

# Environmental Risk Exposure in the Kenyan Banking Sector



# Project Background

Financial Institutions have always been concerned with risks associated with their profitability / Rate of Return and business operations.

Increased focus on the roles of financial institutions in impacting society led to the emergence of Corporate Social Responsibility

Emergence of ESG risks driven by; Climate change, focus on sustainability messages, a shift towards social inclusion and COVID impacts

ESG provides an umbrella framework to consider an institution's **impact and dependencies on the environment and society**, as well as the **quality of its corporate governance**

# Scope and objectives of the study

## The objective of the study was to:

- 1 Understand the level of environmental risk exposure within the banking sector
- 2 Develop potential interventions to support the assessment and management of environmental risks emerging from projects that banks would support in the usual course of business through their lending activities.

## Key aspects that drive the results:

1

The study surveyed 21 commercial banks and undertook in-depth consultations with 5 banks (from each tier i.e., tier 1, 2 and 3)

2

Consultations with relevant stakeholders:

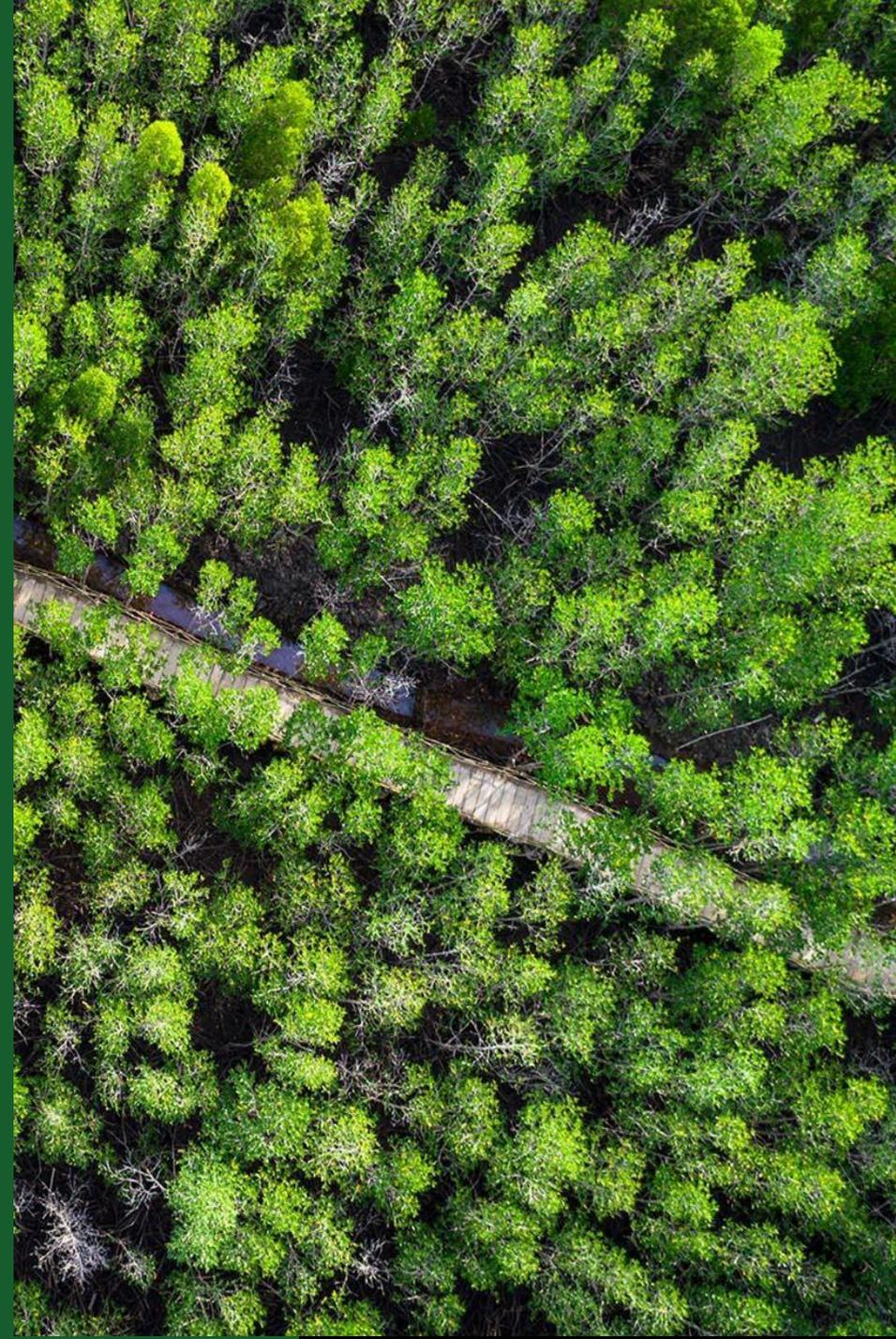
- Environmental sector regulators i.e. National Environment Authority(NEMA) and the Water Resources Authority (WRA)
- Professional associations i.e. Architectural Association of Kenya and Town and County Planners Association of Kenya
- Leading multilateral banks

3

The study focused on risks, challenges and opportunities for intervention at:

