retrieved from https://cytonn.com/media/article/retirement-benefits-schemes-continue-to-grow [July 2023]

While there is currently no requirement for ESG disclosures in Kenya, pension scheme trustees have a fiduciary duty to maximise the returns for their members by making prudent investment decisions considering all relevant financial and non-financial factors. However, since Kenya's assets under management are tied to quoted securities listed on NSE which in turn have ESG guidelines (mentioned in the capital markets section above), there is some level of ESG integration in the pensions industry. **However, there is no specific ESG framework for the pensions industry in Kenya**.

a. Current attitude towards ESG in the pension industry

Between March and May 2023, Genesis and FSD Africa, in collaboration with the RBA, asked market participants to respond to a survey about ESG. The survey was anonymous and was completed by asset managers (57.1% of the sample), a pension fund investment association (14.3% of the sample), an investment consultant (14.3% of the sample) and a regulator (14.3% of the sample). The survey received seven responses.

Of the survey respondents, 57% stated that all three components of ESG risks are important for their investment decisions. The minority of respondents, prioritise governance over environmental and social risks. This aligns with desktop research that showed that when one of the components of ESG was prioritised, that tends to be the governance component. It is interesting that the majority of the respondents consider all three components of ESG, because ESG regulations or guidelines in Kenya do not explicitly mention how to consider environmental factors.

Many of the respondents hold their investments for between two and five years. This indicates that their decisions need to consider long-term risks. Because ESG risks are often long-term in nature, considering them can help improve the risk management process of a pension fund. This is important given that ESG risks can have a negative impact on the financial performance of the asset in the long-term; for example, climate change might increase the risk of flooding thus reducing the value of assets that are in areas that are likely to be flooded.

When asked to prioritise which risks are more important, the respondents ranked financial risk as the most important risk. This makes sense given that pension funds exist to bring financial returns to their members. The pension funds are bound by a fiduciary duty which is to increase these returns, but doing so also involves considering other risks. The ranking of ESG-related risks gives insight as to which other risks are considered important to the pension funds.

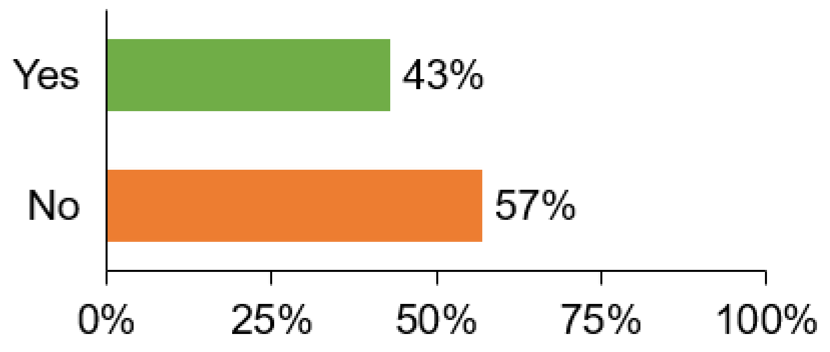
Figure 12: The ranking of ESG related risks from most to least important.

Source: Genesis Analytics (2023). Based on the results of the survey filled out by the Kenyan pension industry.

b. Current ESG practices

When asked whether their organisation currently policies has related to any of the aspects of ESG, 57% responded that they do not have such policies whilst 43% responded that they do have such policies. This shows that there is room to provide guidelines to increase the development of ESG related policies.

