

Opportunities for Emerging Market Development Banks

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 1st edition (SA GFT) for their processes. This is one of four case studies showcasing the taxonomy **as a valuable opportunity for emerging market development banks to align their investment decisions with leading practice and attract international finance**. In undertaking pilot projects, several learnings and insights were noted in embedding the taxonomy into development bank reporting frameworks which are presented in the following case study.

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 and Mphakiseng Zuma, GFS: Office of the CFO

This case study may be applicable to:

Development banks; international funders; national and sub-national governments

Ways of Working

The SA GFT is of high interest to Development Finance Institutions (DFIs) due to the mandate for stimulating sustainable development. Furthermore, DFIs in emerging markets are often vehicles for foreign direct investment (FDI) and support significant financial flows. The SA GFT has the potential to be integrated into DFI decision-making, as a tool to tag and direct finance toward high quality green projects, and to attract international investment from highly discerning investors and those with interests aligned to regulatory developments in international markets. DFIs are often already undertaking substantial ESG processes and demanding internal and external reporting; SA GFT integration with existing processes (to the extent possible) has been esteemed as the preferred approach for implementation.

The pilot processes captured SA GFT embedding opportunities, undertaking the following activities:

- > Understanding mechanisms for selecting, monitoring, and reporting project performance indicators
- > Understanding internal and external reporting obligations and priorities, including reporting to funders
- > Providing recommendations for integrating taxonomic considerations into DFI reporting frameworks

Simplistically stated, DFIs follow a cycle of reporting determined by internal sustainability strategy, funder requirements, and external reporting requirements. These levers determine the selection, monitoring and reporting of project performance metrics.

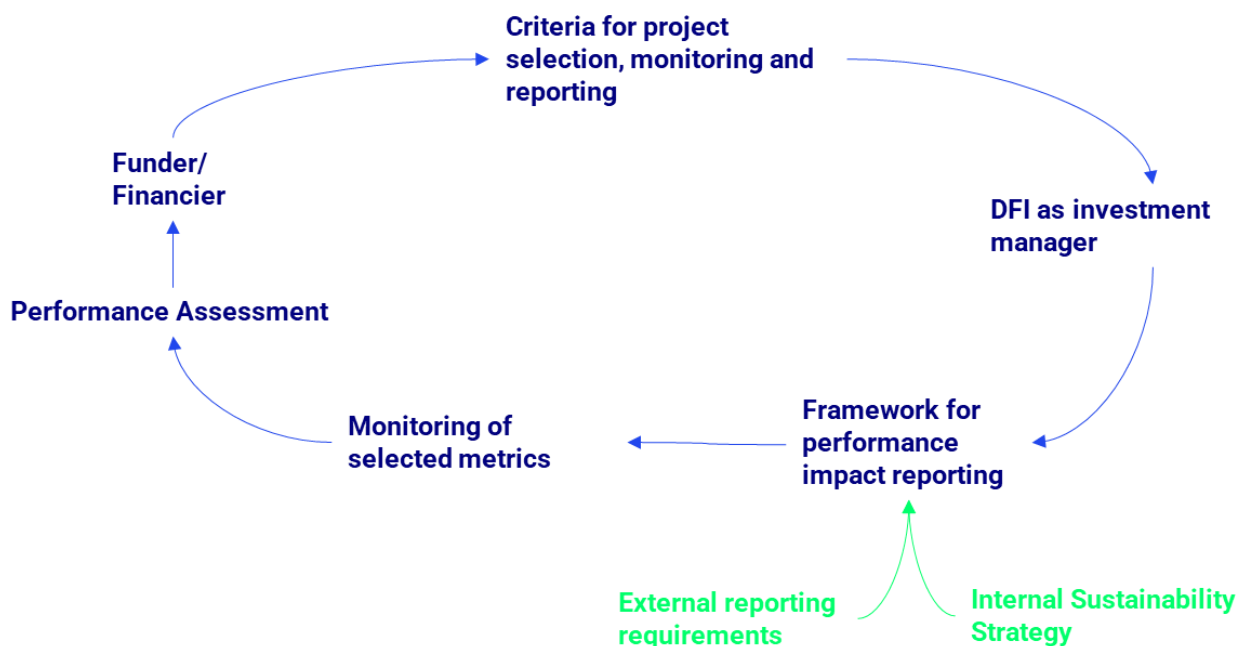


Figure 1: Process flow depicting the monitoring and reporting of project performance indicators

The GFT is a definitional tool that could be integrated into these processes and add to the standardisation of green projects, aligning with international best practice for sustainability reporting and attracting FDI with high quality investments.

