FINANCING A SUSTAINABLE ECONOMY

Draft Technical Paper
Released May 2020

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2020

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National Treasury
REPUBLIC OF SOUTH AFRICA

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CONTEXT: SUSTAINABLE FINANCE

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- How does the world deal with **global problems** that are not limited to individual countries: 2008 global financial crisis, COVID-19, Climate Change
- G20 Financial Stability Board in 2015 considered impact of stranded assets as a risk to financial stability. G20 Sustainable Finance Working Group.
- Increasing demand by investors for companies to disclose their climate risks and GHG emissions (e.g. LSE, JSE, WEF, UN's Global Investors for Sustainable Development Alliance (GISD))
- SA Signatory to UNFCCC, Paris Agreement, submitted Nationally Determined Contributions (NDC) and NCCRP, Climate Change Bill
- SA economy is highly carbon intensive- the 13th highest emissions per capita in the world
- Physical risks, arising from damage to property, infrastructure, and land. Exposures manifest themselves through increased default risk of loan portfolios or lower values of assets; increased insurance claims and/or premiums
- Transition risk, results from changes in climate policy, technology, and consumer and market sentiment during the adjustment to a lower-carbon economy.
- NDP and Just Transition: recognising Climate Change as a Social Justice Issue

Physical Risks

Transition Risks

CONTEXT: TECHNICAL PAPER

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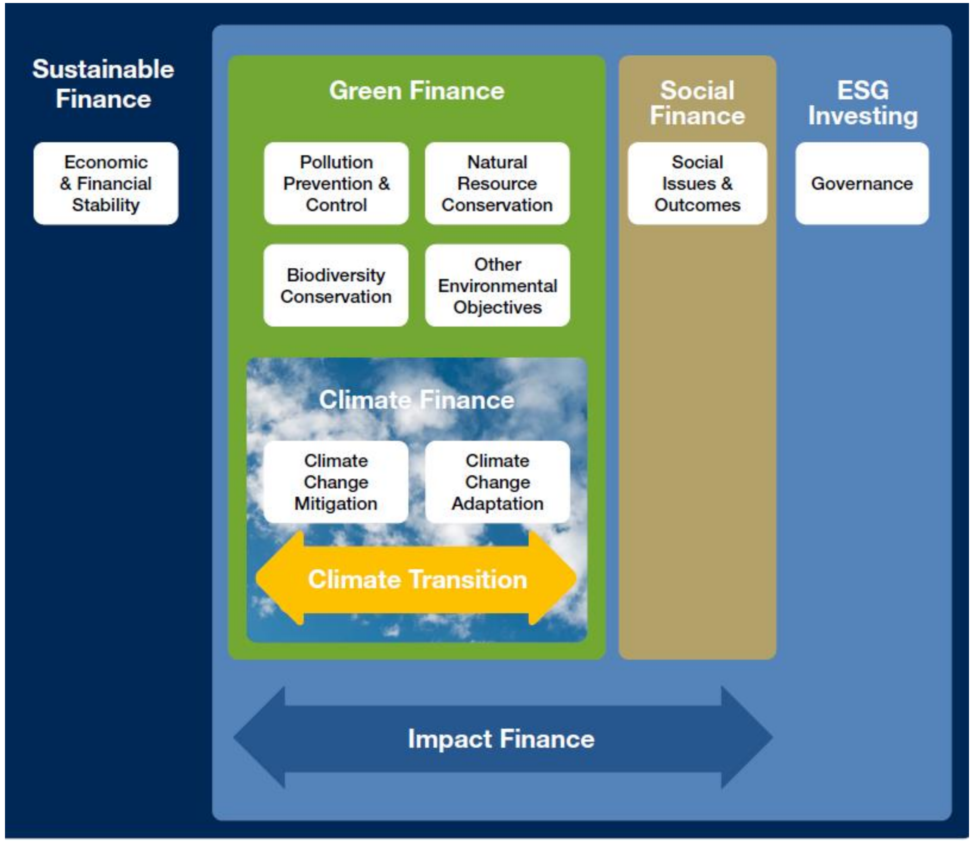
- Treasury and SARB **financial stability mandate** is to protect SA economy and citizens from shocks to the financial system, building resilience through solvency and effective risk management
- Climate risk is a financial risk
- For financial institutions- this requires identifying, managing and disclosing environmental and social risks in their portfolio through strengthening the regulatory framework and uptake of best practices
- Treasury initiated a process in 2016 which culminated in the publication in May 2020 draft technical paper Financing a Sustainable Economy
    - South African Reserve Bank , Prudential Authority, Financial Sector Conduct Authority
    - Department of Environment Affairs, Forestry and Fisheries (DEFF)
    - South African Insurance Association (SAIA); Banking Association of South Africa (BASA)
    - Association for Saving and Investment South Africa (ASISA); Johannesburg Stock Exchange (JSE)
    - Batseta – Council for Retirement Funds
    - SA Development Finance Institutions (DFIs) and Department of Monitoring and Evaluation (DPME), SAICA, SAVC, PRI have since been included in the working groups to take forward recommendations