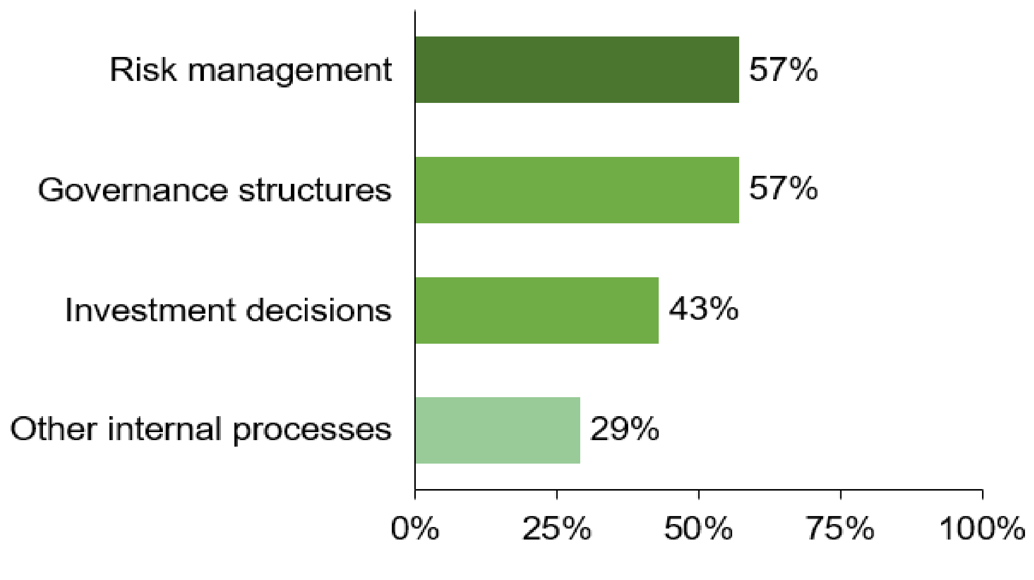
Figure 13: Survey responses to the question of whether the respondent's organisation currently has ESG-related policies.



Source: Genesis Analytics (2023). Based on the results of the survey filled out by the Kenyan pension industry.

However, whilst pension funds may not currently have specific ESG policies, the majority do consider ESG factors in risk management and governance structures or leadership meetings. This indicates that incorporating elements of ESG is already happening despite the lack of ESG policies.

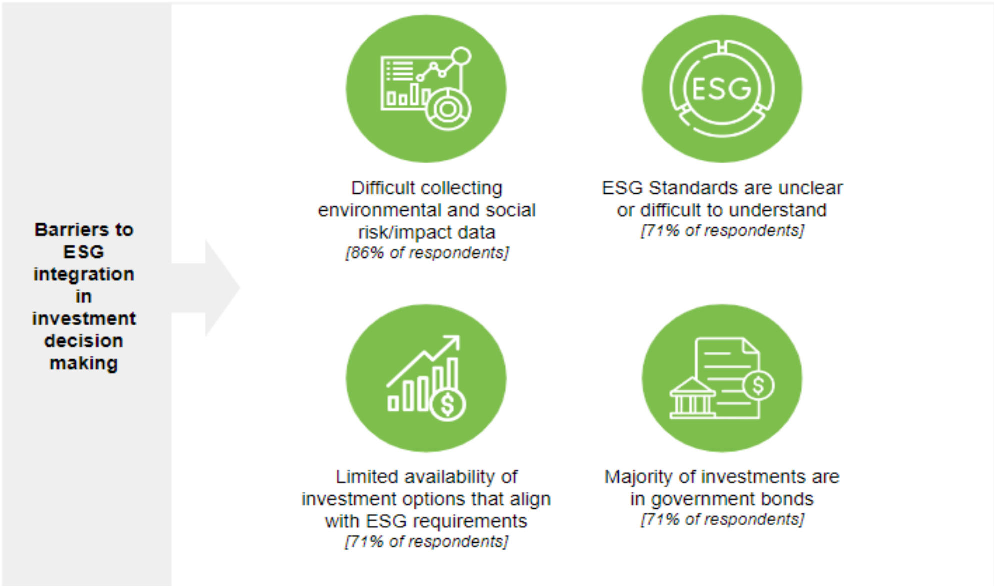
Figure 14: Survey responses to the question of whether ESG factors are considered by pension funds.



Source: Genesis Analytics (2023). Based on the results of the survey filled out by the Kenyan pension industry.

There are a number of challenges limiting the implementation of ESG considerations in the pension industry in Kenya. The key barrier identified by survey respondents is the difficulty in collecting environmental and social risk and impact data (86%). Additional barriers mentioned were: the complexity of ESG Standards (71%), the limited availability of ESG aligned investment options (71%), and the fact that most of their investments are in government bonds (71%). These barriers reveal the importance of equipping the pension industry to understand ESG considerations and provide recommendations on how to collect data on environmental and social risk/impact. This is relevant when RBA considers how the industry should monitor and report on their progress in incorporating ESG considerations into investment and risk management processes.[115]

Figure 15: The barriers identified by survey respondents.



Source: Genesis Analytics (2023). Based on the results of the survey filled out by the Kenyan pension industry.

