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# ESG

## A Peek into the Future: Mission Possible?

JUNE 2022

# What is ESG?

**ESG, a concept that was formerly considered to be a first world phenomenon, is unquestionably a global one. It refers to a broad range of environmental, social and governance factors that businesses are progressively inculcating into their way of doing business. These factors have also been used to set the criteria upon which 'socially responsible investors or conscious investors' assess whether to invest in any given company.**

Despite some high-profile naysayers, including Elon Musk who has referred to the ESG movement as a "scam", it is undeniably the case that development finance institutions (DFIs) and many other financial institutions are imposing ESG conditions in their lending decisions. (Incidentally the tirade against ESG from Musk was a reaction to Tesla being downgraded in the S&P 500 ESG Index due to issues of racial discrimination and poor working conditions at one of its factories).

The 'E' in ESG encompasses environmental issues such as how a company's activities affect the environment. It looks into how the company exploits natural resources, the effect of its operations on the environment and its efforts towards curbing the current climate crisis.

While environmental and corporate governance issues are easily defined, social issues are less tangible and more prone to change. For example, in the wake of the COVID-19 pandemic, companies were forced to implement new policies to respond to the adverse effects of the pandemic. The social aspect is therefore partly focused on a company's employees and how the workplace can be a healthy environment for them in terms of safety, fair pay, diversity and inclusion. Beyond this, the 'S' in ESG calls for the consideration of persons living within the community and the direct positive impact companies could have on them. A good example of this would be the Wings to Fly scholarship program established by Equity Bank. The idea behind this program is to give children from less fortunate backgrounds access to education that they could not otherwise afford.

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The third limb of ESG is 'G' for governance. This aspect focuses on how a company is managed by its board of directors and executives, as well as the values the company promotes and implements. Governance further considers the integrity and transparency in a company's activities such as its financial reporting and accounting practices.

# An Overview of the Legal Framework in Kenya Relating to ESG Issues

**In Kenya, we have seen a gradual but evident shift in the conversation surrounding ESG issues. Over the years, it has slowly evolved from the notion of 'nice to have goals' to 'apply or explain' for many entities such as listed companies and financial institutions. The indications are clear - the incorporation of ESG considerations into a company's operations strategy is becoming essential.**

It is important to mention a few notable initiatives that paved the way for ESG in Kenya as we know it today. One of them is the Vision 2030 launched by the Late President Mwai Kibaki back in 2008. The aim of Vision 2030 is to create a newly industrializing, middle-income country providing a high quality of life to all its citizens by 2030 in a clean and secure environment.[1] Inspired by the 2030 Vision blueprint, the Kenya Bankers Association launched the Sustainable Finance Initiative (SFI) in 2013. The SFI put together a set of principles whose aim was to create a Kenya-specific set of harmonised guidelines for sustainable development to be adopted across the banking industry in pursuit of meeting Vision 2030.

The goal of a clean and secure environment is also protected under the Constitution.[2] It not only makes it a constitutional right but also provides an enforcement mechanism for its protection to the extent that any individual who feels that this fundamental right is being violated can apply to the court for redress. This Constitutional right has been severally tested.[3] One of the more notable cases was that of ***Okiya Omtatah v National Land Commission [2019]*** which had been filed on the basis that the government had not considered the harm the standard gauge railway (SGR) will cause to wildlife animals. It was also argued that the government had seven options to choose from but instead decided to choose the national park route. However, the Lands and Environment Court dismissed the case on the grounds that the necessary environmental considerations had been taken. On Appeal, the Court of Appeal upheld the High Court's decision.

Unlike the Omtatah case, prior to the 2010 Constitution, the 'common mwananchi' could not bring a legal action on behalf of the public. In ***Wangari Maathai v Kenya Times Media Trust [1989]***, the petitioner (who went on to become the first woman in Africa to be awarded the Nobel Peace prize), had

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1 https://vision2030.go.ke/
2 Article 42, Constitution of Kenya,2010.
3 Article 70, Constitution of Kenya,2010.

applied to the Court seeking an injunction to restrain the respondent from building an office block in Uhuru Park on the grounds that it would destroy the environment. The court dismissed the petitioner's claim on the grounds that she lacked the standing (locus standi) to represent the public. At the time, only the Attorney General could pursue a legal action on behalf of the public. The reforms brought about by our 2010 Constitution allows anyone to institute a case concerning the environment and the Omtatah case is but just one example.

Currently, the Central Bank of Kenya (CBK), Nairobi Securities Exchange (NSE) and the Capital Markets Authority (CMA) are at the forefront of the ESG campaign.

## i. The Central Bank of Kenya

Back in October 2021, the CBK published the Guidance on Climate-related Risk Management (the Guidance). The CBK Guidance drew on the aspirations contained in the Paris Climate Accords which were domesticated in Kenya through the Climate Change Act, No. 11 of 2016. The Climate Change Act is intended to be applied to the development, management, implementation and regulation of mechanisms to enhance climate change resilience and low carbon development for the sustainable development of Kenya.