- Regulatory and policy level
- Institutional level
- Organisational level

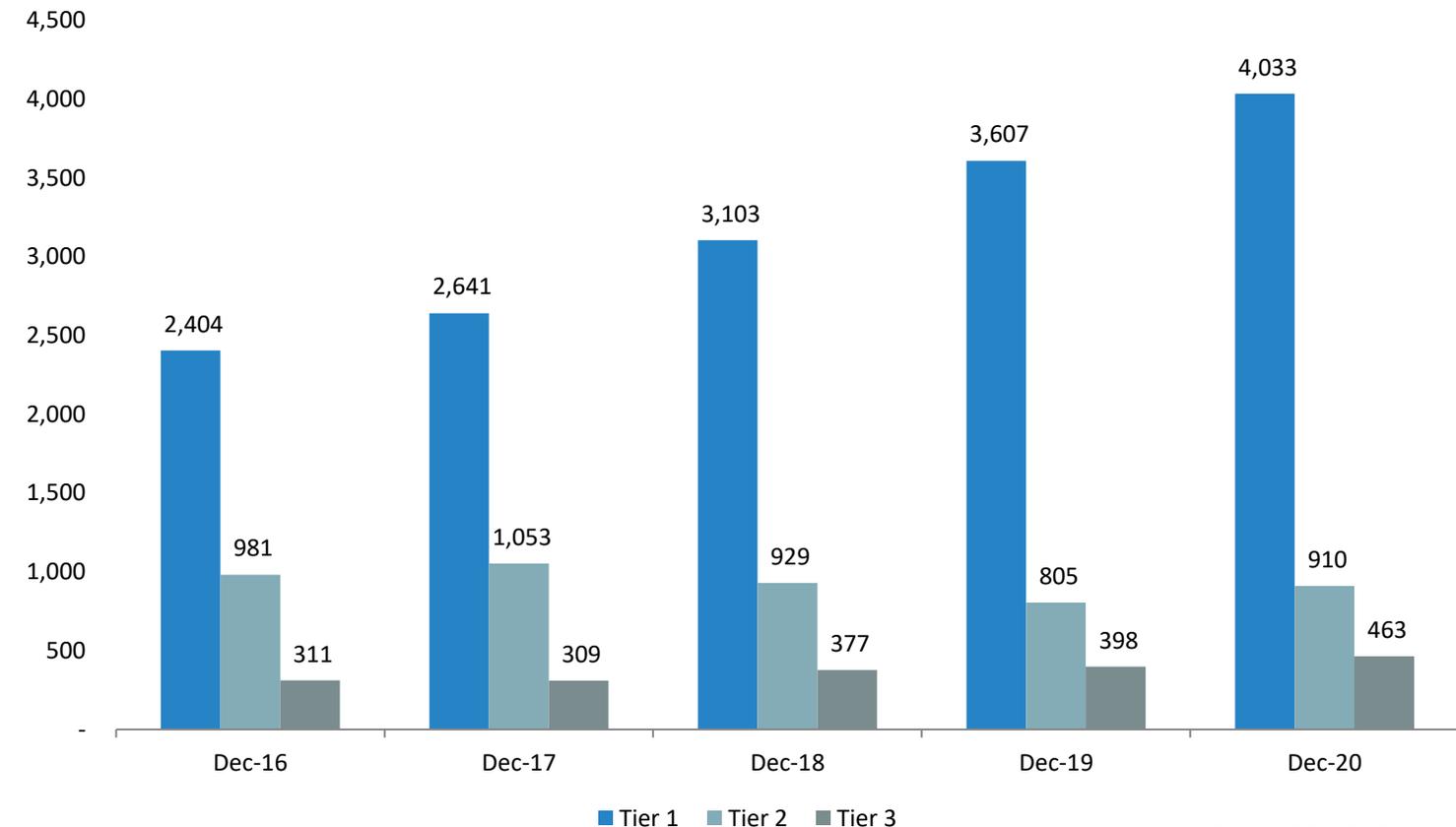
# Banking sector overview and sectoral exposures



# Banking sector overview and sectoral exposures

- ✓ The Central Bank of Kenya (CBK) identified 41 active commercial banks operating in the country as of December 2020<sup>1</sup>.
- ✓ The sector is moderately concentrated, with the nine largest Kenyan banks accounting for c.75 percent (KES 4,033 billion) of sector's assets as of December 2020.
- ✓ This gives rise to a 3-tier classification of the Banks with tier 1 banks accounting for 75 percent of the market share, while tier 2 and tier 3 banks account for 17 percent (KES 910 billion) and 9 percent (KES 463 billion) of the market share respectively, as of December 2020.

Bank assets according to tiers, KES 000's billion



Source: CBK, PwC analysis

1. Includes Charterhouse Bank Limited and Chase Bank (K) Ltd which are in liquidation and Imperial Bank Ltd, which is in receivership

2. The market share statistic is calculated on a net asset basis

# Banking sector overview and sectoral exposures

- ✓ CBK identified that the majority of the commercial banks' loan portfolio as of December 2020 related to personal and household lending (28 percent), which was approximately KES 844 billion.
- ✓ There is also significant lending to the Trade (KES 518 billion), Real Estate (KES 445 billion), and Manufacturing (KES 417 billion) sectors which represent 46 percent of the total lending as of December 2020.
- ✓ Lending generally increased at an annual rate of 8 percent to building and construction, manufacturing, and real estate sectors between 2016 and 2020 mainly supported by economic growth.

