SNAPFI CASE STUDY

Kenya

Transforming the finance sector with technical assistance

JUNE 2021

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View of Kilimanjaro from Amboseli National Park
by Sergey Pesterev

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CHAPTER ONE →

Introduction

In its updated NDC, Kenya commits to reduce its greenhouse gas (GHG) emissions by 32% below business-as-usual levels by 2030 and to ensure a climate resilient society. The government estimates that it needs USD 62 billion to implement actions to achieve these goals (Ministry of Environment and Forestry, 2020).

Given limited public resources, the Kenyan government recognises the need for additional climate finance to meet its climate goals (Odhengo, Wafuke and Magero, 2020). Kenya considers green bonds as one major instrument that could contribute to meet its mitigation and adaptation goals. Notably, Kenya's **Green Economy Strategy and Implementation Plan**[1], the **National Climate Change Action Plan**[2] and the **National Policy on Climate Finance**[3] all identify green bonds as a key instrument to finance projects with a large GHG abatement potential or with high climate resiliency benefits (Odhengo, Wafuke and Magero, 2020). A green bond is a type of fixed-income instrument that is specifically destined to raise money for climate and environmental projects (See Box 1 for more information on green bonds).

In 2017, the Kenya Bankers Association (KBA), together the Nairobi Securities Exchange (NSE) and international donors such as the Climate Bonds Initiative, the Dutch Development Bank FMO and FSD Africa launched the **Green Bonds Programme Kenya**. However, several barriers hinder(ed) the establishment of a green bond market in the country. These include: the availability of concessional finance in mature economic sectors; an interest rate cap; and limited knowledge on how green bonds work and benefits they may bring. **Technical assistance activities** played a role in lowering some of these barriers. The international donors involved in the Green Bonds Programme provided technical assistance as an instrument for knowledge transfer and capacity building, amongst others.

Establishing a green bond market can contribute to transformative change in the finance sector. This sector, as an intermediary, is to play a key role in ensuring that Kenya's climate finance needs are met. However, to help Kenya achieve its climate goals, the finance sector needs to align with the goals of low-carbon and resilient development.

In this report, we assess **whether and to what extent the technical assistance activities provided in the context of the Green Bonds Programme Kenya contributed to transformative change in Kenya's finance sector.**

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1 The Green Economy Strategy and Implementation Plan (GESIP) identifies a number of strategies aimed at accelerating a transition towards a globally competitive low carbon pathway. It also outlines a plan aimed at eliminating fiscal constraints leveraging on international financial mechanism (Ministry of Environment and Natural Resources, 2016).

2 The National Climate Change Action Plan (NCCAP) sets out adaptation and mitigation actions for the period 2018-2022 (Ministry of Environment and Forestry, 2018).

3 National Policy on Climate Finance aims to position Kenya to better access climate finance to help advance the Vision 2030 agenda (National Treasury, 2016).

To gauge the impact of the technical assistance activities, we use the framework of transformative change put forward by Vivid Economics (2020). We elaborate on this framework in Chapter 4.

BOX 1

Green Bonds

Green bonds are a fixed-income debt instrument aimed to raise capital to fund green projects and assets. They can be used to mobilise (additional) resources for (large-scale and long-term) climate mitigation or adaptation projects, beyond bank lending and equity financing. Green bonds differ from traditional bonds by the commitment of the issuer to use the bond's proceeds exclusively for green purposes. The explicit labelling of bonds as green can facilitate the connection between green projects and the increasing demand for green investments (European Commission, 2016).

There are different types of green bonds, including sovereign and corporate green bonds. **Sovereign green bonds** are issued by a national government, whereas a **corporate green bond** is issued by a private company.

The main actors in the green bond markets are:

- **Green bond issuer:** Any entity (company, government agency, financial institution) that develops, registers and sells a bond.
- **Green bond underwriter:** Financial institution that organises the issuance of the green bond.
- **Green bond investor:** Individuals, companies or institutional investors who buy a green bond with the expectation to receive a financial return.
- **External reviewers or verifiers:** Entities that verify the "greenness" of the project/ asset or that verify compliance with green bond standards. This can include credit rating agencies, auditors and intermediaries (such as stock exchanges) and investors.

The green bonds issuer has an obligation to track, monitor and report on the use of proceeds which leads to additional costs. Therefore, a minimum issuance volume is usually required. At the same time, green bonds can have a green premium (interest rebate) meaning that capital providers might be willing to accept lower returns when compared to traditional bonds. This in turn means that issuers might be able to raise capital at lower costs (Löffler, Petreski and Stephan, 2021).

For this research study, we conducted two confidential interviews with representatives of the Dutch development bank FMO and FSD Africa. These organisations provided technical assistance, in addition to financial support, to Kenyan banks and other stakeholders in the context of the Green Bonds Programme. In addition, we conducted a confidential interview with a representative of the KBA. We complemented these interviews with desk research.

Chapter 2 outlines key actors and developments in the Green Bonds Programme Kenya. It also discusses the Green Bonds Programme in the context of wider developments in Kenya's finance sector. Chapter 3 provides an overview of main enabling factors and barriers to the Green Bonds Programme. Chapter 4 discusses whether and to what extent various technical assistance activities helped reduce these barriers, and we assess how these activities contributed to transformative change, following the six principles introduced above. Chapter 5 outlines lessons learned, thereby focusing on both the providers of technical assistance and policy-makers.

