



**Green Bonds
Programme**

— KENYA —

Kenya Green Bond Guidelines Background Document (Final)





Green Bonds Programme

— KENYA —







Kenya's Green Bond Guidelines (Final)

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Climate Bonds INITIATIVE

The background document has been prepared by the Climate Bonds Initiative in collaboration with Kenya Bankers Association, Nairobi Securities Exchange, Financial Sector Deepening Africa and FMO.



Introduction

The background document for the Kenya green bond guidelines has been developed as part of the Green Bond Program - Kenya, which aims to develop a domestic green bond market. The Programme is brought together by the Kenya Bankers' Association, Nairobi Securities Exchange, Climate Bonds Initiative, Financial Sector Deepening Africa and the Dutch development bank FMO.

Green bond guidelines are an important tool to give guidance to issuers and lower friction in the market. The Kenya green bond guidelines are issued by the Nairobi Securities Exchange and approved by the Capital Markets Authority. The paper aims to support the consultation process on the guidelines with Kenyan market participants.

The background document provides an overview of the global green bond market, the development of guidelines in other jurisdictions and the underlying for Kenya's Green Bond Guidelines developed by the Nairobi Securities Exchange.

The global green bonds market

Green bonds are regular bonds with one distinguishing feature: proceeds are earmarked exclusively for projects with environmental benefits, mostly related to climate change mitigation or adaptation but also to natural resources depletion, loss of bio-diversity, and air, water or soil pollution.

Green bonds are an important channel for low-carbon and climate-resilient investments to support the

transition to a sustainable economy. The green label is a discovery mechanism for investors; it enables the identification of climate-aligned investments with limited due diligence from investors, which reduces market friction and facilitates growth in environmentally friendly investments.

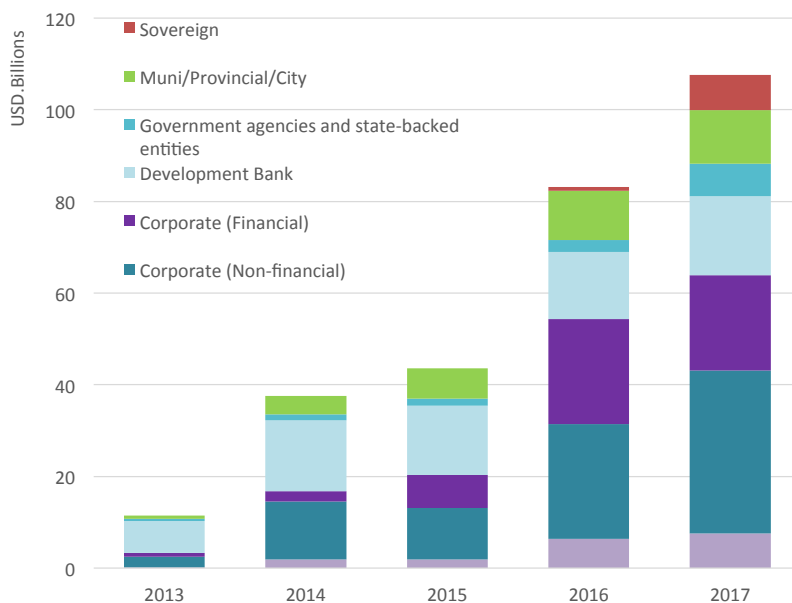
Green bonds can deliver several benefits for both issuers and investors, as summarised in the table below.

Benefits for investors	Benefits for issuers
<ul style="list-style-type: none"> • Comparable financial returns with the addition of environmental benefits • Satisfy Environmental, Social and Governance (ESG) requirements for green investment mandates • Enable direct investment in the 'greening' of brown sectors • Enable alignment with current or future climate policies in line with the Paris Agreement 	<ul style="list-style-type: none"> • Provide an additional source of green financing • Match maturity with project life • Improve investor diversification and attract buy-and-hold investors • Enhance issuer reputation • Attract strong investor demand leading to high over-subscription

The green bond market has grown exponentially over the past 5 years, reaching USD155.5bn¹ issuance in 2017,

almost double that of 2016. A key characteristic of labelled green bonds is that it is about green assets, not green entities.