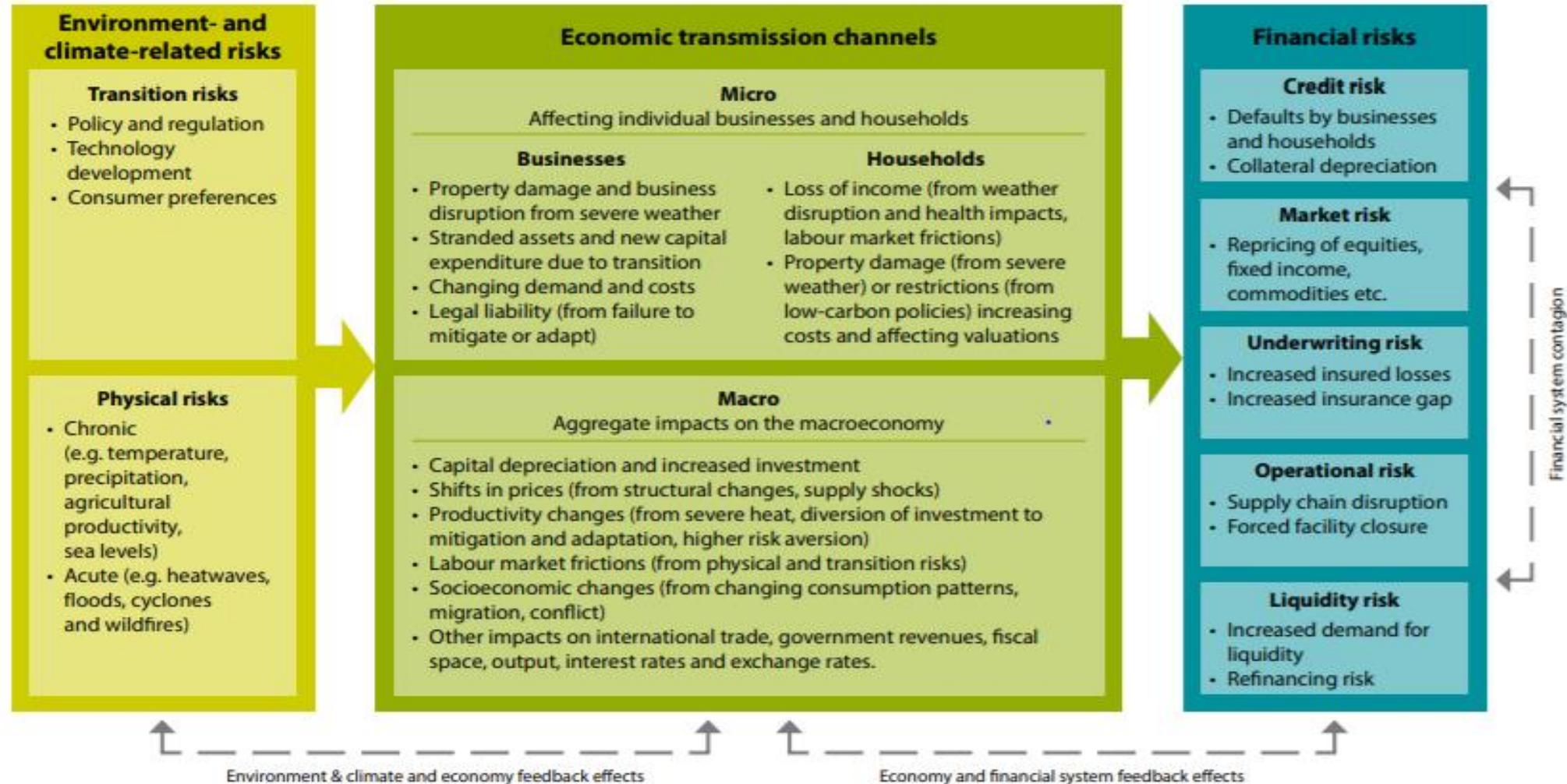
Sectorial exposures, KES billions



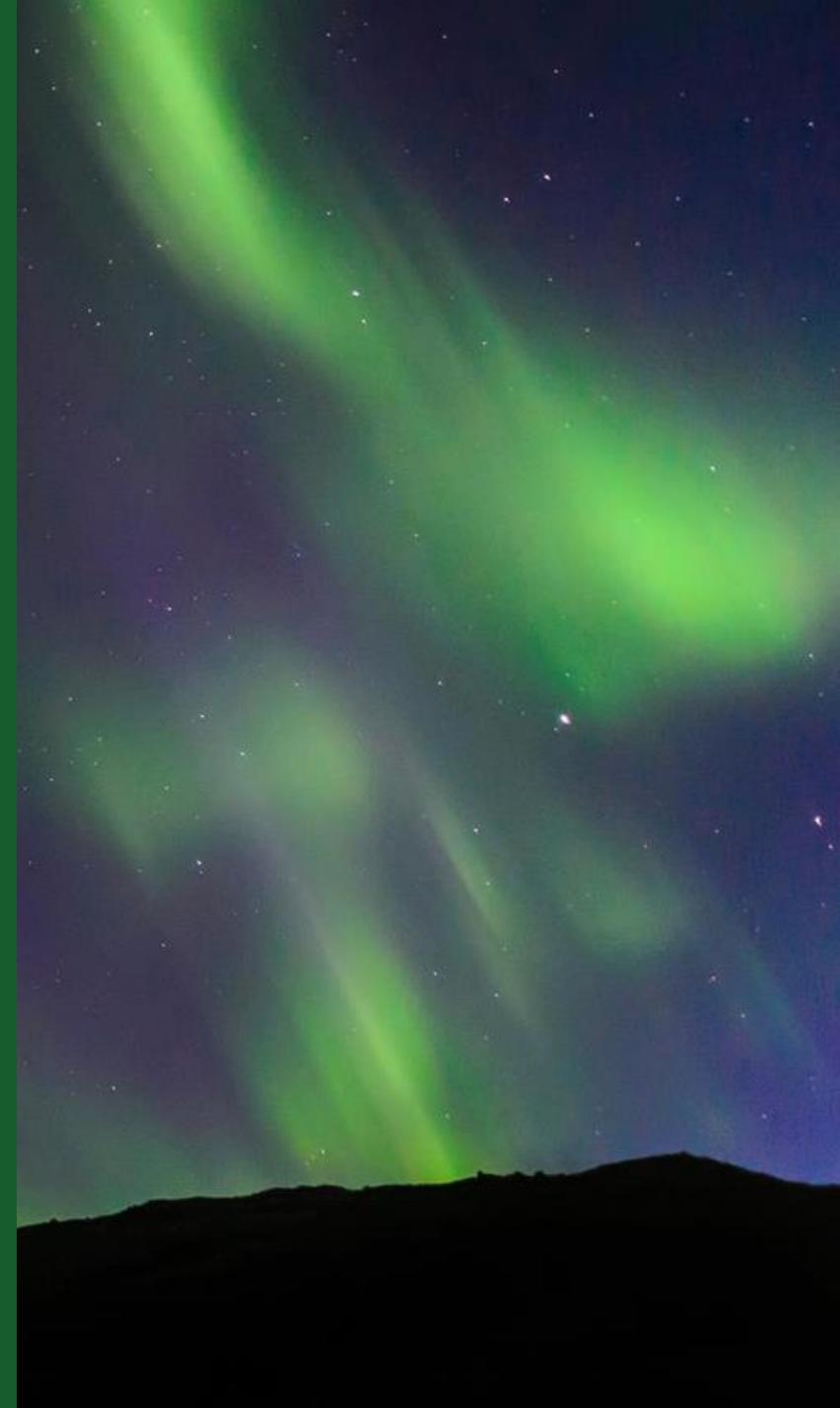
Loans, KES in billions



# Environmental risk exposures in the banking sector

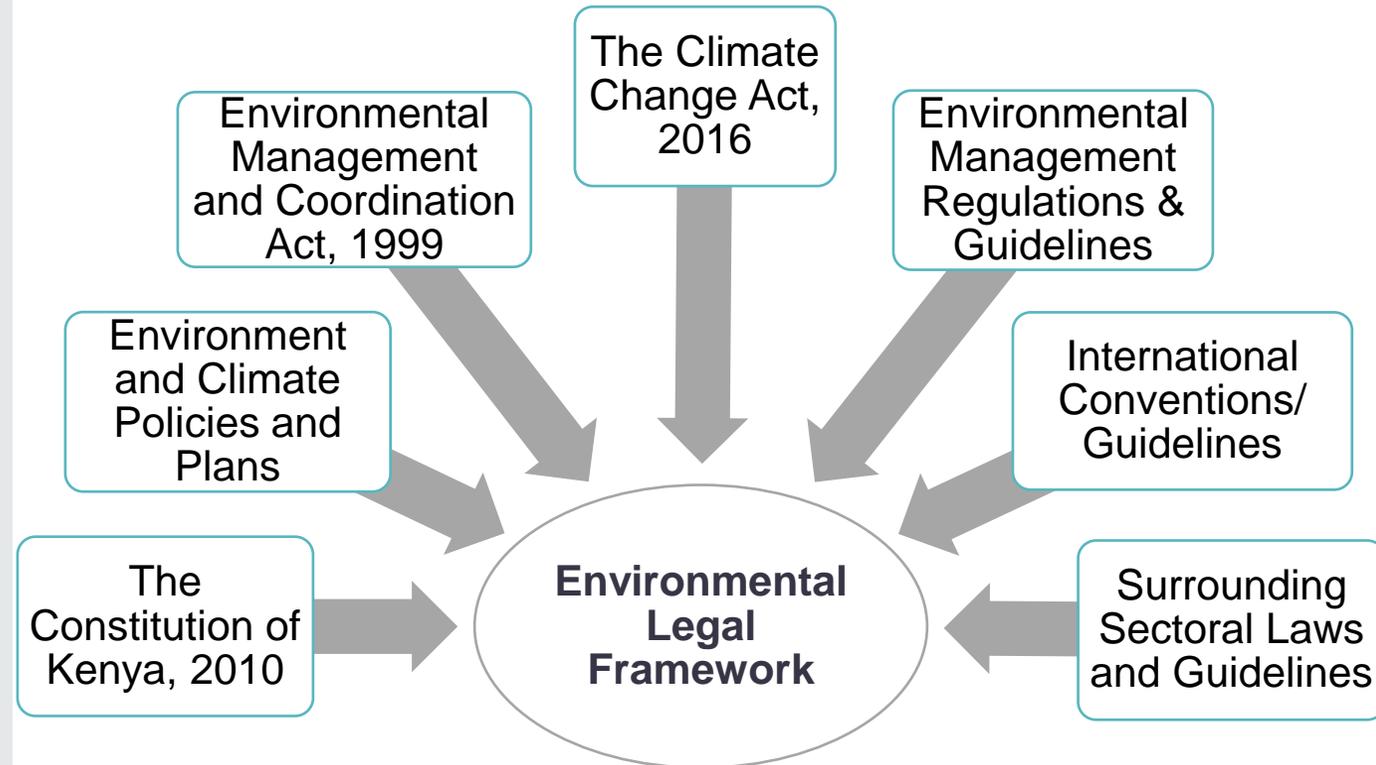


# Enabling improved environmental risk management



# Regulatory and Legislative framework

- Kenya has a distinct legislative and institutional framework catering to social and environmental protection and management.
- Recent policy and legislative interventions involving enforcement of existing regulations and enactment of new legislation has had an impact on local businesses and by extension, affected the lending operations of financial institutions.
- Feedback gathered from interviews conducted during the study suggests that most banks' approach to environmental risk related compliance is to ensure that all the relevant regulatory approvals have been obtained and that customers/borrowers make contractual representations to comply with environmental laws and regulations.