View across Nairobi skyline
by James.x. co

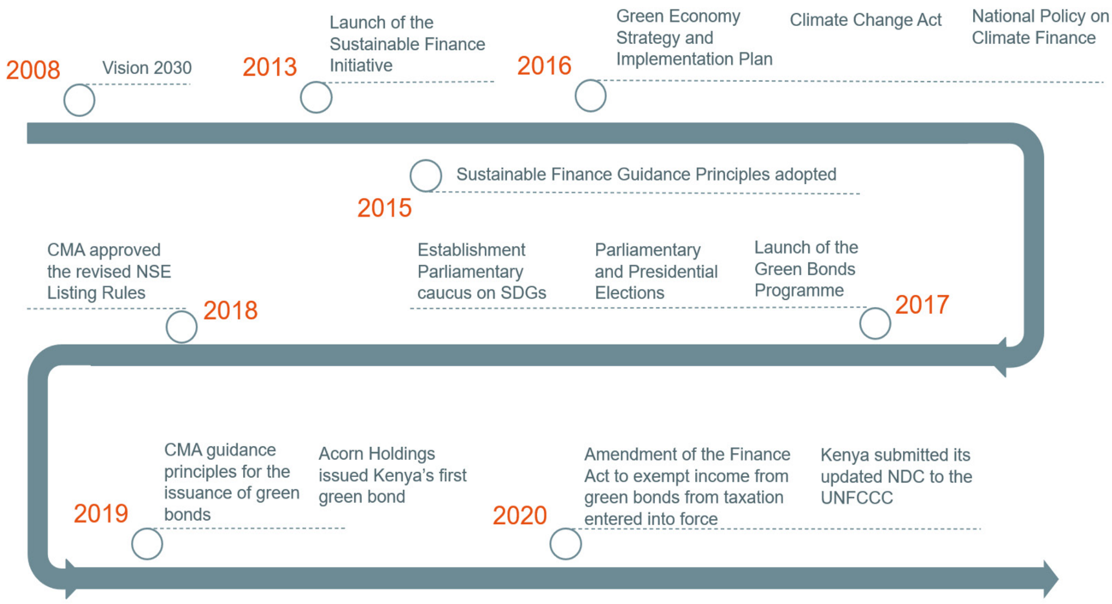
CHAPTER TWO

The Green Bonds Programme Kenya and wider financial sector reforms

For Kenya to meet its climate goals, it is essential that all sectors, including the finance sector, align with the goals of sustainable, low-carbon and resilient development. In Kenya, various actors undertake efforts to achieve a sustainable finance sector that meet the country's climate goals, including the government and the banking sector. Figure 1 provides an overview of key events and policy documents in Kenya since 2008.

FIGURE 1

Milestones in Kenya's climate policy framework and the Green Bonds Programme



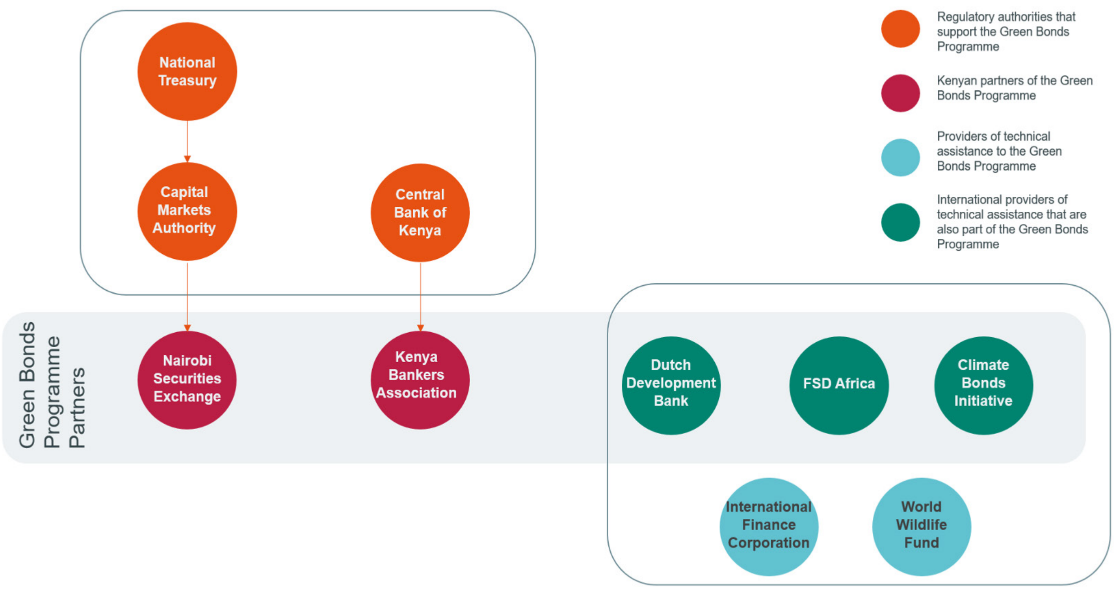
The banking sector plays an important role in Kenya's economy. The sector's assets contributed to 49.5% of nominal GDP in 2018 and the sector provided 81% of tracked domestic private sector climate-related expenditures in the same year (Central Bank of Kenya, 2019; Odhengo *et al*., 2021). The banking sector also undertakes efforts to increase awareness on the need for green finance. Notably, the **Sustainable Finance Initiative (SFI)**, which was initiated by the KBA, adopted five guiding principles that support banks to balance their business goals with environmental and social concerns. The principles focus on economic viability; growth through inclusion and innovation; managing and mitigating social and environmental risks; resource scarcity; and business ethics and values (Kenya Bankers Association, 2015; Sustainable Banking Network, 2019). The SFI's principles laid down the foundation for future workstreams, including Kenya's Green Bond Programme (Interview 1; Interview 2; Interview 3, 2021).