Figure 1: The Global Green bonds market (annual issuance 2013-2017)



Source: Climate Bonds Initiative

The first green bonds were issued by the EIB and World Bank in 2007. The market is growing and increasingly diversifying, with corporates, financial institutions and sub-sovereigns playing an increasing role.

1 This figure is for green bonds aligned with the Climate Bonds Taxonomy.

2 The policy toolkit includes fiscal support for issuers, credit enhancement, green financial warehousing, preferential treatment in liquidity operations from the central bank.



Why green bond guidelines are important

Developing clear guidelines and standards for what is green, establishes the foundation for a green bond market.

They are the basis for:

- **Climate and infrastructure targets:** robust green credentials can help achieve the overarching goal of meeting climate mitigation and adaptation targets and infrastructure demand, contributing to the country's sustainable development agenda by addressing food security, public health, poverty and unemployment.
- **Market integrity:** issuance guidelines and standards provide clarity for investors that are attracted to the 'green' flavour and want to avoid the risk of 'greenwashing' sustaining the demand in what is currently an investor-driven market
- **Targeted policies:** clarifying what is green enables further targeted policy support for low-carbon projects and green bond issuance²
- **Achieving scale:** high volumes of investments are necessary to develop a liquid market and facilitate

more investments, enabling the transition to a low-carbon economy. Green standards reduce transaction costs, therefore facilitating scale.

The green bond market was born as a voluntary market, relying on self-labelling from the issuer - at the market's onset these were development banks. As the market has grown and diversified over the years, voluntary guidelines and standards have been increasingly used and external reviews on the green credentials of the bonds have become a common practice. As of 2015, some regulators have started developing and releasing guidelines for issuance in domestic markets.

This paper reviews existing market practices and proposes a set of green bond guidelines for the Kenyan market. Starting from an analysis of international good practice and latest developments in other national markets, the paper explores how guidelines can support the development of the Kenyan market, based on the Kenya's ambitions as mapped in the Vision 2030, the Green Economy Strategy and Implementation Plan (GESIP) and the National Policy on Climate Finance developed by Kenya's National Treasury.

State of the market – green bond guidelines & standards

International good practice

At the international level, two main voluntary processes for green bond issuance have emerged:

- the Green Bond Principles provide process guidance around issuance and disclosure
- the Climate Bonds Standard adds science-based criteria to identify assets that are compliant with a sub-2 degree world³, consistent with the Paris Climate Agreement.

The Green Bond Principles (GBPs) are a set of underlying principles for the green bond issuance and disclosure process. They are an industry-led initiative convened by the International Capital Market Association (ICMA), promoting the idea that green bonds are about the use of proceeds for green assets rather than green issuers.

The Green Bond Principles were launched in 2014 and have since undergone yearly revisions. They cover the establishment of sound management processes for the use of proceeds and the use of independent reviewers for both environmental credentials and reporting practices.

The GBPs are based on four pillars, outlining disclosure and guiding the issuer in four areas:

- 1) **Use of proceeds:** which projects and assets the bond proceeds can finance
- 2) **Process for project evaluation and selection:** how the eligible projects are selected
- 3) **Management of proceeds:** how the proceeds are tracked and spent
- 4) **Reporting:** how often and what information the issuer will disclose to investors.

Social Bonds & Sustainability Bonds

Following the GBPs, ICMA has also coordinated the development of Social Bond Principles and guidance on Sustainability Bonds. These follow the same principles for green bonds but target projects with social benefits. Projects include basic infrastructure, access to essential generation, employment generation, food security and poverty alleviation. Sustainability bonds include both social and green projects. It is to be noted that green projects can often have social and developmental benefits, with the addition that they are low carbon and climate-resilient.