The limited availability of investment options that align with ESG requirements is a concern for the pension industry. It is difficult to increase the supply of such investment options in the short-term; however, this might be more likely in the long-term. For example, not long ago the options of investing in assets that have a quantifiable value were extremely limited, but in some countries social bond investment options have been created. There may be scope for RBA to provide guidance or guidelines that will assist pension funds in identifying such ESG-aligned assets, but it would be beyond the scope of the regulator to increase the supply of such investments or assets. Thus, collaboration with Kenya's capital market regulator, CMA, will be of importance in catalysing the supply of ESG-aligned assets. In addition, incorporating ESG into investment and risk management decision making is broader than selecting ESG-aligned investments; as such, there are other ways for RBA to assist the pension industry in incorporating ESG factors.

Kenya does have regulations or guidelines that relate to the social and governance aspects of ESG; however, no pension specific documents explicitly consider environmental risks and impacts. Below is a table categorising Kenyan regulations or guidelines by their link to the environment, social or governance aspects.

Table 8: ESG integration in the pension industry in Kenya

ESG aspect	Sub-aspects	Regulations or guidelines that cover these aspects	Key gaps/ opportunities
Environmental	Carbon emissions, air and water pollution, biodiversity, deforestation, energy efficiency, waste	• Climate Change Act, 2016 • National Climate Change Action Plan (NCCAP)	No pension specific incorporation of environmental sustainability factors.

[115] International Organisation of Pension Supervisors. (2019). *IOPS Supervisory Guidelines on the Integration of ESG Factors in the Investment and Risk Management of Pension Funds.* [Online]. Available: https://www.iopsweb.org/IOPS-Supervisory-guidelines-integration-ESG-factors.pdf. [April 2023].

ESG aspect	Sub-aspects	Regulations or guidelines that cover these aspects	Key gaps/ opportunities
	management and water scarcity	● Green Fiscal Incentives Policy Framework 2022 (pending)	Need for consideration of specific environmental risks when it comes to investments
Social	Customer satisfaction, data protection and privacy, gender and diversity, employee engagement, community relations, human rights and labour standards, cybersecurity	● The Data Protection Act 2019 ● National Social Protection Policy ● CMA's Stewardship Code for Institutional Investors 2017 ● National Policy on Gender and Development (NPGD) 2019 ● Protection of assets under management are guided under the RBA	Diversity considerations with listed entities Protection of member contributions Pending policy on cryptocurrencies to enhance cybersecurity
Governance	Governing body composition, bribery and corruption, executive compensation, lobbying, political contributions, and whistleblowing	● Retirement Benefits Act ○ Good Governance Guidelines 2018 ● Companies Act 2015 & 2017 ● CMA's Stewardship Code for Institutional Investors 2017 ● A whistleblowing portal is available on the RBA's website.	Principles on good governance for pension schemes

Source: Author based on linked sources

c. Aspirations for ESG adoption in the Kenyan pension industry

Supporting the Kenyan pension industry in integrating ESG factors is a priority for Kenya's pension regulator, RBA. It is important that the right balance is struck between providing realistic guidance on ESG integration and considering the financial outcomes for the pension funds.

Pension funds in Kenya have asked (via the survey) for an ESG industry-wide policy framework which will guide the drafting of their investment policy statement, disclosures, and reporting. This should align to the ISSB standards and should be accompanied by capacity building for the pension industry. The introduction of ESG policy guidelines could address the gap between the perceived importance of ESG and the number of pension funds that do not have ESG policies as discussed in section b above.

Whilst pension funds want ESG policy guidelines, only one respondent indicated that they are motivated to incorporate ESG factors because of a legal mandate. Instead, they are motivated to do so because it can help identify potential risks to mitigate that they had not previously considered, and incorporating ESG considerations could improve internal accountability with regards to risk management.

Figure 16: Primary motivators for incorporating ESG considerations.

Source: Genesis Analytics (2023). Based on the results of the survey filled out by the Kenyan pension industry.

Overall, from the survey responses, and desktop regulatory review of ESG adoption in the pension industry, it becomes apparent that:

1. Attitudes towards ESG adoption are positive;
2. The pension industry would like RBA to issue ESG policy guidance/guidelines;
3. Future attitudes towards ESG adoption are positive to improve risk management, ensure internal accountability and signal a corporate commitment to sustainability.

