PRI RESPONSE

DRAFT KENYA GREEN FINANCE TAXANOMY

10 June 2024

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To inform this briefing, targeted regional PRI signatories have been consulted. This consultation is not an endorsement or acknowledgement of the views expressed in this briefing.

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ABOUT THE PRI

The Principles for Responsible Investment (PRI) works with its international network of signatories to put the six Principles for Responsible Investment into practice. Its goals are to understand the investment implications of environmental, social and governance (ESG) issues and to support signatories in integrating these issues into investment and ownership decisions. The PRI acts in the long-term interests of its signatories, of the financial markets and economies in which they operate and ultimately of the environment and society as a whole.

The six Principles for Responsible Investment are a voluntary and aspirational set of investment principles that offer a range of possible actions for incorporating ESG issues into investment practice. The Principles were developed by investors, for investors. In implementing them, signatories contribute to developing a more sustainable global financial system. More information: www.unpri.org

The PRI develops policy analysis and recommendations based on signatory views and evidence-based policy research. The PRI welcomes the opportunity to respond to the Central Bank of Kenya's call for feedback on the draft Kenya Green Finance Taxonomy (KGFT).

ABOUT THIS CONSULTATION

The Central Bank of Kenya (CBK) has released the draft Kenya Green Finance Taxonomy (KGFT) for public consultation. The KGFT is part of the outputs of the ongoing European Investment Bank (EIB) - Central Bank of Kenya (CBK) Greening Financial Systems Technical Assistance Programme that commenced in October 2023.

The proposed KGFT is intended to serve as a tool to classify whether particular economic activities are 'green' or environmentally sustainable. It is also intended to serve as a guide for both banking sector participants and other market participants in making informed investment or financing decisions.

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KEY RECOMMENDATIONS

The PRI welcomes the release by the Central Bank of Kenya (CBK) of the draft Kenya Green Finance Taxonomy (KGFT) for public consultation.

The KGFT design aligns with the key features of a sustainable finance taxonomy as outlined in implementation guidance that PRI published in collaboration with the World Bank, and therefore forms an excellent basis for increasing financial flows to sustainable economic activities. The PRI's key recommendations are:

- **Move forwards swiftly with the expansion of the KGFT from banks to other parts of the financial sector.** This will allow pension funds, investment managers and insurance companies to also redirect their activities in support of a sustainable transition of Kenya's economy.
- **Provide sufficient resources to support end-users in the application of the KGFT.** The ambition level and granularity of the KGFT is commendable and allows a high degree of alignment with other sustainable finance taxonomies. But experience indicates that it also increases the policy instrument's complexity: implementation by corporates and financial institutions will require capacity building and awareness raising.
- **Consider the integration of the KGFT into a broader sustainable finance strategy.** A sustainable finance taxonomy is a cornerstone policy instrument for increasing financial flows to sustainable economic activities, but will only reach its full potential if it is connected to disclosure requirements for corporates and financial institutions. The Kenyan government should provide clarity on the timeline by which it intends to put in place such mandatory regulation, keeping some flexibility for a gradual roll-out of reporting requirements.
- **Develop enabling real-economy policies as part of a whole-of-government approach to the economic transition.** The KGFT will enable finance towards achievement of sustainability goals, but will need to be complemented by policy instruments that address economic externalities (e.g. pricing instruments, fossil fuel phase-out, subsidy reform) and build markets for solutions (e.g. subsidies, tax incentives, sectoral policies).

DETAILED RESPONSE

NOTICE

PRI's comments in this consultation response are focused on KGFT's design (as outlined in the draft v2 of 28 March 2024) and its integration into broader policy frameworks. PRI has not provided feedback on the selection of sectors or specific technical screening criteria (as outlined in annexes 1-10), as this falls outside the remit of our work and expertise.

DESIGN OF THE KGFT

The sustainable finance taxonomy implementation guide from PRI and the World Bank identifies three key components of a sustainable finance taxonomy:

- **Objectives** which define the aims of the taxonomy.