The KBA, NSE, Climate Bonds Initiative, the Dutch development bank FMO and FSD Africa launched the Green Bonds Programme in 2017.

Their objectives include: promoting financial sector innovation; developing a pipeline of green investments; developing a pool of Kenya-based licensed verifiers; developing a cooperative fixed income fundraising facility to enable smaller banks and corporates to take advantage of the wholesale debt capital markets; and leveraging Kenya's experience to catalyse similar programmes in other East African countries (Green Bonds Programme Kenya, 2020). Key regulatory authorities - the National Treasury, the Capital Markets Authority (CMA) and the Central Bank of Kenya (CBK) – endorse and therefore provide critical support to the Green Bonds Programme; while the International Finance Cooperation (IFC) and the World Wildlife Fund (WWF) Kenya supported various workstreams under the Green Bonds Programme (see Figure 2) (Green Bonds Programme Kenya, 2019).

FIGURE 2

Overview of the most relevant actors involved in Kenya's Green Bond Programme



The Green Bonds Programme contributed to the establishment of an ambitious green bonds policy framework in Kenya. The programme partners supported the drafting of the **NSE Listing Rules** with provisions for green bonds. These rules are based on the Climate Bonds Standard and the Green Bond Principles, which were developed by the Climate Bonds Initiative and the International Capital Market Association (ICMA), respectively (ICMA, 2018; Climate Bonds Initiative, 2020). The CMA approved the NSE Listing Rules in December 2018 (Nairobi Securities Exchange, 2019).

Further, the KBA and NSE, with support from FSD Africa, the FMO and Climate Bonds Initiative developed a **Green Bonds Issuer's Guide**.

This document provides background information on green bond markets internationally and an overview of international best practices. The document also outlines step-by-step how to issue a green bond in Kenya (Green Bonds Programme Kenya, 2019).

Based on the work that the organisations behind the Green Bonds Programme had undertaken, the CMA published **a Policy Guidance Note on Green Bonds** in 2019 (CMA, 2019). This document outlines the requirements that issuers of green bonds must meet. Importantly, the Guidance Note stipulates that the proceeds of green bonds must be used "to finance or refinance new or existing projects that generate climate or other environmental benefits that conform to green guidelines and standards [...] including Green Bond Principles [...]; Green Bond Standards such as the Climate Bonds standard [...]; government policies and guidelines such as [...] the Green Economy Strategy[4] [...]; and any other standard acceptable to the Authority" (CMA, 2019).

In August 2019, the Nairobi-based real estate business **Acorn Holdings issued the first - and thus far only - Kenyan green bond**, worth KES 4.3 billion (USD 40 million). This was the fifth green bond issued in Africa (Climate Bonds Initiative, 2019). The proceeds are used to finance the construction of seven low-carbon residential buildings in Nairobi. These buildings will provide several thousand rental housing units for students (Acorn, 2020). Two other issuances are planned for spring 2021, but further details are unavailable at the time of writing (Interview 2, 2021).

To increase the attractiveness of green bonds to investors, the CMA submitted a **proposal to exempt investors from paying withholding taxes on their interest earning from infrastructure bonds, including green bonds** in 2018. The following year, the Kenyan government amended the Finance Act to include this exemption, which came into force on 1 January 2020 (Republic of Kenya, 2019).

4 The Green Economy Strategy and Implementation Plan (GESIP) identifies a number of strategies aimed at accelerating a transition towards a globally competitive low carbon pathway. It also outlines a plan aimed at eliminating fiscal constraints leveraging on international financial mechanism (Ministry of Environment and Natural Resources, 2016).

Parliament of Kenya, Nairobi
by Michael Jefferies

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CHAPTER THREE

Enabling factors and barriers to the Green Bonds Programme Kenya

3.1

Enablers

Five enabling factors played an important role in the establishment of Kenya's Green Bond Programme. We outline these here.

Involvement of the Kenya Bankers Association and domestic finance sector engagement

A key enabler of the Green Bonds Programme was the strong involvement of the Kenya Bankers Association (Interview 1, 2021). The KBA brought the various programme partners (i.e. the NSE, FSD Africa, the FMO and Climate Bonds Initiative) together and played a crucial role in getting relevant decision-makers on board (Interview 1; Interview 3, 2021).

