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# ESG Regulation - A Must Have to Ensure Adoption and Compliance

Georgina Kirabo

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# Working Paper Series

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**Uganda Bankers Association**
Plot 2702, Block 244 Nyangweso Road
Off Kironde Road, Tankhill Muyenga, Uganda
P.O. Box. 8002, Kampala
secretariate@ugandabakers.org
www.ugandabakers.org

# ABSTRACT

The acronym 'ESG' is the new 'kid on the block', with many companies hoping to jump on board to comply in one way or another to ensure sustainability of their businesses. While ESG and sustainability are used interchangeably, it is important to note that ESG only represents the lenses/ pillars through which actions to deliver a sustainable business are viewed.

Sustainability has been defined by the United Nations Brutland Commission to mean "meeting the needs of the present without compromising the ability of future generations to meet their own needs." The acronym 'ESG' on the other hand refers to Environment, Social and Governance factors that affect businesses. Whereas in the past investors, shareholders and potential investors have focused on the financial performance of the companies in which they invest, hold stakes in or anticipate investing in and the return on investment earned, recent trends have revealed a change in expectations. Stakeholders including shareholders, employees, regulators, and the wider communities are becoming aware that non-financial factors such as the impact of the company's activities on the environment, equal treatment of employees, executive pay, the ethical culture of the business and its stand on matters such as corruption, bribery and tax evasion have an effect on the longevity of the company's business. These non-financial factors are what are termed as 'ESG'.

The need to adopt good ESG practices was accelerated by the COVID-19 pandemic which amplified issues such as how companies treat their employees and the communities in which they operate. Customers, especially the younger generations, are also putting ESG considerations in mind before making purchasing decisions. Their decisions are based on among others, the social and environmental impact of products and services that they consume. Lenders and Development Financing Institutions are also requiring borrowers to exhibit good ESG/sustainability practices as part of prerequisites to acquiring financing. Additionally, there is an increased awareness of the need to finance companies and projects that are sustainable and put ESG into consideration.

The sustainability/ESG agenda also takes into consideration the UN Sustainable Developmental Goals (SDGs) which are aimed at achieving a sustainable future by 2030. The 17 SDGs are premised on the need to achieve sustainable development while integrating economic growth, social well-being, and environment protection. Companies are expected to consider the SDGs, such as SDG 7 relating to affordable and clean energy, and SDG 13 Climate Action, while developing their ESG strategies and frameworks.

With the above in mind, it is important for companies to adopt good ESG practices as part of their overall strategy as the term can no longer be looked at as just a nice to have. However, companies need to be careful not to overstate their adoption strategies as this can lead to disclosure of misleading information and worrisome practices such as green washing (defined as the act of a company making its practices more environmentally friendly than they really are/making false statements about its ESG practices).

# 1.0 INTRODUCTION

Adoption of good ESG practices/sustainability requires companies to be aware of the regulatory frameworks and laws that govern compliance and disclosure. Currently, there is no single law/framework that imposes obligations with regards to ESG compliance and disclosures. Various countries, including some African countries, have enacted their own local laws to guide on compliance with the various ESG considerations. These laws relate to protection of the environment and management of waste, fair treatment of employee, employee remuneration and good governance practices.

For most countries, the above considerations have been embedded in laws that have been in existence for several years, however, the increased need to comply and disclose compliance has led to the enactment of guidelines and supplemental regulations to ensure targeted compliance/adoption. In Africa, countries such as Nigeria, South Africa, Mauritius, Egypt, Namibia, and Kenya have taken great strides in issuing guidelines and laws to ensure compliance with good ESG practices, with initiatives being spearheaded by Governments, Capital Markets Authorities (CMAs) and private member associations such as bankers' and insurers' associations.

CMAs and securities exchanges globally have issued various guidelines to ensure that companies listed on the stock exchanges adhere to compliance and disclosure requirements in relation to their ESG practices. This is aimed at ensuring transparency and confidence in the stock exchanges.