- **Activity lists** which detail eligible economic activities (i.e. those activities that can make a positive contribution to the objectives of the taxonomy). Taxonomies may also go beyond sustainable economic activities and include, for instance, economic activities that are needed to enable a transition towards achieving social or environmental goals or economic activities that are inherently harmful: such 'extended' taxonomies should always make clear that they are not only identifying sustainable economic activities, and maintain a clear distinction between the different types of economic activities (i.e. sustainable, transition, harmful) so that investors can clearly distinguish the degree to which their investments are (not) contributing to the objectives defined by the taxonomy.
- **Performance criteria** which determine whether the eligible activities are aligned with the objectives of the taxonomy. Criteria should be defined for how economic activities can significantly contribute to the objectives of the sustainable finance taxonomy, as well as for ensuring that economic activities do no significant harm to any of the objectives. To be aligned with a sustainable finance taxonomy, an economic activity must significantly contribute to one its objectives, while doing no significant harm to any of the other objectives

■ **The KGFT's design is fully aligned with all these three components**, and goes even one step further by adding a requirement for a climate change vulnerability assessment. This will provide end-users with a high-level of granularity. It also allows for the **KGFT to align with key conditions for interoperability with other sustainable finance taxonomies** (e.g. EU, South Africa), being that these policy instruments:

- Have similar objectives as other taxonomies, although there can be some adaptation to national contexts;
- Use the same or easily comparable industry classification systems to define economic activities;
- Have a similar approach regarding the design of technical screening criteria (i.e. including both significant contribution and do no significant harm criteria), and use technical screening criteria that are transparent and broadly similar; and
- Use consistent metrics and calculation methodologies.

APPLICATION TO AND BY END-USERS

■ PRI has engaged extensively with investors and other end-users about the implementation of sustainable finance taxonomies, most prominently in the EU through an [EU taxonomy practitioners group](#) (2020-2022) and its contribution to [a compendium of market practices](#) by the EU platform on sustainable finance (2023-2024). This engagement has shown a high interest by investors to integrate the EU sustainable finance taxonomy in their investment activities, both in- and outside the EU. The KGFT's alignment with the EU sustainable finance taxonomy therefore creates **a unique opportunity to attract domestic and international investor capital towards sustainable economic activities in Kenya, and is a strong argument to move forwards swiftly with the expansion of the KGFT from banks to other parts of the financial sector.**

■ However, as the KGFT notes, the application of a sustainable finance taxonomy comes with challenges in terms of data availability and defining the alignment of economic activities. PRI therefore supports the KGFT emphasis on the role of the Taxonomy Working Group (TWG), as custodian, to prioritise knowledge dissemination and capacity building. Bodies through which capacity building can be achieved are amongst others, the Nairobi Stock Exchange (NSE), Institute of Certified Public Accountants of Kenya (ICPAK), FSD Africa, the IFC Integrated ESG Program, and Karibu Business Support Centres.

TAXONOMIES WITHIN A SUSTAINABLE FINANCE STRATEGY

■ The PRI and World Bank have published a policy toolkit for a sustainable finance system, in which a sustainable finance taxonomy is mentioned alongside four other policy instruments:

- Corporate ESG disclosures
- Stewardship (engagement and voting)
- Investors' duties to incorporate ESG-related considerations in their investment decision making
- National/regional sustainable finance strategies, that encourage and enable the low-carbon transition and the delivery of the SDGs.

A sustainable finance taxonomy is thus a cornerstone policy instrument for increasing financial flows to sustainable economic activities, but will only reach its full potential if it is connected to disclosure requirements for corporates and financial institutions.

The complexity of an instrument such as the KGFT justifies a period of voluntary application to build market maturity and expand the group of end-users from banks to other parts of the financial system. However, providing clarity on the timeline by which the Kenyan government intends to put in place mandatory requirements to disclose taxonomy alignment will provide further incentives for market participants to engage with the KGFT at an early stage.

With regards to keeping mandatory disclosure requirements manageable, PRI suggests the Kenyan government considers:

- To prioritise a limited number of critically important economic activities for initial disclosures, before rolling out disclosure requirements to all economic activities included in the KGFT.
- To define thresholds to limit disclosure requirements, in a first phase, to large companies and financial institutions. Allowing voluntary disclosure for smaller companies will allow them to adopt the KGFT at a reasonable pace, and build capacity in their organisations to fully implement the instrument at a later stage
- To clarify what parts of a financial institutions' activities the KGFT applies to (i.e. debt instruments, funds, entity level); and to present a timeline for gradual expansion of the scope of activities covered.