This project seeks to address the specific regulatory interventions required for ESG adoption in the Kenyan pension industry. As such, the challenges and opportunities for ESG adoption are described in section 3.3 below.

3.3 Preliminary regulatory gaps/opportunities for ESG adoption

In addition to the survey responses, our research identified that there are several obstacles to the integration of ESG in Kenya's pensions industry. These include structural, regulatory and legal hurdles such as:

1. **Reporting standards:** ESG reporting is currently voluntary and thus inconsistent. Due to a lack of a universal reporting standard, pension funds can choose to report on the array of ESG metrics and third-party disclosure frameworks available - see the introduction to this document for the range of international ESG frameworks. These frameworks can be implemented on their own or together, making it confusing and costly.
2. **Enforcement:** Most regulators have often taken the approach of "comply or explain" as used in CMA's Stewardship Code for Institutional Investors 2017. Thus, ESG metrics and disclosure frameworks are either embedded into related legislations making them enforceable or remain as recommendations on best practice.
3. **Regulatory uncertainty:** There is still a conflict between what ESG metrics and methods will deliver the most profit for retirement scheme members and the risk that may befall a retirement scheme that fails to move toward sustainability.[116] This calls for internal policies on ESG considerations in

[116] Nation Africa. (2023, February 26). What is expected of trustees in pension schemes growth. Nation Africa. https://nation.africa/kenya/business/leadership/what-is-expected-of-trustees-in-pension-schemes-growth-4138770 [March 2023]

investments, scaling up opportunities for green investments in capital markets, and establishing regulatory certainty in the industry.

4. **Greenwashing:** Similar to international markets, and due to pressure from shareholders, companies may be tempted to start misrepresenting ESG credentials of some of their products, services and compliance levels. This poses a high risk of litigation and reputational damage.
5. **Cross-border alignment:** About 90% of the assets under management of pension funds and other institutional investors in Africa is concentrated in South Africa, Nigeria, Namibia and Botswana.[117] However, these countries may have similar or vastly different ESG reporting standards which can be tedious for companies to comply with. This can make reporting confusing and costly if there is no cross-border alignment of ESG frameworks.
6. **ESG-related data:** Despite the African Pension Supervisors Network (APSN) attempting to encourage the continent's funds to adopt ESG strategies, it is difficult to find accurate figures on the proportion of ESG-based investment undertaken in Africa by African funds.

Based on this analysis, our desktop review suggests there are a number of opportunities for RBA to consider for interventions relating to ESG:

1. **Overall, there is an opportunity for Kenya to integrate global best practice on social and environmental risk management and the impact of this on investment decision making.** As the Kenyan industry embarks on the journey towards ESG integration, Kenya can learn from best practice and case studies from comparable countries.
2. **Governance aspects are well covered.** The Kenyan governance standards align with global best practice; these can be leveraged in the design and implementation of the tools and interventions on this project.
3. **Social aspects focus on protection of members and diversity.** However, there is limited mention of cybersecurity/ data protection.
4. **Environmental risks are not explicitly covered by pension regulations or guidelines.** This is a common finding throughout the three countries discussed in this report. The current guidelines do not consider the impact of climate change on investment valuation or financial returns, nor the treatment of environmental risks in investment decision making.
5. **Finally, two critical enablers for ESG integration could be improved within the current regulatory framework:**
    a. **Reporting and monitoring of progress:** It is unclear to what extent aspects around governance and society that are provided for are actively reported or enforced. Additionally, 60% of market regulators state that their regulatory mandates do not include any specific references to ESG matters;[118] and,
    b. **Promoting knowledge and awareness throughout the industry:** Capacity challenges both at the regulator and industry level requires urgent attention.

These recommendations note that managing ESG risks as a mechanism to ensure the sustainability of the financial sector requires various interventions. Some of these interventions are described as detailed, sector-specific toolkits, which the next phase of this project will address.

[117] Ford, N. (2022, June 2). African pension funds lead the way on ESG. African Business. https://african.business/2022/06/finance-services/african-pension-funds-lead-the-way-on-esg/ [March 2023]
[118] IOSCO (2020). Sustainable Finance and the Role of Securities Regulators and IOSCO.

4. CONCLUSION AND NEXT STEPS

As this diagnostic report has shown, there are some clear opportunities in current ESG practices in the pension industry in Kenya. This presents an excellent base for RBA to leverage international best practice and identify the most impactful approaches.