## KEY INSIGHTS AND LESSONS FROM KENYA ON CLIMATE CHANGE REGULATION AND DISCLOSURES

Kenya is leading the race in promoting sustainability in East Africa by enacting and enforcing various laws, guidelines, and notices. Various public and private entities such as the Government, the Central Bank of Kenya, the Kenya Bankers Association, the CMA and Nairobi Stock Exchange have taken the forefront in this move. Several laws and guidelines have been enacted to guide on implementation of the ESG parameters. The following are some of the initiatives taken by the country specifically relating to environmental considerations and disclosures:

**The Climate Change Act No. 11 of 2016** was enacted to ensure the development, management, implementation, and regulation of mechanisms to enhance climate change resilience and low carbon development for the sustainable development of Kenya. The Act establishes the climate change council whose role is to, among others, ensure enforcement of the Act by creating applicable policies and strategies aligned with the country's commitments under the Paris Agreement. The Act further formalises carbon credits, carbon offset projects and the trade in carbon markets as a means of reducing greenhouse gases and their effects. These initiatives can therefore be adopted by some of the companies as part of their ESG transformation journey.

The above Act is enforced together with the **Environmental Management and Coordination Act of No. 8 of 1999**, which establishes the National Environmental Management Authority (NEMA) to exercise general supervision and co-ordination over all matters relating to the **Environment and the Sustainable Waste Management Act, No. 31 of 2022** which sets out a legal and institutional framework for the sustainable management of waste including segregation and responsible disposal of waste. One of the key enforcement measures taken under the above Acts was the ban of polythene bags (kavera) in 2017.This was further followed by a noticed published by NEMA on April 2024, requiring that all waste should be collected and disposed of in biodegradable polyethene bags and required all households, government agencies and private entities to comply with the requirement within 90 days from the date of the notice. This ban on polythene by the Kenyan Government was later followed by a similar ban in Rwanda and Uganda

In addition to the above, the Central Bank of Kenya (CBK) and the Nairobi Stock Exchange (NSE) have been at the forefront of fostering positive climate change practices. In October 2021, the CBK issued the **Guidance on Climate-Related Risk Management ("Guidance").** The Guidance requires all institutions licenced by the CBK to embed considerations of financial risk from climate change in their governance, strategy, and risk framework. Directors and Senior Management were required to consider climate related risks when formulating the strategy for their respective institutions. The institutions were required to;

(ii) Incorporate financial risks from climate change into their financial risk management practices and

(ii) To develop approaches to disclose financial risks from climate change.

The Guidance recommended that the institutions should benchmark the recommendations of the **Task Force on Climate-Related Financial Disclosures (TCFD)** as the basis for disclosure of climate-related risks. The TCFD was set up by the Financial Stability Board in 2015 to develop voluntary disclosure recommendations for use by companies in reporting climate-related financial risks.

The CBK's guidance was operationalised by the **Climate-Related Disclosures Template** which was issued by the Kenya Bankers Association. The template is based on the four pillars of the TCFD framework, namely, governance, strategy, risk management and metrics & targets. This template provides guidance to financial institutions in reporting their climate-related risks and opportunities thereby enhancing transparency. The template is accessible to all commercial banks licensed by the CBK.

Following the issuance of the CBK's guidelines, the Nairobi Stock Exchange (NSE) in partnership with the Global Reporting Initiative (GRI) issued the **Nairobi Securities Exchange ESG Disclosures Guidance Manual** in November 2021. The manual is applicable to all entities listed on the NSE and seeks to provide guidance on how listed companies in Kenya can collect, analyse, and publicly disclose ESG information using an approach that meets international standards on sustainability reporting. The manual was further issued to create certainty on which frameworks listed companies should adopt for ESG reporting by recommending adoption of the GRI standards.