The **Climate Bonds Standard** is a standard for green bonds that includes the GBPs and adds a definition of green assets, which is consistent with the COP21 Paris Climate Agreement, advocating for **limiting global warming by well below 2 degrees** by the end of the century.

- The Climate Bonds Taxonomy sets out which sectors are compliant with a 2-degree world; sector-specific science-based criteria are developed to ensure the level of ambition is met and consistent through the application of the taxonomy.

- The Climate Bonds Initiative acts as a Secretariat convening Technical Working Groups of experts to develop the criteria, Industry working groups of business leaders to test their feasibility, and finally the Climate Bonds Standard Board is made up of investors with green mandates who approves them.
- Approved verifiers can evaluate the compliance of a Green Bond against the Standard and report back to the Board.
- Certified bonds are present in countries throughout all continents; the largest market in terms of size is the US. Certified climate bonds currently account for less than 15% of the market globally but certification is the dominant practice in some markets such as the Australian and Indian ones.

³ A sub-2 degree world is one where the increase in global average temperature by the end of the century is kept below 2 degrees C above pre-industrial levels. The limit of 2 degrees global warming by 2100 is a threshold identified by scientists to limit the most severe impacts of climate change

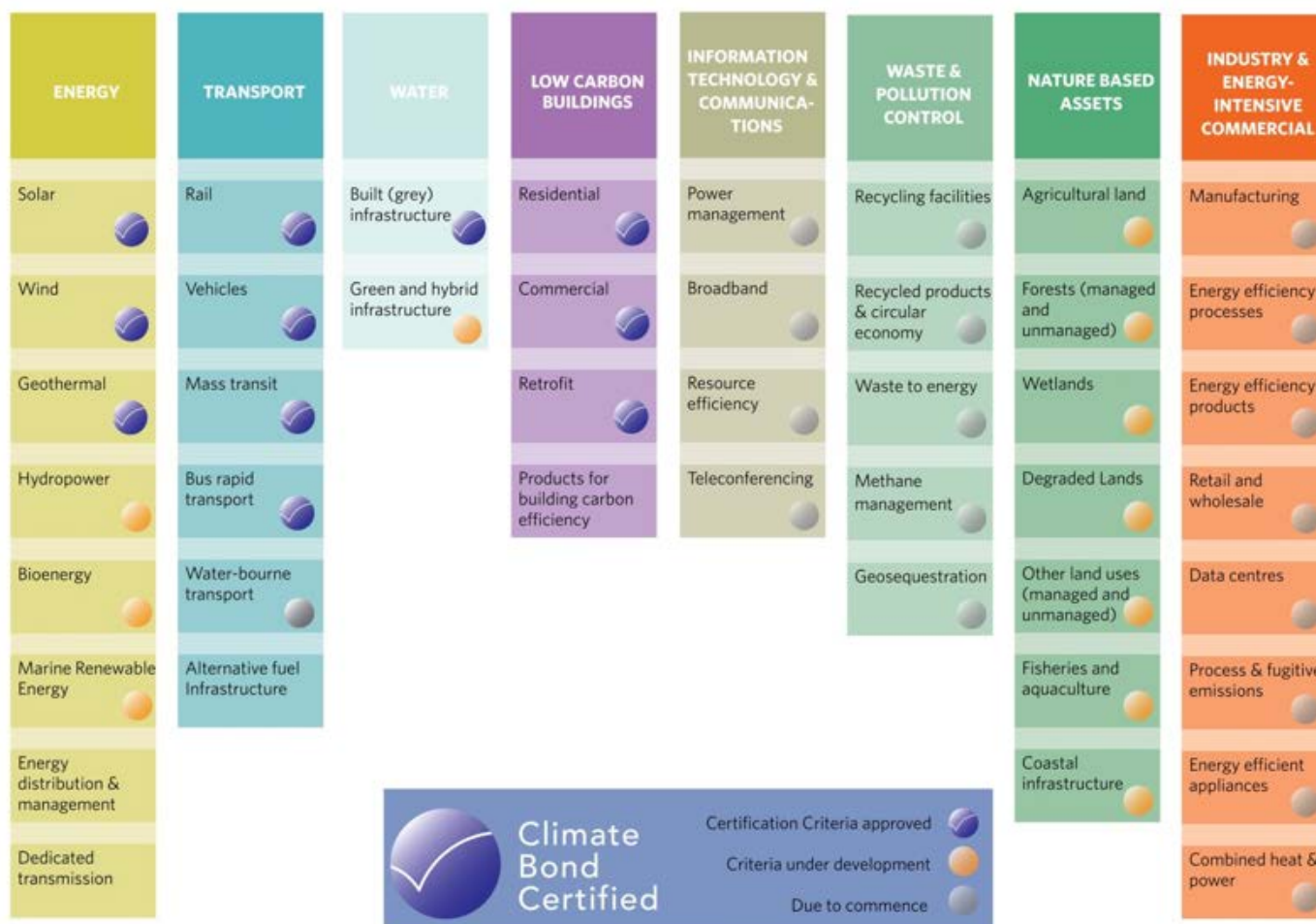


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KENYA

Climate Bonds Taxonomy^{4,5}

Climate Bonds INITIATIVE



There are several tools on the market today to assess the green credentials of a bond. External reviews have become common practice, characterising 62% of the market as of June 2017. They are mostly used to assess alignment with GBPs or verify compliance against the Climate Bonds Standard. The most common form of external reviews are:

1) **Consultant review:** a 'second party opinion' on the Green Bond issuance, which may include the establishment and/or review of the issuer's Green Bond Framework.

- 2) **Certification:** a third-party verification by an expert reviewer of the issuer's Green Bond Framework against a publicly available green standard, such as the Climate Bonds Standard or the Chinese Government's regulations for green bonds.
- 3) **Green rating:** an evaluation of the green bond or related framework against a third-party rating methodology, to further qualify the environmental impact of the investments.