This report found that whilst governance as a theme was relatively well covered through existing financial sector and pension industry regulations and policies, environmental and social considerations were not as well represented and therefore represent a meaningful opportunity for RBA. Additionally, in many cases guidance relating to the various sub-aspects of ESG were found in multiple different pieces of regulations or guidelines, potentially making it difficult for pension funds to follow. Understanding this, along with specific country details contained above will provide a solid foundation for the design of appropriate interventions in each country.

More specifically, we are now in the position to work with FSD Africa and the regulators in each country to develop an ESG toolkit for the pension industry and ESG-focused regulations/policy guidance/guidelines to support the regulators in integrating ESG factors in the pension industry. This support will include capacity building and training of the regulators.

ANNEXURE 1: REGULATORY DOCUMENTS REVIEWED (GLOBAL)

Country	Key words	Comment	Link
United Kingdom	The UK Stewardship Code	In 2020, The United Kingdom's Stewardship Code identifies the principles that underlie an effective board and sets out the principles of effective stewardship by investors. In so doing, the Code assists institutional investors to exercise their stewardship responsibilities, which in turn gives force to the "comply or explain" system.	https://www.frc.org.uk/investors/uk-stewardship-code
United Kingdom	Global Survey on Implementation of the Recommendations of the Task Force on Climate-Related Financial Disclosures (TCFD)	In 2019, responded to a global survey by the Sustainable Insurance Forum (SIF), which has uncovered significant differences among many insurers' and reinsurers' levels of awareness, uptake, and implementation of the Recommendations of the Task Force on Climate-Related Financial Disclosures (TCFD). The TCFD recommendations, released in June 2017, set a framework for the identification, assessment, and disclosure of climate-related risks and opportunities by corporate and financial sector entities.	https://www.greenfinanceplatform.org/policies-and-regulations/united-kingdom-responded-global-survey-implementation-recommendations-task
EU	Regulatory Technical Standards (RTS), on sustainability-related disclosures	The Joint Committee of the three European Supervisory Authorities (EBA, EIOPA and ESMA – ESAs) delivered to the European Commission the final report, including the draft Regulatory Technical Standards (RTS), on the content, methodologies and presentation of disclosures under the EU Regulation on sustainability-related disclosures in the financial services sector (SFDR).	https://www.esma.europa.eu/press-news/esma-news/three-european-supervisory-authorities-publish-final-report-and-draft-rts
EU	Taxonomy Regulation	Regulation 2020/852 on the establishment of a framework to facilitate sustainable investment establishes the criteria for determining whether an economic activity qualifies as environmentally sustainable for the purpose of establishing the degree to which an investment is environmentally sustainable.	https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32020R0852
France	Climate pilot exercise to measure the physical and transitional risks	In May 2020, French Prudential Supervision and Resolution Authority (ACPR) launched the climate pilot exercise which intends to measure the physical and transitional risks to which the French banking and insurance establishments are exposed by 2050.	https://acpr.banque-france.fr/sites/default/files/medias/documents/20200717_main_assumptions_and_scenarios_of_the_acpr_climate_pilot_exercise.pdf
United States	Executive order on Climate	In May 2021, the U.S. President signed an executive order that sets the stage for the US federal government, including its financial regulatory agencies, to begin to incorporate climate-risk and other ESG issues into financial regulation.	https://www.whitehouse.gov/briefing-room/presidential-actions/2021/05/20/executive-order-on-climate-related-financial-risk/
United States	Managing Climate Risk in the U.S. Financial System	In September 2020, the Climate-Related Market Risk Subcommittee of the Market Risk Advisory Committee of the Commodity Futures Trading Commission released a comprehensive report addressing potential risks to the financial system arising from, or related to, climate change. The report presents 53 recommendations to mitigate the risks to financial markets posed by climate change.	https://www.cftc.gov/sites/default/files/2020-09/9-9-20%20Report%20of%20the%20Subcommittee%20on%20Climate-Related%20Market%20Risk%20-%20Managing%20Climate%20Risk%20in%20the%20U.S.%20Financial%20System%20for%20posting.pdf
United States	Revisions to Financial Condition Examiners Handbook	In 2015, The National Association of Insurance Commissioners (NAIC) required that insurance companies disclose to regulators and investors the financial risks that they face from climate change, as well as actions that the companies are taking to respond to those risks.	https://content.naic.org/cmte_e_fehtg.htm
South Africa	Green Finance Taxonomy	Under the leadership of the National Treasury, and with support from IFC, the National Business Initiative and Carbon Trust are working to develop a national taxonomy framework and the first green finance taxonomy for South Africa.	https://sustainablefinanceinitiative.org.za/working-groups/taxonomy/