The Kenyan finance sector is generally well aware of the need for green, sustainable finance and was therefore open to the development of a green bond market. In 2015, the banking industry adopted the SFI Guiding Principles, which inform "financiers on how to optimise the balancing of their business goals with the economy's future priorities and socio-environmental concerns" (KBA, 2015). In addition, the SFI developed an online training for all Kenyan bankers to increase their understanding of sustainable finance. Through its principles and trainings, the SFI laid the groundwork for other workstreams on green finance, including the Green Bonds Programme Kenya (Interview 1, 2021).

Strong government focus on climate change risks and adaptation and mitigation measures

The Kenyan government has developed and implemented a range of policies aimed to increase climate resilience and to shift to a low-carbon development path. In particular, the Vision 2030 long-term development plan, the 2010 Constitution, the Green Economy Strategy and Implementation Plan and the National Policy on Climate Finance outline Kenya's ambitions for sustainable development. The preamble of the 2010 Constitution provides that "the people of Kenya [are] respectful of the environment [...]

and determined to sustain it for the benefit of future generations" (National Council, 2010). The word "sustainable" is included seven times in the Constitution, for instance in Article 10, which stipulates that "sustainable development" is one of the country's national principles (National Council, 2010). The 2016 Climate Change Act provides the legal framework for the promotion of "climate-resilient low-carbon economic development" (Republic of Kenya, 2016).

In addition, Kenya has had a parliamentary caucus on the Sustainable Development Goals (SDGs) since 2017. In its SDGs and Business (KPCSB) Strategic Plan 2019-2023, the caucus specifically mentioned green bonds as a finance instrument to redirect and raise finance for mitigation and adaptation projects (Kenya Parliamentary Caucus on SDGs, 2019). Further, the Plan identifies pursuing and initiating a "friendly taxation regime" as key activities to "promote and influence passing of legislation supportive of the sustainable development goals and businesses".

With its 2010 Constitution and various climate policies, the Kenyan government sent a strong signal to the private sector and created a conducive environment for finance sector reform. The parliamentary caucus on SDGs helps drive the development and implementation of regulatory reforms and incentives for green bonds, and green finance more generally (Interview 2; Interview 3, 2021).

International developments, notably the adoption of the Paris Agreement and the SDGs in 2015, further contributed to increased awareness in the private sector. For instance, many banks now include references to the SDGs in their environmental, social and governance (ESG) reports (Interview 1, 2021).

Large pipeline of green projects

Kenya has a large potential for green, sustainable projects, for instance in the energy and manufacturing sectors (SBA Africa Ltd, 2019a, 2019b, 2019c). However, when the Green Bonds Programme was launched in 2017, investors often did not label green investment opportunities as such (Interview 2; Interview 3, 2021). In addition, there was no local capacity to verify green projects.

In combination with increased awareness and capacity building, the large potential for green investments has also enabled the Green Bonds Programme to further develop and to attract the interest of various investors and potential bond issuers (Interview 2; Interview 3, 2021).

Important decision-makers on board

Shortly after launching the Green Bonds Programme, the KBA and other programme partners involved decision-makers from the CBK, the CMA and the National Treasury. Their endorsement has given the programme necessary traction (Interview 2, 2021). Their involvement also helped ensure that important regulations, such as the withholding tax exemption for income from green bonds, were proposed to Parliament. The Parliamentary caucus on the SDGs contributed to the successful passing of this exemption (Interview 3, 2021).

3.2

Barriers

The establishment of the Green Bonds Programme, and the development of a green bond market in Kenya, faced a number of barriers. We highlight the six main obstacles here.

Green bonds have to compete with development finance

As in many lower-middle-income countries, Kenyan project developers may have access to favourable sources of finance, for instance grants or concessional loans from multilateral development banks (MDBs) or international donors (Interview 1; Interview 2; Interview 3, 2021). While concessional finance is particularly useful to support nascent markets, green bonds are generally used to attract finance for more mature sectors, for instance the energy sector. In Kenya, however, a substantial share of international public finance is channelled to finance projects in the energy sector (Odhengo et al., 2021). Accordingly, issuing a green bond is not necessarily attractive for many Kenyan companies. In addition to the higher interest rates, a green bond issuance is generally also more complicated and time-consuming than negotiating over grants and concessional loans (Interview 3, 2021).

Unstable political situation

The Green Bonds Programme was launched in March 2017. In August that year, Kenya also had its Parliamentary and Presidential elections, which were won by Uhuru Kenyatta. However, the Kenya Supreme Court annulled the results after the losing candidate had filed a petition. Following the controversial re-elections in October 2017, President Uhuru Kenyatta was installed for his second term in office, but political turmoil continued for various months.

In Kenya, like in many other African countries, election years usually see a decrease in economic growth.

In those years, the government has a strong focus on election campaigns and decisions on other pressing topics are postponed (Institute of Economic Affairs Kenya, 2017). Further, there is doubt about the regulatory and policy direction in which the country will go after the elections. Fear of post-election violence causes further economic contraction (Dahir and Kazeem, 2019). For these reasons, there was large uncertainty of Kenya's political and economic future at the start of the Green Bonds Programme, which made it challenging to develop a new product for the financial market (Interview 1; Interview 2, 2021).

