

Embedding the Green Finance Taxonomy into Asset Management Investment Decision-Making

Findings and recommendations based on piloting activities with market actors to embed the taxonomy

September 2022

Case Study

During 2022, a series of pilot implementation projects with volunteer organisations, trialled embedding the South African Green Finance Taxonomy (SA GFT) for their processes. This is one of four case studies showcasing the **complexities and potential value for asset managers**, and the wider financial ecosystem. **The SA GFT can be a valuable tool in investment decision-making across asset classes**, including private and listed debt and equity, **and aid standardisation and transparency concerning “green” products.**

Work was carried out by the National Business Initiative (NBI) and Carbon Trust. Oversight for this project was provided by the Taxonomy Working Group, chaired by the South African National Treasury, the members of whom we warmly thank for their engagement and contributions. Embedding the South African Green Finance Taxonomy is supported by the UK PACT (Partnering for Accelerated Climate Transitions), which is a flagship programme under the UK’s International Climate Finance (ICF) portfolio. The programme is jointly governed and funded by the Foreign, Commonwealth and Development Office (FCDO) and the Department for Business, Energy and Industrial Strategy (BEIS). The UK is committed to tackling climate change and is investing £11.6bn via ICF over the five years to March 2026.

Special thanks go to the participants of the pilots, whose efforts and engagement were vital to the process and outcomes, and whose learnings and insights are represented in this case study series:

- > Development Bank of South Africa (DBSA) led by Saphira Patel, Head: Environmental and Social Sustainability Unit
- > Metier Private Equity led by Galelekile Makhathini, Investment Executive ESG Officer
- > Old Mutual Africa Infrastructure Investment Managers (AIIM) led by Tania Swanepoel, ESG Advisor
- > Sanlam Corporate Investments led by Tshegofatso Sekgwele, Investment Specialist
- > Standard Bank Group led by Anneke Lund, Executive: Sustainable Finance
- > The City of Tshwane led by Dolly Mafa, Director Sustainability Finance Mechanisms

This case study is applicable to:

Asset managers; private equity investors; fund managers; venture capitalists; securities exchanges; listed companies; financial instrument issuers

Ways of Working

Successful implementation of the taxonomy in asset management and private equity investment decision making would have vast implications for sustainable financial flows in South Africa. A shift toward greener investments would impact the allocation large volumes of capital, which indirectly, would place pressure on organisations to report and improve their taxonomic alignment, impacting a significant portion of the national economy.

To begin to demonstrate the opportunity for implementing the SA GFT, pilots were designed in collaboration with asset managers and private equity firms to:

- > Test process readiness to integrate the taxonomy into investment diligence.
- > Identify gaps and obstacles to ascertaining and achieving taxonomic alignment in existing investments.
- > Develop tools and highlight actions for resolving these issues.

Implementation routes and processes were developed through the following activities, that can now be built upon and embedded:

- > **Assessment for taxonomic eligibility of portfolios' constituent investments:** the mapping of an underlying investment's operations to the economic activities defined in the SA GFT and reporting high-level alignment.
- > **Assessment of assets' alignment to the SA GFT:** checking whether data is available to prove that all Make Significant Contribution (MSC), Do No Significant Harm (DNSH) and Minimum Social Safeguard (MSS) criteria within the identified economic activity are adhered to.
- > Identifying areas of opportunity for ecosystem development through tools and templates

Stemming from these pilots, the following generic tools and templates have been designed and are available for use (please see additional resources at Taxonomy Working Group | South Africa Sustainable Finance Initiative):

- **GFT Eligibility Template:** helps to map activities to the economic activities in the taxonomy and reporting taxonomic eligibility.
- **GFT Alignment Tool:** based on results of the eligibility tool, each economic activity can then be assessed for taxonomic alignment.