# Institutional framework

- ✓ The National Environment Management Authority (NEMA) is the principal governmental agency responsible for regulating environmental protection.
- ✓ NEMA has a mandate to implement EMCA and to coordinate overall matters relating to environmental protection with other government agencies.
- ✓ However, NEMA shares jurisdiction with other government entities over certain various environmental aspects under different legislative instruments.

## Environmental Policy and Coordination

National Environment Management Authority (NEMA)  
Ministry of Environment and Forestry  
National Environmental Complaints Committee  
National Environment Tribunal  
Environment and Land Court  
Climate Change Directorate  
National Disaster Executive Committee  
County Environment Committees

## Sectoral Implementation

Water Resources Authority (WRA)  
Kenya Forest Service (KFS)  
Kenya Wildlife Service (KWS)  
National Irrigation Board (NIB)  
Mineral Rights Board (MRB)  
National Construction Authority (NCA)  
National Land Commission (NLC)  
Directorate of Occupational Safety and Health Services (DOSHS)

## Other Stakeholders

### Non-State Parties

- Banks and Financial Institutions
- Public Citizens
- Community Based Initiatives
- Industry Associations
- Professional Associations
- Private Sector
- Non-Government Organisations
- Development Partners
- International Organisations
- Media
- Research and academic institutions

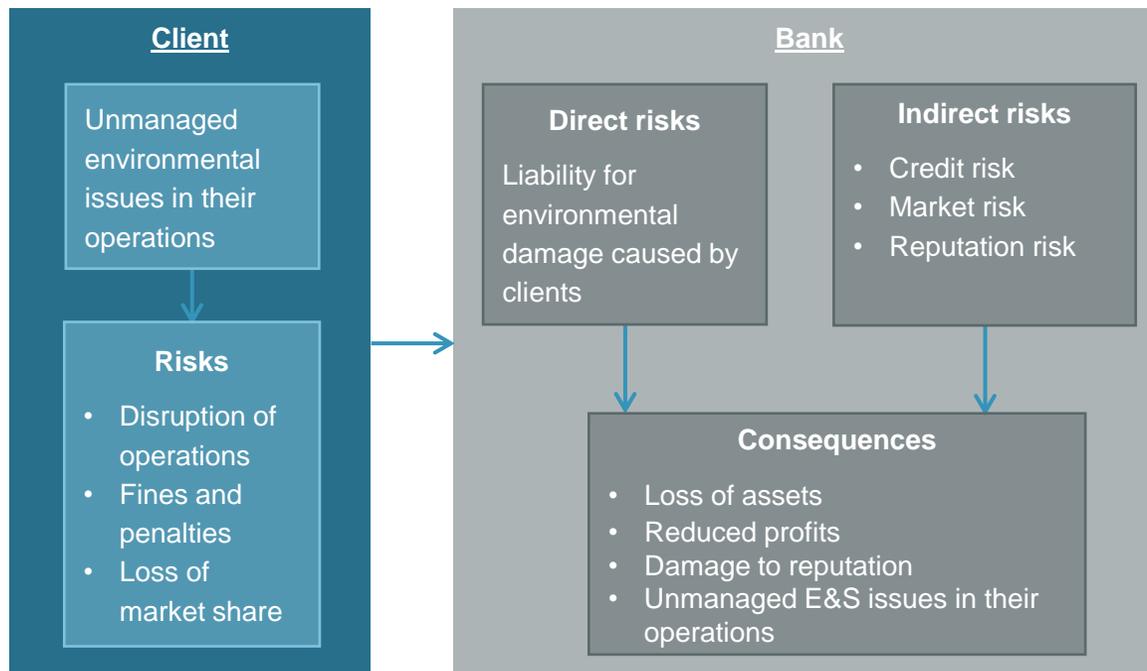
### State Parties

- County Government
- State Law Office
- The National Treasury
- Presidential Commissions
- Ministry of Interior and Coordination
- Ministry of Devolution and Planning
- Ministry of Transport and Infrastructure
- Ministry of Land, Housing and Urban Development
- Ministry of Industrialisation and Enterprise
- Ministry of Agriculture, Livestock and Fisheries

# Organisational level structures and management

Industry wide acknowledgment by Banks that despite the pursuit for growth a great interconnection exists in fulfilment of broader development goals, environmental, and social sustainability.