Interest rate cap

In 2016 interest rates were capped at four per cent above the Central Bank's lending rates (nine per cent in August 2018). This has hampered the issuance of bonds, including green bonds, because investors would usually ask for a premium above government debt, which yielded at approximately 12 per cent in 2018 (Green Bonds Programme Kenya, 2019). For instance, "a planned pooled green bond facility – developed by KBA with financial backing from FMO – did not meet the pricing models" (Ella Milburn, 2019). In November 2019, Parliament removed the interest cap (Miriri, 2019). This was the result of two processes: the KBA and banks lobbied with Parliament to review the cap (Interview 3, 2021) and the International Monetary Fund (IMF) made removal of the cap a precondition for renewal of its credit facility (Amadala, 2021).

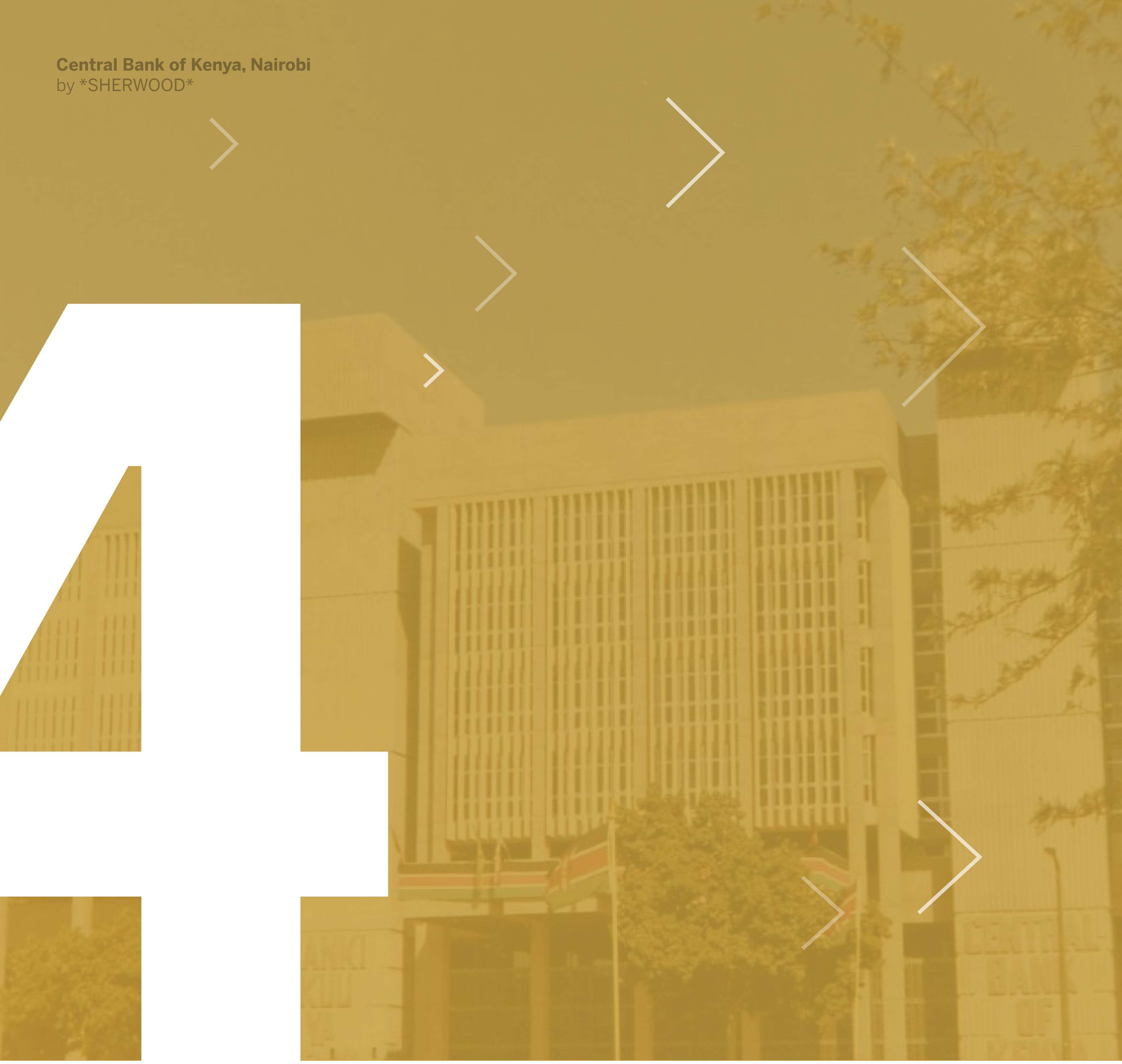
Conventional sovereign bonds crowd out corporate green bonds on the market

Bonds issued by the National Treasury dominate on Kenya's conventional bond market, accounting for around 99% of total turnover in recent years (Capital Markets Authority, 2020). This has two reasons: first, government bonds are generally less risky and cheaper than corporate bonds. Second, the National Treasury occasionally issues infrastructure bonds, which are exempt from a withholding tax and therefore more attractive to investors. This makes it challenging for corporates to successfully issue green bonds.