The manual requires listed entities to report annually on their ESG performance by either including a sustainability/ESG report in their integrated annual reports or in separate ESG reports. It is important to note that the manual is not limited to only listed companies but can be adopted by other entities. The manual mandates all listed companies to report on topics such as governance, stakeholder engagement, taxes, anti-corruption, human rights, labour and working conditions, occupational health and safety, consumer protection and environmental compliance, among others.

## UGANDA'S JOURNEY TOWARDS ESG ADOPTION-A WORK IN PROGRESS

Although Uganda's efforts towards sustainability and ESG adoption cannot be compared with its counterparts in the East African Region such as Kenya and Rwanda, the country is taking steps towards the right direction with the Government taking steps such as making commitments to achieving net zero status by 2060 and achieving the SDGs by 2030. Just like in Kenya, the financial services sector spearheaded by the Bank of Uganda (BOU), Uganda Bankers Association (UBA) and the Insurance Regulatory Authority(IRA) are at the helm of advocating for sustainability and the uptake of good ESG practices. The Capital Markets Authority (CMA) has also taken steps to ensure that the listed entities are complying with good governance practices.

The ESG regulatory framework cuts across several laws covering the three parameters of environment, social and governance as highlighted below.

### ENVIRONMENT

**The National Climate Change Act, 2021** was passed following Uganda's ratification of international agreements on climate change such as the Paris Agreements, the Kyoto Protocol, and the United Nations Framework Convention on Climate Change. The Act operationalises Uganda's commitment to reducing carbon emissions and achieving net zero among others. It further provides a regulatory framework for monitoring, verifying, and reporting effects of climate change and measures taken to combat climate change. Important to note is the provision imposing climate change obligations on private entities and individuals however this is yet to be operationalised by the regulations which are yet to be enacted.

The above law is supplemented by the **National Environment Act, 2019** which seeks to protect the environment against climate change, hazardous waste, and management of waste. It establishes the National Environment Management Authority (NEMA) charged with enforcing the provisions of the law.

Several Regulations have been enacted subsequent to this Act including the **National Environment (Waste Management) Regulations, 2020** which provide for among others, the disposal of waste, enforcement of environmental, health and safety measures concerning the personnel handling hazardous waste, the control of emissions, discharges and contamination of the environment, the protection against exposure to noxious fumes among others. One of the key requirements under the Act and the Regulations

is for entities undertaking specific projects that affect the environment and communities to carry out Social and Environmental Impact Assessments (SEIA) to determine the effect of their activities on the environment and communities in which such projects are to be implemented.

Cognisant of the petroleum activities currently underway in the Albertine region, the **National Environment (Oil Spill Prevention, Preparedness and Response) Regulations, 2020** were enacted to protect the environment against oil spills and to put in place measures and mitigation plans to prevent such spillage. These Regulations further impose a duty on the licensees under the oil projects or persons operating an oil storage, processing, or distribution facility to prevent an oil spill.

These laws do not strictly require entities to report on compliance with the various laws therefore disclosure is majorly voluntary with just a handful of Ugandan companies majorly listed entities and international companies reporting on compliance with provisions such as measures taken to protect the environment including reduction of carbon emission, carbon offsets and natural resource protection among others.

## CORPORATE GOVERNANCE

BOU and CMA have been at the forefront of this agenda. In 2022, BOU issued and is enforcing the **Consolidated Corporate Governance Guidelines** (the Guidelines) to promote good governance, transparency, and accountability of supervised financial institutions. The guidelines provide a framework for matters such as directors code of conduct, board and board committee composition, risk management and managing conflict of interest among others.

The above guidelines are preceded by **Capital Markets Corporate Governance Guidelines of 2003** (CMA Guidelines) which apply to all listed companies and issuers of public debt in Uganda. The provisions of the CMA Guidelines are similar to those issued by the BOU. The CMA is in the process of enacting Corporate Governance Regulations applicable to all listed entities and market intermediaries such as stockbrokers. The Regulations introduce matters such as equitable treatment of shareholders, they apply or explain principle which requires entities to apply the corporate governance principles provided for within the Regulations or to explain any departure from the same. They further introduce disclosure requirements relating to director remuneration, confirmation that the business will continue as a going concern and the sustainability of the company's business model among others.