Country	Key words	Comment	Link
South Africa	South Africa Sustainable Finance Initiative	In 2017, South Africa's Sustainable Finance Initiative aims to: Define sustainable finance for a South African context; Incorporate perspectives from all parts of the financial sector, including banking, pension funds, insurance, asset management, and capital markets; Describe the global and national drivers for sustainable finance, as well as existing industry initiatives; Map supply and demand for, as well as barriers to, sustainable finance; and Provide recommendations on a national strategic approach and the role of regulatory agencies and industry stakeholders.	https://sustainablefinanceinitiative.org.za/
South Africa	Amendment to South Africa's Pension Funds Act of 1956 (Amendment of Regulation 28)	South Africa's amendment to its Pension Funds Act (of Regulation 28 under Section 36) provides a set of principles on investment practices and rules stipulating asset allocation limits as well as the consideration of environmental, social, and governance (ESG) factors. Specifically, the amendment states the trustees of Pension Funds or institutional investors acting on a trustee's mandate must consider the effects of ESG factors on the long-term performance of the fund or investment as part of their fiduciary duties as trustees of a Pension Fund.	http://content.momentum.co.za/Content/regulation-28/reg-28-budget-2011.pdf
Brazil	Improvement of rules on risk management and social, environmental and climate responsibility applicable to financial sector	In April 2021, Banco Central Do Brasil launched the Public Consultation No. 85 on the improvement of rules on risk management and social, environmental and climate responsibility applicable to the financial sector. These aim to enhance the Brazilian regulatory framework on risk management and responses by incorporating the most recent international debates on sustainability issues.	https://www.bcb.gov.br/en/pressdetail/2388/nota
Brazil	The Brazil Innovation Lab for Climate Finance	In 2016, the Global Innovation Lab for Climate Finance (the Lab) is a local network of public and private investors and leaders that identify, develop, and launch transformative investment solutions that can drive funds for Brazil's national climate priorities.	https://www.climatefinancelab.org/the-labs/brasil/
India	National Guidelines for Responsible Business Conduct	In March 2019, the National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business were updated to include the Sustainable Development Goals (SDGs), and the United Nations Guiding Principles on Business & Human Rights (UNGPs) and were released as the National Guidelines for Responsible Business Conduct (NGRBC). The NGRBC are designed to be used by all businesses and contain thematic pillars called Principles.	https://www.greenfinanceplatform.org/policies-and-regulations/indias-national-voluntary-guidelines-social-environmental-and-economic
India	National Voluntary Guidelines on Social, Environmental, and Economic Responsibilities of Business	In 2009, India's Ministry of Corporate Affairs published corporate social responsibility (CSR) voluntary guidelines, which suggest that business entities should formulate CSR policies to guide their strategic planning and provide a roadmap for their CSR initiatives. In 2011, the guidelines were superseded by the expanded and more detailed National Voluntary Guidelines on Social, Environmental, and Economic Responsibilities of Business.	https://www.greenfinanceplatform.org/policies-and-regulations/indias-national-voluntary-guidelines-social-environmental-and-economicc
Botswana	Guidance for listed companies on reporting ESG information to investors	In 2018, Botswana Stock Exchange issued guidance for BSE listed companies. The guidance is a voluntary tool and proposes five guiding principles for ESG reporting: Responsibility and Oversight; Clarity and purpose; Relevance and materiality; Accessibility; Credibility and responsiveness	https://www.bse.co.bw/wp-content/uploads/2021/02/BSE_Guidance-for-Listed-Companies-on-Reporting-ESG-Information-to-Invest....pdf
Colombia	Colombia Green Taxonomy	In September 2021, the Superintendencia Financiera de Colombia published the first phase of the construction of the Colombia Green Taxonomy that seeks to facilitate the identification of projects with environmental objectives, develop green capital markets, and promote the effective mobilization of private and public resources towards sustainable investments.	https://www.superfinanciera.gov.co/jsp/10109182

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