However, with the amendment of the Finance Act in 2019, which extends the withholding tax exemption to green bonds, it has become more attractive for corporates to issue green bonds. Further, this barrier hindered the issuance of corporate green bonds, but not sovereign green bonds. While the Kenyan government indicated it would issue a sovereign green bond in the fiscal year 2018/19 (Green Bonds Programme Kenya, 2019), this has not happened to date.

Lack of knowledge on green bonds

Generally, the Kenyan financial sector is aware of the risks and investment opportunities that climate change poses (Interview 3, 2021). However, a lack of knowledge on how to issue and potential benefits of green bonds amongst potential issuers and investors was initially a big hurdle to the Green Bonds Programme Kenya (Interview 1; Interview 2, 2021). Specifically, investors did not know whether the product would be beneficial to them (Interview 2, 2021). In the absence of a regulatory framework and an established green bonds market, many potential issuers did not have the technical expertise to issue a green bond. Further, a lack of Kenya-based licenced verifiers made it challenging to set up a green bonds market (Interview 2, 2021).



Central Bank of Kenya, Nairobi
by *SHERWOOD*

CHAPTER FOUR

Technical assistance activities and their contribution to transformative change

4.1

Technical assistance

Technical assistance is an important instrument to support climate action. It can take the form of information sharing, training programmes, capacity building workshops, best practice sharing and other consultation services (Vivid Economics, 2020). International donors can complement technical assistance activities with financial support, including concessional loans, but this does not necessarily have to be the case.

Technical assistance is typically used to address institutional capacity issues, but can more generally spur change by drawing on existing know-how and international best practices. Technical assistance activities can contribute to lowering barriers that constrain potential financial sector reforms, including the development of a green bond market. International donors can provide technical assistance to the public sector, including government authorities and central banks, or to other entities, such as private banks, companies or civil society organisations.

4.2

Six principles of transformative change

To gauge the impact of technical assistance on the green bond market and the wider finance sector in Kenya, we assess to what extent technical assistance supported six principles of transformative change, as proposed by Vivid Economics (Vivid Economics, 2020). However, technical assistance activities do not have to align with all six principles to lead to transformative change.

The principles stipulate that actions and investments should **strategically** target key priorities and action areas needed to achieve a low-carbon and climate resilient development path to ensure transformative change. Building a knowledge and regulatory foundation with key stakeholders can spur **systemic** change and drive broad and deep changes within key markets and policy environments. Aggregated smaller actions or fewer, larger actions can deliver **high-impact** large-scale mitigation or adaptation benefits and actions or investments that have the potential to increase in **scale** themselves or that are replicable in other contexts are also most likely transformative. Further, actions or investments that are able to continue after any initial support is withdrawn or in the face of changing future conditions lead to **self-sustaining change** and actions or investments that are long-lasting or permanent lead to **enduring change**. Both are more likely to lead to transformative change.

4.3

Technical assistance in the context of Kenya's Green Bonds Programme

The KBA has partnered with international donors in its efforts to green Kenya's financial sector for more than a decade. For instance, FMO, the German Investment Corporation (DEG), UNEP Finance Initiative and IFC provided support to Kenya's Sustainable Finance Initiative, which is led by the KBA (Sustainable Banking Network, 2019).

Various international organisations provided technical assistance to Kenyan stakeholders, including banks, in order to build a green bond ecosystem. Banks play an important role as financial intermediary between potential issuers and investors. Banks may issue green bonds to raise capital for investments; or may underwrite sovereign and corporate green bonds.

The first phase of technical assistance activities started in 2017 with an assessment of the regulatory framework in Kenya and of international standards for green bonds (Interview 2, 2021). Throughout the first phase, technical assistance focused on: labelling green investments as such; capacity building; promoting a regulatory framework conducive to green bonds; and setting up a Special Purpose Vehicle (SPV).

The first phase of technical assistance activities will officially end in 2021. However, in the private sector, not all companies understand how to get their green bonds verified and how to finance this verification, so additional technical assistance may still be necessary on a case-by-case basis in the next one or two years (Interview 2, 2021).

In the following sections, we outline what technical assistance activities entailed; explain how these helped reduce barriers; and whether and how they contributed to transformative change in Kenya's finance sector.

Identifying green investment opportunities and labelling those as such

While many green investment opportunities existed prior to the Green Bonds Programme, these were not necessarily labelled as "green" or "low-carbon". The programme partners helped to identify green investment opportunities in key economic sectors in Kenya (i.e. agriculture, transport and manufacturing[5]); developed a pipeline of potential green bond issuers; and a pipeline of green investments that were labelled as such. Further, the organisations behind the Green Bonds Programme Kenya organised roundtable discussions and peer-to-peer learning sessions to share these findings and bring together potential issuers, investors and financial intermediaries (Green Bonds Programme Kenya, 2019).

Technical assistance aimed at identifying green investment opportunities targeted **strategic** and **systemic** change. Although green investment opportunities are now better labelled, it is unclear whether this has led to transformative change in the finance sector. For such change to occur, it is necessary that the green labels result in *additional* finance for green projects. However, studies that assessed green bond markets in other countries found that green bonds do not necessarily unlock new sources of capital for green investments and they play a limited role in making green investments financially viable (Ehlers, Mojon and Packer, 2020; Maltais and Nykvist, 2020).