## *Direct and indirect consequences of environmental risks*



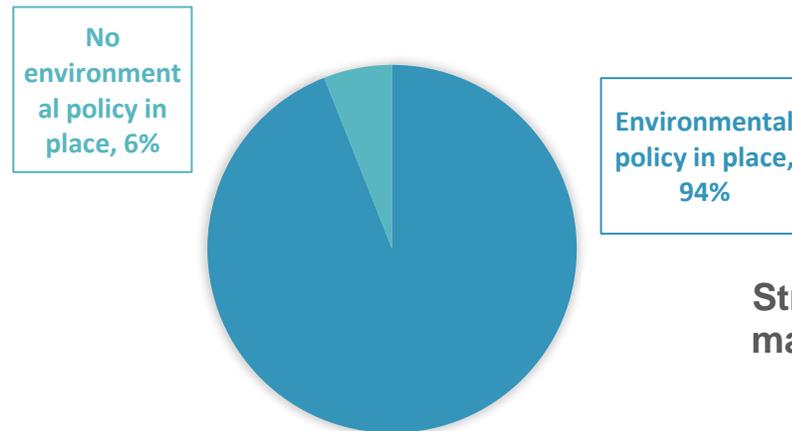
- Loss of business opportunities and financing options through failure to adapt to changing market realities.
- Higher overall risk exposure through a failure to understand the materiality of environmental and social risks.
- Potential pressure or disengagement of investors prioritising sustainable investment choices.
- Lack of preparedness for regulatory and policy adjustments and the ensuing increased cost of compliance.
- Risks to reputation, credibility, and image of the bank through a failure to respond to stakeholder expectations.

# Organisational level structures and management

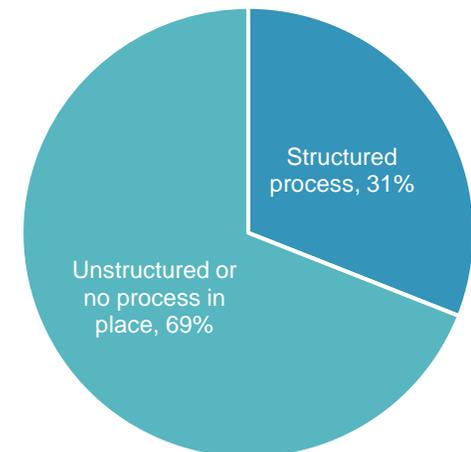
Based on the outcomes of surveys, local banks recognise the impact/challenges that environmental and social risks pose and have implemented a varying range of responses – from minimal compliance checklists in the credit appraisal process to extensive policies and strategies environmental risk management.

Majority of those surveyed have integrated some elements of environmental risk management in their operations.