It is important to note that the development of green bond guidelines and standards is an iterative process; guidance is updated and improved as the market diversifies and more instruments, issuers and asset classes come to market. Both the Green Bond Principles and Climate Bond Standard are reviewed once a year.

4 A more detailed version of the Taxonomy can be found at <https://www.climatebonds.net/standards/taxonomy>

5 Available sector-specific criteria can be found at https://www.climatebonds.net/standard/sector_criteria

National guidelines

Governments and regulators have started developing national guidelines to kick-start domestic markets. These mostly include guidance for issuance and disclosure in line with the Green Bonds Principles and are mostly aligned with the Climate Bonds Standard. China and India have been the first countries to develop guidelines; in other countries, private market players such as Stock Exchanges have taken the lead on providing some guidance and consistency for issuers and investors.

More information on the guidelines developed in China and India as well as examples of listing requirements from stock exchanges can be found in Annex B.





A framework for Kenya's green bond market

Overview

The country's ambitions for sustainable development is outlined in the Vision 2030, the GESIP and the National Policy on Climate Finance. These policies constitute the Government's efforts to advance the sustainable development agenda focused on addressing key challenges such as poverty, unemployment, environmental degradation, climate change and variability, infrastructure gaps and food security. These policies identify priority sectors to support sustainable development and the transition to a green economy (see Appendix A for detail).

Access to finance has been identified as one of the key challenges to achieving the green transition. Green bonds are a tool to mobilise private capital towards financing the transition, tapping into the demand for low-carbon and climate-resilient investments.

Development of Kenya's green bond guidelines

The following section provides some background information on the development of the Kenya Green Bonds Guidelines. These have been developed using the four pillars of the Green Bond Principles and the guidance of the Climate Bonds Standard. The proposed Guidelines are aligned with international practices to attract foreign investor demand for green⁶.