The above corporate governance guidelines are currently enforced together with the provisions of the **Companies Act, 2012** which requires public entities to adopt a code of corporate governance of their preference or in the alternative adopt the code of corporate governance (Table F) provided for within the Act. The Act further requires companies to annually file a statement of compliance with the Registrar of Companies and the CMA. As part of its enforcement measurements, the CMA issued a notice requiring all public companies which have not adopted any code of corporate governance to file a compliance statement confirming compliance with Table F by 31 March 2024.

In addition to the above framework, BOU and UBA are in advanced stages of developing a framework to incorporate sustainability into the financial sector with the aim of creating certainty and uniformity with regards to ESG adoption and disclosure.

## SOCIAL

Social considerations are embedded in laws such the **Employment Act** which provides for employee rights and fair treatment of employees, the **Occupational health and Safety Act** which provides for protection of employees at the workplace and workers compensation and the **Data protection Act, 2019** which protects personal data of individuals including their names, identification documents among others.

# 2.0 CHALLENGES DELAYING UGANDA'S SUSTAINABILITY JOURNEY.

## 1. ESG regulatory and disclosure framework

As noted above, currently there are various laws governing the different ESG parameters with just a few of these obliging entities to report and disclose the compliance and adoption. This has led to entities considering the uptake of ESG as a good to have and not a must have. Additionally, the absence of a framework providing guidance on the nature and form of information to be disclosed to the public with regards to adoption of good ESG practices is further slowing down the advancement of the ESG agenda in Uganda. This in turn makes reporting costly with different entities looking to the different available international reporting frameworks such as the GRI or TFPC or merely ignoring the need to disclose any ESG-related information. Currently, ESG disclosures are embedded within annual reports with just a handful of entities issuing a sustainability report.

## 2. Enforcement

Uganda has several laws governing the various ESG parameters, and their enforcement lies in the hands of various regulators who face challenges in enforcing the provisions of the law. This creates reluctance among entities to comply and adopt the initiatives and regulatory requirements. A case in point is the ban on Kavera in Uganda which is yet to implemented fully. This notwithstanding, there are sector-driven initiatives to drive the ESG/ sustainability agenda. For example, the banking and insurance sectors are at the forefront of ESG/ sustainability adoption, with the Bank of Uganda and Insurance Regulatory Authority focusing majorly on the aspects of governance.

## 3. Awareness

There is a general lack of knowledge of the benefits to be derived from the adoption of sustainable business practices or the demerits of the failure to adopt such practices which has slowed down the adoption of ESG. Few entities are aware of the benefits that come with good ESG practices and those who know are still struggling with how to incorporate such parameters in their strategies and risk management frameworks. There is therefore a need for regulators and associations such as the Uganda Bankers Association, the Insurers Association, Private Sector Foundation (PSFU), and the Uganda Manufacturers Association to sensitise their members about the benefits of ESG adoption as well as how they can integrate good ESG practices in their businesses.

# 3.0 CONCLUSION

The relevance of sustainable business practices/ESG can no longer be overlooked as various stakeholders are becoming increasingly aware of the need for companies to not only focus on creating shareholder value but to be accountable to the people and environment in which they operate. Countries are undertaking various initiatives to ensure that they comply with not only the SDGs but also international best practice. This has not only required countries to enact specific laws/frameworks but has led to specific sector regulators and associations championing the move towards adoption of good ESG practices. Uganda should ensure that it is not left behind on this important global agenda as this will pose dire consequences.

Plot 2702 Block 244 Nyangweso Road off Kironde Road Tankhill Muyenga P.O. Box 8002, Kampala
Tel:+256 312 343 400, Email: secretariat@ugandabankers.org, www.ugandabankers.org