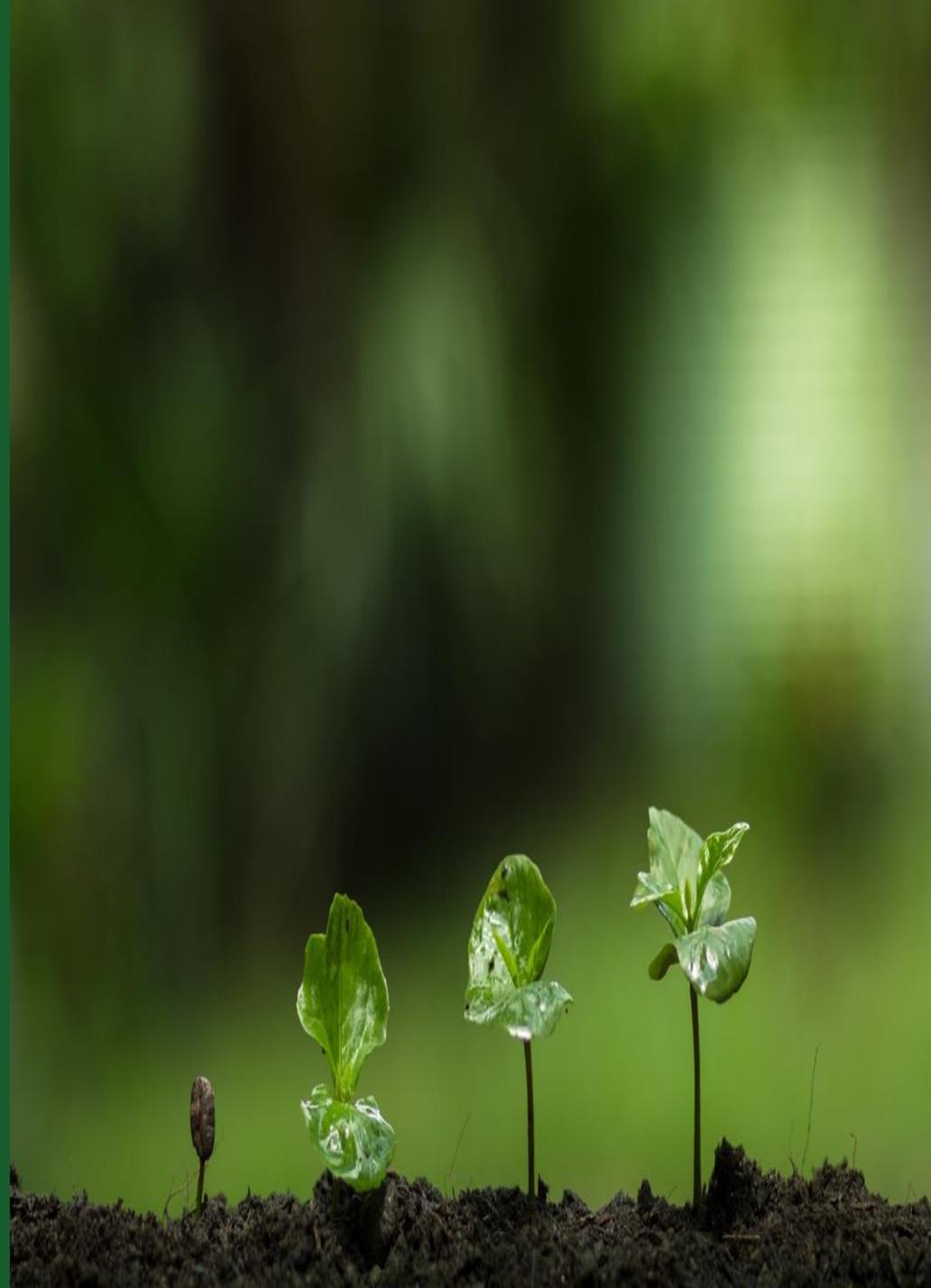
## ENVIRONMENTAL RISK POLICY IN PLACE



## Structured environmental risk management process in place



# Gap assessment and challenges identified



# Regulatory and policy challenges

Challenge / Gap	Examples
<b>Inconsistencies in the existing environmental regulations</b>	<p>Disparities in environmental regulation, specifically riparian land zoning rules. The interplay between zoning guidelines under the Physical Planning laws and the Environment Regulations riparian rules is not well defined - land survey and cadastral maps often do not clearly demarcate expected riparian boundaries. There are several competing laws on the management and protection of riparian reserves.</p>
<b>Institutional overlap conflicting roles of different government agencies</b>	<p>Conflict of roles between NEMA and County Governments. The Constitution, delegated the control of air pollution, noise pollution, other public nuisances, and outdoor advertising (“Delegated Functions”) to the County Governments. This role had been previously conducted by NEMA under the relevant Environment Management and Coordination Regulations.</p>
<b>Public participation challenges</b>	<p>Public participation is a requirement during the EIA process and regulations “The Environmental (Impact Assessment and Audit) Regulations” provides guidelines and procedures on how to conduct an EIA. Practical guidelines to ensure that the consultation process is meaningful both qualitatively and quantitatively are lacking.</p>
<b>Arbitrary issuance of Improvement/Restoration Notices and Stop Orders by NEMA</b>	<p>Under Section 117 (3) of EMCA, NEMA’s environmental inspectors have the power, with the approval of the Director General or his designate, to issue Improvement and Closure Notices for any manufacturing plant or other establishment or undertaking which pollutes or is likely to pollute the environment.</p>

# Institutional challenges

Deficient Environmental Social Impact Assessments

Unethical behaviour among clients/borrowers

Lack of public awareness

Delays in obtaining regulatory approvals

Inadequately constituted EIA consultancy teams

Poor project planning

Lack of comprehensive national databases and information sources

Unfavourable business climate for the manufacturing sector, making it unsustainable to comply with the requirements of EMCA and its subsidiary legislation