Results and Insights

Relying on existing processes

Asset management and private equity involve several niche considerations and the financial flows, investment decisions and due diligence considerations can vary significantly. However, across pilots it was noted that due diligence processes tended to require assessment of particular documents, which were therefore generally available and also useful for SA GFT DNSH evaluation. Namely:

- > **Environmental and Social Impact Assessment (ESIA):** required for designated activities listed under the National Environmental Management Act, as part of obtaining Environmental Authorisation
- > **Environmental and Social Management Plan (ESMP):** site specific implementation guidance tool for environmental and social impacts management
- > **Environmental Management Programme report (EMPr):** Mitigation and monitoring of negative environmental impacts identified in environmental assessment
- > **Integrated Waste and Water Management Plan (IWWMP):** provision made for collection, storage and disposal of waste and water management. Articulates the required management measures and actions to achieve the water and waste related performance on an ongoing basis
- > **Environmental and Social Action Plan (ESAP):** Ongoing monitoring to track activities to completion
- > **Waste Management and Water Use Licences:** legal requirements

While this was the case for large-scale project finance investments, the same types of documents were not as often available for smaller investments which may not meet internal materiality thresholds. See Table 1 for further insights and recommendations.

Making extra-jurisdictional investments

It has been suggested that the European Union (EU) Sustainable Finance Taxonomy (SFT) regulations will affect investments made by EU investors wishing to report eligible investments, including if those investments are made outside of the EU. The European Commission¹ have asserted that to provide sufficient time for non-EU companies to adjust to this requirement, the information is likely to be a mandatory inclusion in reporting from 1 January 2025. To ensure international collaboration and coordinate interoperability, the International Platform on Sustainable Finance (IPSF) has started a working group on taxonomies co-chaired by the EU and China. This effectively subjects any investments inside and outside of the region to report taxonomic eligibility and later alignment as per their regulations.

The team found across many investment funds, finance flows from the EU to and through South African firms into other African countries. The question was therefore raised, as to how to assess these types of investments.

¹ European Commission, FAQ: What is the EU Taxonomy Article 8 delegated act and how will it work in practice?

While the international recognition and interoperability of the SA GFT with the EU Taxonomy is under consideration, it is already useful that the SA GFT shares similar principles and detailed localised technical criteria. It is suggested, to maintain and attract EU finance into South Africa, or via South Africa, application of the SA GFT is beneficial, including for investments into the neighbouring region.

This is notwithstanding that other African countries have adopted and developed their own taxonomies, and that there have been suggestions of regional taxonomic developments.

Due to the EU and SA taxonomies potentially playing a role in extra-jurisdictional investments, as well as regional and national taxonomy developments, we have proposed a decision tree to aid in stringent selection of taxonomic criteria.