⁶ there is currently unmet demand for green, as pricing benefits show (see preliminary Climate Bonds analysis at https://www.climatebonds.net/files/files/March17_CBI_Briefing_Primary_Market.pdf) The current lack of supply will mean investors will have to look to emerging markets to meet their green mandates.

The guidelines have been elaborated in a separate document. Below are some of the principles underlying the development of Kenya's green bond guidelines to be issued by the Nairobi Securities Exchange.

1. Use of proceeds

Proceeds are used for the financing or re-financing of green projects (and their related expenditures, such as R&D).

Eligible projects fall under the categories identified in the international Climate Bonds Taxonomy and the National Policy on Climate Finance. These are laid out in Appendix A and in the attachment. The following should be noted:

- The two classifications are mostly aligned. The Climate Bonds Taxonomy includes the additional sector of Information, Communications and Technology. The National Policy on Climate Finance lists trade, tourism and disaster risk management as separate categories, although these are mostly aligned with the Climate Bonds Taxonomy buildings, energy efficiency and adaptation categories.
- The National Policy identifies research and innovation around green technologies and climate change as a priority sector; these are types of expenditures that have been included in green bonds issued by the public sector, such as sovereigns and sub-sovereigns and can be considered eligible if they relate to the Taxonomy areas.
- All fossil-fuel related projects are excluded. Whereas oil and gas company can issue a green bond to finance green projects, energy efficiency improvements in oil and gas production or related supply chain, such as refineries, do not achieve enough impact to offset the industry-related emissions to put us on a sub-2 degree pathway, making them ineligible. Foreign investors are particularly careful not to invest in fossil-fuel based assets when they are selecting green-labelled investments.

2. Selection of projects

The issuer establishes, documents and maintain a decision-making process to determine the eligibility of the assets as part of its Green Bond Framework.

3. Management of proceeds

The systems, policies and processes to be used for the management of the bond funds and investments are documented and disclosed by the issuers as part of its Green Bond Framework, including arrangements for tracking of proceeds and managing unallocated proceeds.

4. Reporting requirements

The issuer provides to bondholders, at least annually, a Green Bond Report containing the list of the projects and assets to which proceeds have been allocated, for the duration of the bond. The reporting process and authority shall be documented and maintained as part of the issuer's Green Bond Framework.

The Report shall include expected impacts of projects and assets such as energy capacity installed, electricity generated, greenhouse gas emission performance of buildings, numbers of passengers carried by public transport, number of electric vehicles manufactured, volume of wastewater treated. Where feasible, quantitative performance measures of the impact of the projects and assets may also be included⁷.

Where confidentiality agreements or competition considerations limit the amount of detail that can be disclosed, the GBP recommends that the information may be presented in generic terms.

5. External review

An external review, such as a second party opinion or third party certification, is mandatory.

⁷ Impact reporting is reporting that seeks to quantify the climate or environmental impact of projects – is gaining prominence in the green bond market. However, for many it remains a burdensome task that could shy issuers away from the market. Numbers can also be misleading without a baseline or benchmark.

Appendix A: Eligible green sectors and projects



Table 1: Scope of Kenya's National Policy on Climate Finance

These sectors have been identified as making significant contributions to Kenya's broader development goals; investments in these sectors can help Kenya transition toward a low carbon climate resilient development pathway.