# Organisational challenges



Lack of awareness on environmental risks and its impact



Siloed risk-management processes



Shortage of qualified professionals



Limited project monitoring



Lack of integrated ESG focused approach



# Opportunities for intervention



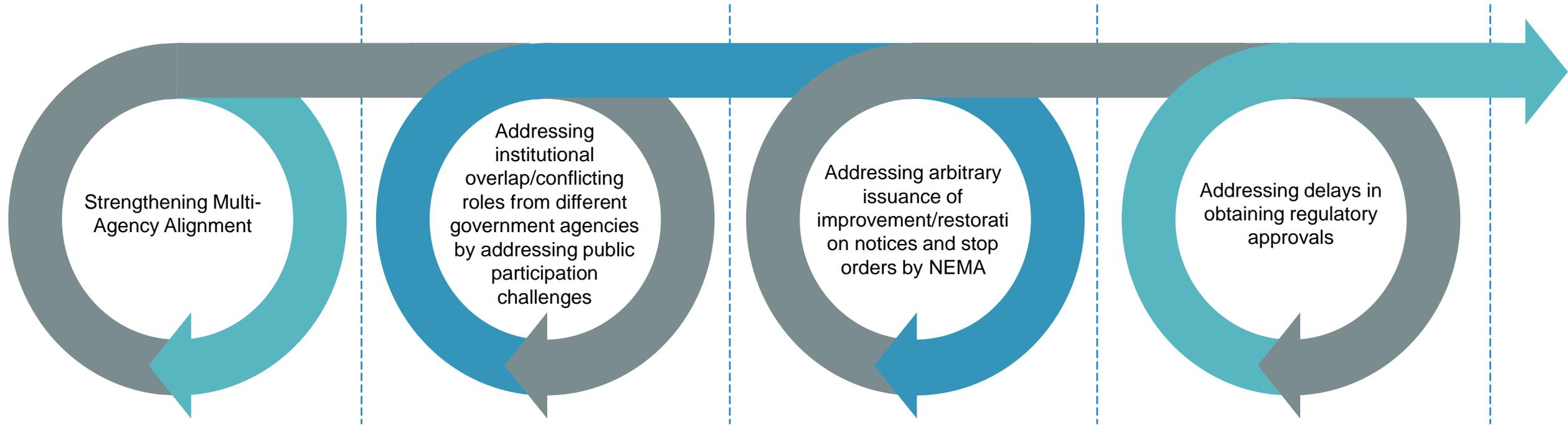
# Regulatory and policy interventions



## Non-regulatory interventions

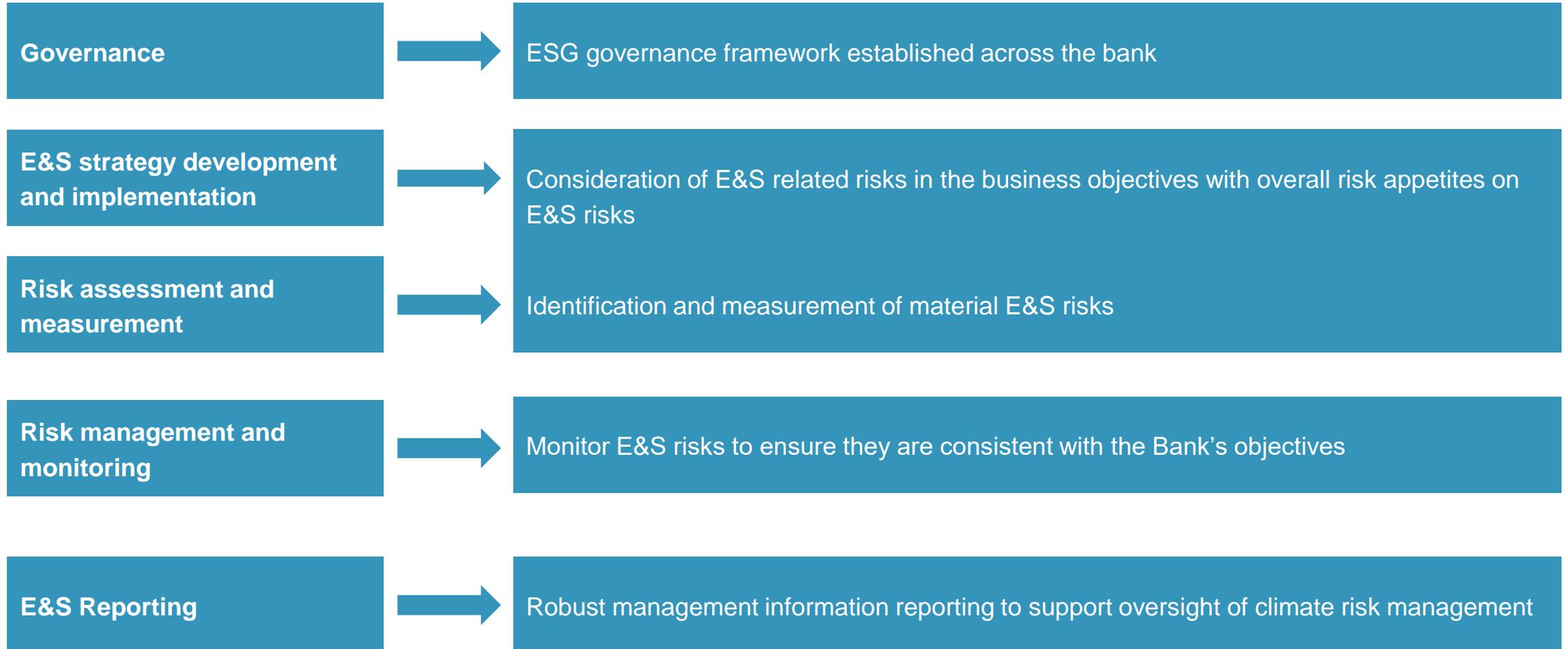
- ✓ Addressing ESG gaps by embedding Sustainable Financing Practices
- ✓ Addressing unethical behaviour among customers/borrowers
- ✓ Addressing insufficient project monitoring through ongoing monitoring
- ✓ Addressing inadequate technical capacity through capacity building

# Institutional level interventions



# Organisational level interventions

A streamlined risk management approach is a key priority for the Kenyan Banking industry's sustainability.



# Questions