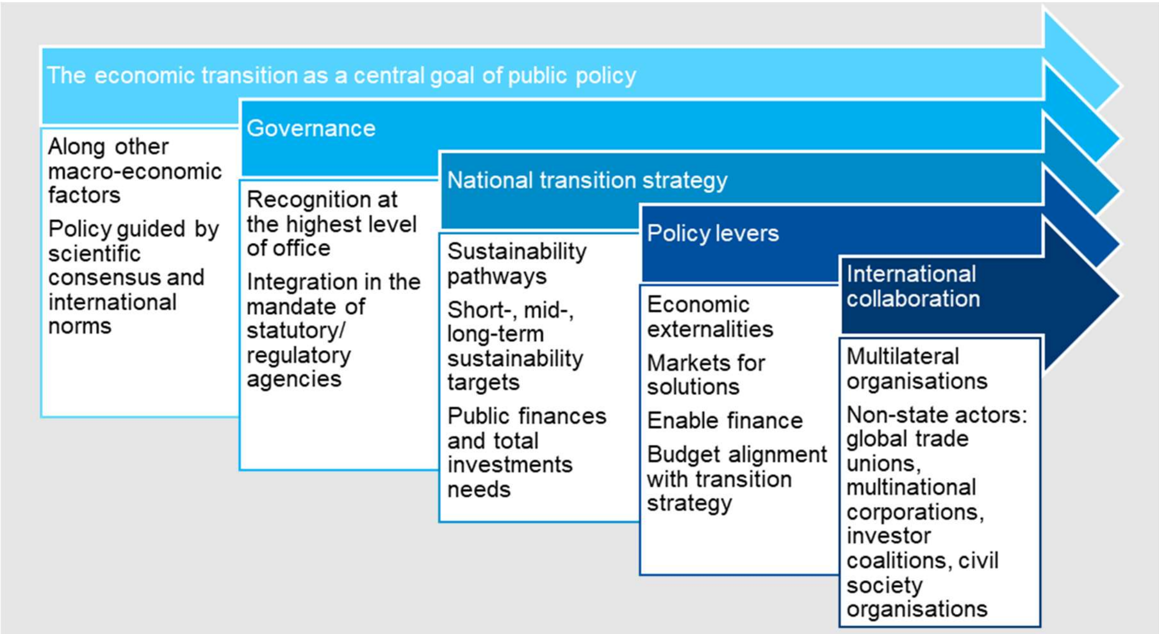
A WHOLE-OF-GOVERNMENT APPROACH TO THE ECONOMIC TRANSITION

Addressing the environmental and social challenges that the world faces will require governments to put in place a mix of regulations and policies. A sustainable finance strategy, of which a sustainable finance taxonomy is part, enables finance towards achievement of sustainability goals, but will need to be complemented by policy instruments that address economic externalities (e.g. pricing instruments, fossil fuel phase-out, subsidy reform) and build markets for solutions (e.g. subsidies, tax incentives, sectoral policies).

In October 2023, PRI published a [white paper]() that sets out how governments can take a coherent, 'whole-of-government' approach to the economic transition. This white paper:

- Describes the economic transition as "the process by which the economy is transformed from its current extractive and unsustainable state to one that is sustainable and equitable, and that benefits both the economy and natural and social systems".
- Presents a high-level conceptual framework to support governments in pursuing such a transition (see figure 1), which stresses the importance of collaboration, consistency and the economic transition added as one of the goals of public policy.

Figure 1. A high-level policy framework for a whole-of-government approach to the economic transition



The specific details of a country's transition strategy and its implementation will depend on a series of factors, including economic context, economic structure, political and institutional capacity and expertise, the sources and types of finance available to the country, domestic economic, social and environmental priorities, and the nature of the relationships between the various actors involved in the policy development and implementation processes.

The publication of the draft KGFT is an important step in establishing a coherent approach to the economic transition – alongside other policy instruments such as the Companies Act, Kenya's Corporate Governance Practices Code, Climate Change Act, National Policy on Climate Finance, Guidance on Climate-Related Risk Management, Policy Guidance Note on Green Bonds, NSE ESG Disclosure Guidance Manual. The Kenyan government could consider how some of these instruments, such as the Corporate Governance Practices Code, should be reviewed to integrate the KGFT requirements.

The PRI has experience of contributing to public policy on sustainable finance and responsible investment across multiple markets and stands ready to support the work of the Central Bank of Kenya to further the establishment of the KGFT and a whole-of-government approach to the economic transition.

Please send any questions or comments to policy@unpri.org.

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