Further, the quality of green project matters – it is not enough for these projects to be greener than standard projects. Rather, they need to contribute to the climate objectives of the Paris Agreement.

As of March 2021 only one green bond has been issued; the proceeds of which have been used to construct environmentally friendly apartments. We do not have the information to assess whether Acorn Holdings would have raised the money to build these apartments in the absence of a green bond programme – in other words, whether the green bonds led to additional green finance flows. Further, we do not know whether these buildings are net zero, or merely greener than standard apartment buildings in Nairobi.

5 The assessment reports can be found on the Green Bonds Programme Kenya's website: https://www.greenbondskenya.co.ke/publications (last accessed on 26 March 2021).

Capacity building

The African green bond market is still in its infancy. Most issuances come from Development Finance Institutions (DFIs), including the African Development Bank (AfDB) and the IFC. In October 2019, corporates and sovereigns across the continent had issued a total of seventeen green bonds (Marbuah, 2020). Accordingly, the private sector had limited knowledge of green bonds, their potential benefits, and what requirements such bonds must meet. An important focus of the technical assistance activities was therefore on capacity building (Interview 1; Interview 2, 2021). The technical assistance providers targeted various stakeholders, including issuers, investors, and verifiers. Further, the KBA, FSD Africa, and the FMO created an e-learning module on green bonds to educate potential issuers, investors and financial intermediaries. The course aims to increase relevant actors' understanding of how green bonds can be used to attract and redirect green finance that contributes to the sustainable development goals (Sustainable Finance Initiative, 2021).

The FMO, together with the IFC, also contributed to capacity building by connecting the Kenya Bankers Association and the Mongolian Bankers Association, who signed a Memorandum of Understanding in 2017 with the aim to advance sustainable financing practices in both countries. This collaboration provided Kenyan banks with the opportunity to learn from the Mongolian banking sector's experience with green bonds (FMO, 2017).

By building capacities within Kenya, technical assistance providers helped to reduce barriers that a lack of technical expertise amongst potential issuers and investors posed. A core strategy of the technical assistance was to build capacities in the entire green bond ecosystem to spur **strategic** and **systemic change**. Actors in the financial sector now refer to the same definitions and documents when speaking about green bonds. This helped to build trust in green bonds and may enable more issuances in the near future.

However, while larger financial institutions understand how the green bonds market function, many potential issuers of green bonds in the private sector still lack the capacity and understanding to do so. Specifically, how to verify green bonds remains an obstacle and additional technical assistance targeted at those actors will be needed in the near future (Interview 2, 2021). Further, if no or few green bonds will be issued in the near to medium-term future, it is likely that knowledge of green bonds, as well as the capacities to issue and verify them, will diminish. Therefore, it is too early to assess whether the technical assistance contributed to **scalable, enduring** and **self-sustaining** change.

Promoting a regulatory framework

The technical assistance activities also promoted a **regulatory framework conducive to green bonds.** For example, the Green Bond Programme Kenya supported the preparation of the Green Bond Listing Rules, which outline the requirements that green bond issuers must meet and which were approved by the CMA in December 2018.

The technical assistance also focused on setting up the **Green Bonds Programme Kenya Advisory Committee**, which is meant to influence new policy incentives and regulations. Through this advisory committee, the KBA lobbied for a tax exemption for green bonds (Green Bonds Programme Kenya, 2019; Interview 3, 2021). In 2018, the Capital Market Authority **submitted a proposal to exempt investors from paying withholding taxes to the National Treasury and Parliament.** In 2019, the Kenyan government amended the Finance Act to include this exemption (Republic of Kenya, 2019). This may make green bonds more attractive relative to conventional government bonds.

A clear regulatory framework and financial incentives for potential issuers and investors are crucial factors in the establishment of a green bond market. Therefore, actions aimed at improving the regulatory framework likely have a **strategic** and **systemic** effect. However, with just one green bond issued to date, we cannot draw any conclusions on whether technical assistance activities aimed at promoting a regulatory framework contributed to transformative change.

Developing a Special Purpose Vehicle

The FMO supported the development of a Special Purpose Vehicle (SPV) - a business entity that is created by its parent company for a specific purpose and protects the parent business from financial risks incurred to the SPV. Under the Green Bonds Programme, the SPV was envisaged to take the form of a **pooled fund facility** that would aggregate the funds held by various banks and companies. This construction would allow smaller KBA member banks and corporates to access the debt capital markets. While the SPV was considered innovative and ambitious, it proved difficult to establish. The FMO involved an external consultant to understand how such a SPV would function and to get local banks interested. However, the pooled fund facility has not come off the ground, as the SPV-set up was too complicated and general economic conditions unfavourable (Interview 1, 2021).

Conclusion on technical assistance and transformative change

At first sight, the Kenyan Green Bonds Programme may not seem very successful yet, with only one bond issued as of March 2021. Whilst implementing partners would have expected more issuances, the programme and the technical assistance laid the groundwork for green bonds in Kenya (Interview 1; Interview 2, 2021). Many Kenyan banks now have the capacities to issue green bonds and there is a pool of Kenya-based certifiers, so rapid growth could take place any time. In that sense, technical assistance activities contributed to **strategic** and **systemic** change.