Agriculture, livestock and fisheries	Forestry	Energy	Transport	Trade	Tourism	Manufacturing	Water and Sanitation	Disaster risk management	Research & Innovation
<ul style="list-style-type: none"> Promotion of climate smart agriculture Price stabilisation schemes for livestock and crop farmers Post-harvest management of crop, livestock and fisheries Protection and conservation of fish critical habitats 	<ul style="list-style-type: none"> Reduction of deforestation and forest degradation Conservation and sustainable management of forest areas Increased afforestation and reforestation Sustainable fuel wood plantations 	<ul style="list-style-type: none"> Renewable energy: geothermal, solar, wind, biomass Energy efficiency in public buildings Energy efficient household products (lighting, cookstoves) Climate-proofing energy infrastructure Exploration of allocation of royalties from extractives to a fund to support low-carbon and climate-resilient development 	<ul style="list-style-type: none"> Low-emitting sources such as bio-fuels and LPG/LNG Transition from fossil-fuelled to electric railway Mass rapid transit (bus and light rail) in Nairobi Improvement in heavy duty and passenger vehicle efficiency Climate-proofing transport infrastructure 	<ul style="list-style-type: none"> Promotion of low-carbon and green commodities Climate proofing of transport and storage facilities 	<ul style="list-style-type: none"> Energy efficiency such as solar water heating and lighting and efficient transport Research on the potential vulnerabilities of wildlife to tourism 	<ul style="list-style-type: none"> Promotion of new technologies in energy-intensive industries Energy efficiency Industrial-scale cogeneration using biogas Development of green industrial zones Climate-proofing of industrial facilities 	<ul style="list-style-type: none"> Integration of climate risks in water modelling Enhanced water storage capacity Promotion of energy efficient technologies in water supply projects Conservation of water towers Improved water management and water conservation 	<ul style="list-style-type: none"> Monitoring systems Multi-year food and cash mechanisms Water management Climate-proofing of infrastructure Livelihoods diversification 	<ul style="list-style-type: none"> Incentives for private sector to undertake research Mechanisms to encourage uptake of clean techs Educate public sector institutions on climate change

8 including, for example, drought tolerant high value and alternative crops; water harvesting for crop production; efficient irrigation systems; index-based weather insurance; conservation agriculture; agroforestry; soil management; animal breeding; and integrated farming systems including aquaculture;

Table 2: Eligible projects and sectors as per the CBI Climate Bonds Taxonomy.

Climate Bonds Taxonomy							Climate Bonds <small>INITIATIVE</small>
ENERGY	TRANSPORT	WATER	LOW CARBON BUILDINGS	INFORMATION TECHNOLOGY & COMMUNICATIONS	WASTE & POLLUTION CONTROL	NATURE BASED ASSETS	INDUSTRY & ENERGY-INTENSIVE COMMERCIAL
Solar	Rail	Built (grey) infrastructure	Residential	Power management	Recycling facilities	Agricultural land	Manufacturing
Wind	Vehicles	Green and hybrid infrastructure	Commercial	Broadband	Recycled products & circular economy	Forests (managed and unmanaged)	Energy efficiency processes
Geothermal	Mass transit		Retrofit	Resource efficiency	Waste to energy	Wetlands	Energy efficiency products
Hydropower	Bus rapid transport		Products for building carbon efficiency	Teleconferencing	Methane management	Degraded Lands	Retail and wholesale
Bioenergy	Water-borne transport				Geosequestration	Other land uses (managed and unmanaged)	Data centres
Marine Renewable Energy	Alternative fuel Infrastructure					Fisheries and aquaculture	Process & fugitive emissions
Energy distribution & management						Coastal infrastructure	Energy efficient appliances
Dedicated transmission							Combined heat & power

	Certification Criteria approved	
	Criteria under development	
	Due to commence	

NB: Red circles represent the synergies between the Kenya National Policy on Climate Finance and the CBI taxonomy.



Appendix B: National and regional green bond guidelines



China

Various regulatory authorities and stock exchanges in China have played important roles in sparking the development of the green bonds market by releasing guidance around green bond issuance and listing. Most prominently, the People's Bank of China (PBoC), the regulator of the Chinese interbank market, which accounts for around 93% of the domestic bond universe, issued guidance for green financial bonds in December 2015. The announcement included a Green Bond Endorsed Project Catalogue providing clarity for issuers over the eligibility of sectors and projects. The issuance of green bonds is dependent on an approval process from the regulator and quarterly disclosure is required. Ring-fencing of proceeds is not required but is used by most issuers.

The National Development and Reform Commission regulating state-owned enterprises and the China Securities Regulatory Commission managing listed companies have also issued guidelines for the corporate bond market; listing requirements have followed from Shanghai and Shenzhen Stock Exchanges.