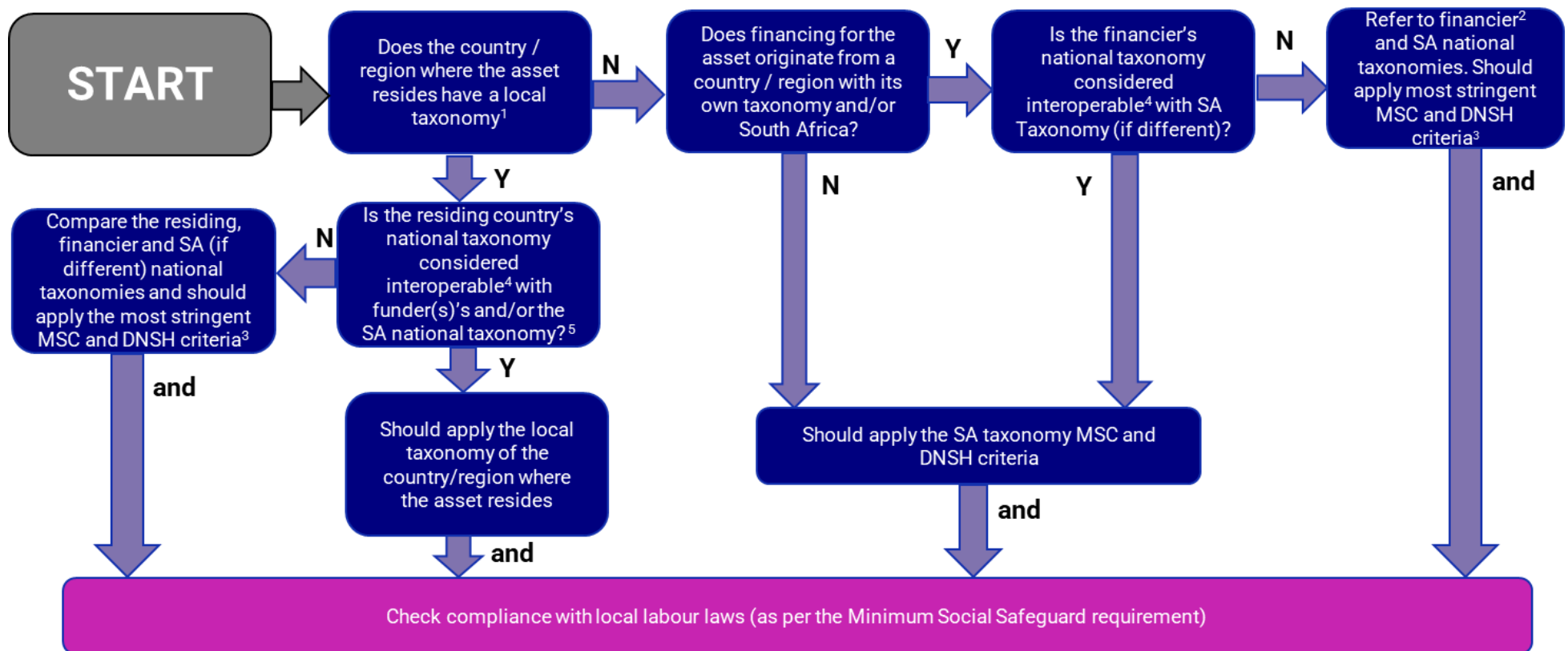


Figure 1: Decision tree for extra-jurisdictional investments

1 Green taxonomies currently exist for the EU, China, Russia, Singapore, Malaysia, Mongolia and Bangladesh. Check whether there is a national taxonomy in the country where the asset resides.

2 Note that the Common Ground Taxonomy can be referred to for a comparison between the EU and China taxonomies. Most stringent criteria was applied.

3 Most stringent performance threshold, must comply with local regulation, consider local environmental and social performance contexts, risks and impacts.

4 Refer to latest documentation from authorities

5 If there are funders from multiple jurisdictions investing in an asset, determining interoperability may become difficult. Refer to investment strategy and financier specifications

Data gaps challenge DNSH reviews

The most pressing result was that no assets tested through the pilots could be shown to be fully taxonomically aligned, with most assets being partially aligned. This was most often because data gaps were prevalent concerning environmental and social impact and performance.

- > These data gaps often hindered the process to demonstrate compliance with the SA GFT's Do No Significant Harm (DNSH) criteria. One premise of the SA GFT is that activities triggering DNSH do harm or adds to system risk; as such it may form part of risk management in due diligence and investors should be cognisant of such issues for informed decision-making. The inability to test alignment for DNSH was concerning because, while the lack of data meant the assets' conformance could not be positively demonstrated, it also meant that performance that might trigger disqualification could also not be detected. In cases where technical elements of the project required consideration of physical climate risk, for example flooding in the design of a hydroelectric dam, then these were well modelled.
- > While the criteria to undertake a Climate Risk and Vulnerability Assessments (CRVA) as per the climate adaptation requirements in DNSH may have been partially undertaken through resilience assessments in Environmental Social Impact Assessments (ESIAs), in all cases the full extent of the criteria were not met.

This sort of data gap and assessment challenge is likely to be an implementation challenge for asset managers, and other financial sector actors.

Addressing key implementation challenges

Since data availability is noted to be a significant barrier to success for SA GFT implementation – but also more widely for effective ESG management, this case study's recommendations focus on:

- > Addressing data issues; and thereafter,
- > Developing readiness and capabilities for applying the data to assessment and decision-making.

Solutions to these key SA GFT implementation challenges, may be categorised as

- > **"Easy-to-implement"**: these are relatively straight-forward applications that demand minimal or easy adjustments to existing processes, and already begin to value-add through additional insights.
- > **"Transformational change"**: solutions that demand intentional intervention and greater effort and resource to implement, but promise longer-term value-adds in the effort to shift portfolios.

Table 1: Insights and recommendations for asset managers and private equity firms