However, with merely one bond issuance thus far, it is not apparent whether and to what extent the technical assistance activities contributed to high impact, scalable, self-sustaining, and enduring change.

It is also **too early to judge whether the technical assistance activities contributed to transformative change in Kenya's finance sector.** It is still uncertain whether more green bonds will be issued in Kenya, and whether the Green Bonds Programme will serve as a blueprint for similar programmes in other African countries. For the Green Bonds Programme to contribute to transformative change, it is also key that proceeds are used to finance projects that contribute to the Paris Agreement goals; and that these projects are additional. In other words: the projects would not go ahead without the green bond (Maltais and Nykvist, 2020). Future assessments of technical assistance provided in the context of Kenya's Green Bonds Programme need to consider these aspects.

Olkaria II Geothermal Plant, Nakuru, Kenya
by Frank van der Vleuten

CHAPTER FIVE

Lessons learned

5.1

Lesson for public authorities

Financial incentives and conducive policies are key preconditions for green bonds issuance

To successfully establish a market for green bonds, it is essential that policy makers support green bonds and provide a conducive regulatory framework and financial incentives.

The Central Bank of Kenya, the Capital Markets Authority and the National Treasury endorsed the Green Bonds Programme soon after its launch. For instance, the CBK's Governor serves as the Green Bonds Programme's patron (Green Bonds Programme Kenya, 2020). Having important decision-makers involved helped drive policy changes, for instance the amendment of the Finance Act that exempts income from green bonds from withholding taxes (Interview 2, 2021). In Kenya, the removal of the interest rate cap and the tax exemption for income from green bonds have made it more attractive to issue and invest in green bonds – although the numer of issuances has not yet increased since the amendment.

Providers of technical assistance should try to involve and get the support from key policy-makers early on in the programme. However, involving key decision-makers can be challenging in countries where green bonds are a new product (Interview 2, 2021).

5.2

Lessons for providers of technical assistance

International donors should focus on developing a local market

As highlighted in Chapter 3.2, the availability of international development finance may compete with green bonds (Interview 1; Interview 2, 2021). Whereas green bonds are generally useful to finance established activities in more mature sectors, for instance in the energy sector, there is a need for international donors to increasingly support nascent technologies and sectors that do not receive private finance at scale (Odhengo *et al.*, 2021). In Kenya, however, a substantial share of finance from multilateral and bilateral partners is used to finance more mature activities in the energy sector (Odhengo *et al.*, 2021).

For potential issuers of green bonds it is generally more attractive to source finance at concessional terms from international donors than issuing a green bond at higher interest rates. Providers of development or climate finance may thus – unintentionally - disrupt the local market.

Providers of technical assistance need to make the development of a local green bond market a key priority. Specifically, international donors that provide financial assistance should consider whether this hinders the establishment of a green bond market.

Local ownership is key to the success of a green bonds programme

The financial sector plays a crucial role in the economy, as the intermediary that distributes capital flows to all parts of the economy. Therefore, private financial actors' involvement is necessary to transform the financial sector and align investments with the Paris Agreement's objectives.

In Kenya, the KBA was the driving force behind the Green Bonds Programme. As an association with 46 member banks, the KBA is an important organisation in Kenya's financial sector and played an important lobbying role for the programme at the political level. For instance, the amendment of the 2019 Finance Act was passed after the KBA had lobbied for this for two years (Interview 3, 2021). Technical assistance activities would have been more expensive and likely not as effective if the KBA had not been intrinsically motivated to drive the Green Bonds Programme (Interview 1, 2021).

Moreover, providers of technical assistance usually commit to providing support for a limited period of term. For the Green Bonds Programme to continue after international donors have pulled out, local stakeholders need to feel responsible.

Technical assistance activities should focus on sharing expertise to support the development of local capacities

One of the success factors of the Green Bonds Programme Kenya is the widespread awareness of how green bonds function across the market. As the technical assistance providers targeted a wide range of stakeholders, potential issuers and investors now understand what green bonds are and what benefits they may bring. In addition, there is now a large pool of Kenya-based verifiers. The focus on this wide range of stakeholders has been key to build an ecosystem for green bonds in Kenya (Interview 2, 2021).

Technical assistance providers should ensure local presence

As ownership by local stakeholders is important, providers of technical assistance need to invest time in building good relationships and acquiring trust. This is difficult to accomplish through virtual communications (Interview 1; Interview 2, 2021), so technical assistance activities are likely most successful if the providers of such assistance are based in the country or able to travel there regularly.

In addition, good contact with local banks has been key in the Green Bonds Programme (Interview 1, 2021).

A stable political environment is key for developing a green bond market
The political environment can hinder or enable setting up a green bond programme. In the year that the Green Bonds Programme was launched, and technical assistance activities started, Kenya had parliamentary and presidential elections. This led to political and economic uncertainty and less trust in the potential of green bonds (Interview 2, 2021). Many African countries see a slowdown in economic growth, coupled with an unpredictable political situation during election years. Providers of technical assistance and financial sector actors alike, should ideally plan to establish a new product for the financial market in non-election years, when the political and economic situation is more predictable.

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