OBJECTIVES

- The technical paper includes recommendations on sustainable finance initiatives to be undertaken in **financial services industry**: Banks, Retirement funds, Capital Markets, CIS, Insurance, Private Equity and Venture Capital
- Objectives
  - Define sustainable finance (mainly related to climate change mitigation) for all parts of the South African financial sector
  - Take stock of the global and national financial sector policy, regulatory and industry actions taken to date in dealing with environmental and social (E&S) risks and opportunities
  - Identify market barriers to sustainable finance and the implementation of E&S risk management best practices.
  - Identify gaps in the existing regulatory framework and recommend actions required of regulators, financial institutions and industry associations.
- Released in May; comments received & paper being updated
- Climate Risk Steering Committee established with 5 working groups
- Website updated: http://sustainablefinanceinitiative.org.za/

SUSTAINABLE FINANCE DEFINITION

- **Sustainable finance** encompasses financial models, products, markets and ethical practices to deliver resilience and long-term value in each of the economic, environmental and social aspects and thereby contributing to the delivery of the **sustainable development goals** and **climate resilience**
- This is achieved when the financial sector: Evaluates portfolio and transaction-level environmental and social risk exposure and opportunities, using science-based methodologies and best practice norms; discloses and mitigates these risks and links these to products, activities and capital allocations
- An evolving area and emergent global practice and trend
- Starting with **climate risk**
- Recognises opportunities for attracting green and social finance to build a more sustainable, low carbon, green economy
- The paper encourages a voluntary approach to sustainable finance initiatives



Source: International Capital Markets Association, May 2020

INDICATIVE CHALLENGES AND SECTOR RECOMMENDATIONS

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- Sustainable **banking** initiatives are not currently supervised by the PA or the FSCA. Regulators are unable to draw conclusions on exposure to climate change and other ESG risks from published information. Recommend further analysis on feasible regulatory instruments
  - Co-develop technical guidelines to facilitate implementation and disclosure on performance with regard to addressing climate and other key environmental and social risk management.
  - Develop capacity building and technical training programmes to enable regulators and directors of banks to exercise sufficient oversight and bank management teams to implement sustainable finance strategies.
- **Insurance** survey by PA 2019: 79% of respondents surveyed believe that climate change will affect their business but only 37% already report on information relevant to climate change impacts. Recommend PA to consider tools and instruments that can assist with identification, assessment and reporting of material risks, including emerging risks
- Retirement funds and asset managers to develop and disclose E&S risk management policy frameworks and governance systems in line with the recommendations in the Guidance Note published in 2019.

KEY RECOMMENDATIONS

Develop a taxonomy for green, social and sustainable investments

- Starting with Green
- Financial classification, common language
- Coordinated and consistent approach to determine eligibility
- EU adapt and adopt
- Transitional activities and social disclosures

Co-develop technical guidance for disclosures as per TCFD

- Principles for disclosure
- Technical requirements
- Possible regulatory mechanisms

Develop a benchmark scenario for use in stress tests

- Regulators and Treasury group at this stage
- Exploring weather scenarios; models
- Start with insurance and banks
- SARB as a member of NGFS

Build sector capacity and competencies

- Needs survey done
- General awareness raising events planned
- Starting with Fin sector and regulators
- TCFD requirements

NEXT STEPS

- Mapping SF instruments and applicability to SA (additional working group)
- Working groups consist of industry specialists looking at technical aspects; develop common assessment and common purpose
- Incorporating broader stakeholder consultations as drafts are developed
- The FSCA and PA to engage with the sector and undertaking further analysis on the feasibility of regulatory instruments
- Finalise an Action Plan

- Manageable starting point to mobilise the financial sector to move towards more responsible practices that will ensure a stable, resilient and competitive economy
- Building on a sustainable finance narrative in SA and networks of cooperation and coordination- to move forward, develop an action plan
- No silver bullet, requires an integrated response
- Incorporate transitional activities and social safeguards
- Fiscal constraints
- Create investment opportunities for local and international finance into green, low carbon economy