Summary of alignment between China and international standards

The PBoC guidelines are mostly aligned with international good practices. On external reviews, the Guidelines encourage issuers to arrange external reviews on the green credential of the bonds, but do not require it. On the green definitions, most sectors are aligned, except for coal-powered generation. In order to attract more foreign investors, the Chinese authorities are working on aligning existing taxonomies with international ones.

More information can be found at: <https://www.climatebonds.net/resources/Roadmap-for-China/April/2016/Paper1>.



India

The Securities and Exchange Board of India, which regulates the Indian securities market, released disclosure requirements for the issuance and listing of green bonds in June 2017 after an extensive consultation with the Ministries of Finance and New and Renewable Energy⁹.

Overall SEBI's final guidelines are in line with the international practices following on from GBP and Climate Bonds Standard:

- High-level categories for what is green are outlined; these are in line with the GBPs and Climate Bonds Standard, although the regulator also retains the discretion to specify further categories as they arise.
- Using a second party review or third-party certification to review the green credentials of the bond is optional.
- Issuers are required to disclose the procedures they will use to track green bond proceeds and get this verified by an external auditor. Disclosure around the environmental objectives of the bond, qualitative performance indicators and quantitative measures of the environmental impact, as available, are also needed.
- Reporting from issuers needs to take place every six months.

⁹ <https://www.climatebonds.net/2017/06/howzat-india-sebi-delivers-new-gb-regs-pitched-line-international-best-practice-look-bounce>

Examples of listing requirements from Stock Exchanges

- Luxembourg Green Exchange (LGX): eligibility criteria include clear disclosure of use of proceeds for green or social bonds in line with the guidelines developed by the GBPs or compliant with the Climate Bonds Standard, an independent third-party review (second opinion, certification, verification or rating report), and commitment to regular post-issuance reporting starting from one year after listing.
- London Stock Exchange: to admit green bonds to the dedicated segment, the issuer must provide a relevant external review carried out by an independent third-party.
- Johannesburg Stock Exchange: listing requirements for a green segment have been released for public consultation. These currently include an external

review showing alignment with GBPs and criteria for the reviewer, which can be one of the Climate Bonds approved verifiers.

There are other ongoing initiatives to develop guidance for green bonds, both at the regional and national level:

- The ASEAN Capital Markets Forum is conducting an effort to deliver
- European Commission has committed to start work on European green bond standards in early 2018 following the recommendation of the High-Level Expert Group on Sustainable Finance, convened by the Commission to advise on how to integrate sustainable finance into financial market regulation
- Securities Exchange Commission in Nigeria is developing green bond guidelines to follow the sovereign green bond issuance planned for 2017.





Green Bonds Programme - Kenya

About Kenya's Green Bond Programme

The Green Bond Program - Kenya is coordinated by Kenya Bankers Association (KBA), Nairobi Securities Exchange (NSE) and Climate Bonds Initiative (CBI) in conjunction with the Sustainable Finance Initiative. The technical and funding partners are Financial Sector Deepening Africa and the Dutch development bank FMO. The Green Bond program - Kenya is endorsed by the Central Bank of Kenya, Capital Markets Authority and National Treasury.

Partners:



Government Affiliates:



Green Bond Program Project Plan

The Green Bond Program - Kenya will focus on the following work streams and outputs to support the issuance of the first Kenyan green bond and the development of a domestic green bond market:

1. Researching the potential of green bond issuance in Kenya
2. Developing a pipeline of green investments and engaging with local and international investors
3. Supporting demonstration green bond issuance from leading banks and corporates
4. Promoting green Islamic finance
5. Developing a pool of Kenya-based licensed verifiers
6. Development of a cooperative fixed income fundraising facility that would allow smaller banks and corporates to also take advantage of wholesale debt capital markets
7. Leveraging the Kenya experience to catalyze similar programs across East Africa Community

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