Easy-to-implement interventions	Transformational interventions
<p>Eligibility screening: for project finance or scenarios whereby ring-fencing financial flows to specific economic activities is simple, taxonomic eligibility should be assessed and reported. This allows transparency as to whether investments meet the first principle of assessing taxonomic requirements and to what extent the portfolio can be assessed for alignment in future.</p> <p>Taxonomic alignment readiness reviews and data gap analyses: for eligible finance, an understanding of where current due diligence systems encompass data requirements and where they do not is an important first step. While MSC criteria vary per economic activity, DNSH criteria are often similar across, for example the requirement of a climate risk and vulnerability assessment, and MSS criteria are the same for all activities. Therefore, portfolios can be retrospectively scanned for compliance as a way to spot gaps that need to be addressed for future assets.</p> <p>A useful first step would be to require asset-level alignment reporting if possible and an explanation if not possible. This ‘comply-or-explain’ model is used in the regulation of financial institutions in the EU under the reporting directive.</p> <p>Due diligence integration: for many large project finance deals, particularly if the investor is a majority shareholder, it was often noted that either all or part of the International Finance Corporation (IFC) Performance Standards are applied as part of the pre-investment phase due diligence process. There is significant overlap between the IFC Performance Standard requirements and the SA GFT DNSH. Therefore,</p>	<p>Increased resource capacity: for smaller private equity firms, sustainability teams are likely to be under resourced to take on additional rigorous diligence and reporting. Considering the movement towards increased assessment and disclosure expectations, not limited to the SA GFT and frameworks such as the Task Force on Climate-related Financial Disclosures (TCFD), it would be beneficial to increase resources in this area. The benefits include improved communication with stakeholders concerning the environmental and social performance of investments.</p> <p>Pressure on organisational reporting: the taxonomy requires economic activity-level reporting and data collection. For listed equity or general listed debt (other than use of proceeds), this may cause a challenge as typically these investments don’t disclose sufficiently granular information that would enable asset managers to assess against the SA GFT. In the absence of upfront disclosure of this type and level of detailed information from investees, individual asset managers would have to undertake an additional taxonomic alignment assessment.</p> <p>In the absence of regulatory requirements, the pressure for investees to provide this level of information, must come from within the market. If this pressure comes from investors through more detailed and effective ESG engagement, then there is likely to be a shift in the way that listed organisations report.</p> <p>Materiality considerations: for deals that currently do not undergo rigorous due diligence processes due to size or a low perceived risk, the integration of taxonomic requirements will be</p>

if this type of due diligence is already an integrated part of the pre-investment phase process, then there is a high potential for effective streamlining. However, for smaller deals or when the investor is a minority shareholder due diligence processes may not be as robust. In this case, intervention would need to be transformational.

Design phase involvement: if investors have influence or are involved during the project design phase, it would be highly impactful to consider taxonomic requirements while planning the project. In that way, taxonomic alignment becomes a key design consideration and may justify improving performance if it had not been considered, and therefore it is of course easier to evidence and report.

Internal capacity building: while internal sustainability teams may support taxonomy application, buy-in from across the organisation, including trustees, may require additional effort and demonstration of strategic importance. It is important to disseminate knowledge and opportunities throughout the business and to build internal capacity, to increase the likelihood of successful uptake.

complex and challenging. However, if green finance is sought for these projects or bundles of these projects, taxonomic alignment assessments will be required.

Therefore, materiality thresholds and the potential for process streamlining is necessary.

Reporting and strategy: as taxonomic considerations are integrated into decision-making; asset managers can begin to report taxonomic alignment on fund and portfolio level, which has been noted of particular interest to some asset owners. Taxonomic alignment may also be applied to determine the structuring of funds or portfolios to appeal to a growing investor group.

Progressive alignment target setting and reporting changing taxonomic alignment data over time can be used to demonstrate commitment to SDGs and green economy development objectives.

Taxonomic development: the SA GFT will continue to develop with additional economic activities and environmental objectives added. This will expand the options against which funds and portfolios can report taxonomic alignment and prioritise sustainability areas.

If thoughtfully integrated, the SA GFT has the potential to stimulate climate change action and increase green finance in the private sector. This case study provides an indication of the readiness of asset management and private equity to integrate taxonomic considerations, and where these actors should support action to address implementation challenges, opportunities for streamlining, and other considerations for success.

Disclaimer: this case study is based on experiences of individual organisations through limited applications, and recommendations are based on general insights. The piloting process and this case study are part of the broader South Africa-UK PACT project overseen by National Treasury; however, this case study is not endorsed by National Treasury, nor does it express the views of National Treasury.



Embedding the South African Green Finance Taxonomy is supported by the South Africa-UK PACT (Partnering for Accelerated Climate Transitions) programme, jointly governed and funded by the UK Government's Foreign, Commonwealth and Development Office (FCDO) and the Department for Business, Energy and Industrial Strategy (BEIS) through the UK's International Climate Finance.