The CBK derives its authority from Section 33 of the Banking Act which empowers it to guide institutions in order to maintain a stable and efficient banking and financial system. In the Guidance, the CBK acknowledges climate change as one of the major risks threatening the welfare of mankind. Extreme weather events such as floods, droughts and famine have affected people's livelihoods because of death of livestock and crop reduction. Financial institutions and corporates are also affected as these catastrophic events also infringe on business opportunities.[4]

The purpose of the CBK Guidance is for banks and other financial institutions to:

i. embed considerations of financial risks from climate change in their governance arrangements;
ii. incorporate financial risks from climate change into their existing financial risk management practices; and
iii. develop approaches to the disclosure of financial risks from climate change.

The Guidance mandates the Board of Directors and Senior Management of institutions licensed under the Banking Act to consider climate - related risks when formulating and implementing the business strategies for their respective institutions. Each institution will be required to submit a quarterly report to CBK on the progress of its implementation of the Plan within ten (10) days after the end of the quarter ending 30 September 2022 and continue to do so every calendar quarter.[5]

Banks are also required to submit a plan on how they intend to implement the Guidance by 30 June 2022.

4 https://www.centralbank.go.ke/wp-content/uploads/2021/10/Guidance-on-Climate-Related-Risk-Management.pdf
5 https://www.centralbank.go.ke/wp-content/uploads/2021/10/Guidance-on-Climate-Related-Risk-Management.pdf

## ii. Nairobi Securities Exchange

Shortly after the CBK published the Guidance, the NSE in Partnership with the Global Reporting Initiative (GRI), issued the ESG Disclosure Guidance Manual (NSE Guidelines) for listed companies in Kenya.[6] This made it the fourth exchange in Africa to issue an ESG manual after Egypt, Nigeria and Botswana.[7] The NSE Guidelines provides a guide to listed companies to collect, analyse, and publicly disclose ESG details about their business activities. Listed companies on the NSE are required to report publicly on their ESG performance at least annually, with mandatory reporting beginning in November 2022.

Safaricom PLC, East Africa Breweries Limited (EABL) and Kenya Commercial Bank Limited (KCB) are part of a handful of listed firms who have been publishing annual reports which show how their business activities impact society. This ranges from their contribution to the country's Gross Domestic Product (GDP) to the measures they have taken to protect the environment. However, there has been a lack of uniformity in how the reporting is done hence the need for a comprehensive framework on ESG disclosures and reporting.

## iii. The Capital Markets Authority

The CMA was ahead of its regional peers on ESG matters when in 2015, it released a Corporate Governance Code for Listed Companies (the Code). The Code contains seven pillars with guidelines on board operations, structure and control; rights of shareholders; stakeholder relations; ethics and social responsibility; accountability, risk management and internal control; transparency and disclosure and supervision and enforcement. Under each pillar, the Code outlines various recommendations for companies to implement within their operation structures. It requires them to either apply the principles under the Code or explain why they have departed from the same. An example of a recommendation under the Code is the introduction of governance audits. Companies are now encouraged to carry out a governance audit at least once a year to confirm that the company is operating on sound governance practices.[8]

To supplement the Code, the CMA formulated the Stewardship Code for Institutional Investors which was gazetted in 2017. The Stewardship Code has been a core reform to the corporate governance sector in Kenya. It encourages companies to operate with a positive social impact and encourages investors to incorporate social, environmental and ethical initiatives into their investment processes. 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.[9]

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6 https://sseinitiative.org/wp-content/uploads/2021/12/NSE-ESG-Disclosures-Guidance.pdf
7 https://africasustainabilitymatters.com/what-do-esg-guidelines-mean-for-corporates/
8 https://www.cma.or.ke/index.php/news-publications/press-center/376-cma-releases-corporate-governance-code-for-listed-companies
9 https://www.bloomberg.com/news/articles/2021-11-29/kenya-s-bourse-gives-companies-one-year-to-grasp-esg-reporting

# The Implementation of ESG Policies in Organisations; Has ESG Become a Mere Buzzword?

**While there has been a positive reception on ESG considerations within business practices, implementation of the same has been rather slow. The deadlines for implementation of the guidelines issued by the NSE and CBK are fast approaching yet we understand few institutions have yet to comply with the requirements.**

In countries like the US, institutions such as the US Securities and Exchange Commission (SEC) have been somewhat effective in imposing fines on entities that do not comply with ESG requirements when carrying out their investment activities.

Very recently, the SEC fined BNY Mellon USD 1.5 million after having been suspected and found to have omitted and misstated information on ESG considerations for the funds it managed.[1] As the impetus on ESG measurement develops in Kenya, firms need to be careful that they have policies and strategies in place to ensure they are ready to comply. As pressure on the country builds on its external debt obligations, it can only be expected that organisations like the World Bank, the IMF and others will continue to reinforce the ESG message.

It is not a question of if, but rather, when, all sectors of the business environment are going to be held accountable for their ESG standing - or lack thereof

10 https://www.ft.com/content/ff0097c4-3f1c-49d8-8189-153fc56aeeb3

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