Opportunities and Impact

The EU Taxonomy is now mandatory for financial market participants and large companies covered by the Non-Financial Reporting Directive (NFRD) which excluded non-EU companies until 2025. Applying a staggered approach, covered organisations and applicable financial products must report taxonomic eligibility for their 2022 activities, and then eventually taxonomic alignment. These requirements extend to any EU investments abroad. Similarly, the expectation is that over time other global taxonomic regulations will apply such regulations over their investments.

The SA GFT was developed with the EU Taxonomy as its foundation. The positioning and connectivity of the South African economy in global

economic and financial systems is such that alignment to the shifting expectations of international finance, and especially European practice, is essential. Therefore, there is both a risk and opportunity for DFIs to integrate SA GFT principles and foreign investment rests in the balance.

Emerging market DFIs therefore stand to benefit from aligning internal processes with the SA GFT to increase alignment with international best practice.

We also anticipate further benefits from implementation, set out in the schematic below.



Engage with a developing ecosystem

- We've noted through engagements with market participants and regulators that the ecosystem is gradually embedding GFT principles into ESG thinking
- Embedding the GFT into systems and processes is no longer a risky undertaking



Prepare for regulatory advancements

- The GFT is a voluntary tool. Regulators likely to issue guidance around GFT reporting and await organic market readiness
- We see mandatory enforcement to occur once GFT reporting is already the status quo due to market pressure



Maintain international standing

- EU FIs and DFIs investments are the first to require taxonomic reporting, this is a trend likely to gain momentum
- The interoperability between national and international taxonomies is key to accessing foreign direct green investment



Advance sustainability agenda

- There is a risk that green investments and reporting is inadequate and unaligned with net zero targets
- The mitigation of greenwashing and standardisation of green reporting is a significant opportunity for DFIs

Results and Insights

The SA GFT as a supplement to the role of DFIs

DFIs play an important role in the flow of investment in emerging markets. They are definitively market-makers investing into projects that may have more complex value models than commercial banks have appetite for but are essential to economic development. For example, early-stage technologies and high-risk sectors.

The SA GFT and DFIs have a compatible mandate. There is potential for DFI's to align their processes to the SA GFT by making relatively modest changes and enhancements to existing evaluation and reporting processes. In so doing, the DFI may attract / maintain existing FDI which is critically being driven towards this alignment expectation for EU investments.

SA GFT criteria could strengthen internal processes, especially in not allowing room for a trade-off between social and environmental contribution which is embedded in the do no significant harm (DNSH) criteria. This is consistent with a risk- and impact-mitigated approach. Furthermore, the SA GFT sets out the assessment criteria which could add to / streamline existing evaluation processes. Standardisation of criteria for green economic activities reduces an obstacle to investment in providing clarity and reducing uncertainty when reporting performance to impact-orientated investors and financiers. The intention is that the SA GFT, though increasing the diligence effort, also increases market certainty and support. It has been noted internationally that implementation appears to raise the level and ambition of activity, supporting the mandate of a DFI through positive impacts for the economy and the environment.

DFIs tend to have well-established and resourced ESG teams who may readily understand how to use the taxonomy and systems that allow it to be integrated relatively easily, DFIs are therefore one of the most opportune locations in the sector for SA GFT integration.

The taxonomy within the ecosystem

The piloting process included the commercial banking, municipal and asset management sectors. We noted that SA GFT integration into sustainable finance issuance frameworks, procurement processes and investment decision making, each create a more standardised and robust approach to investment decision-making concerning green credentials and may stimulate market change in different ways, which could;

- > Encourage additional market adopters of the SA GFT,
- > Build a pipeline of investable aligned projects, and
- > Increase transparency in reporting.

These processes in conjunction with capacity building through DFIs may work to de-risk adoption of the GFT.

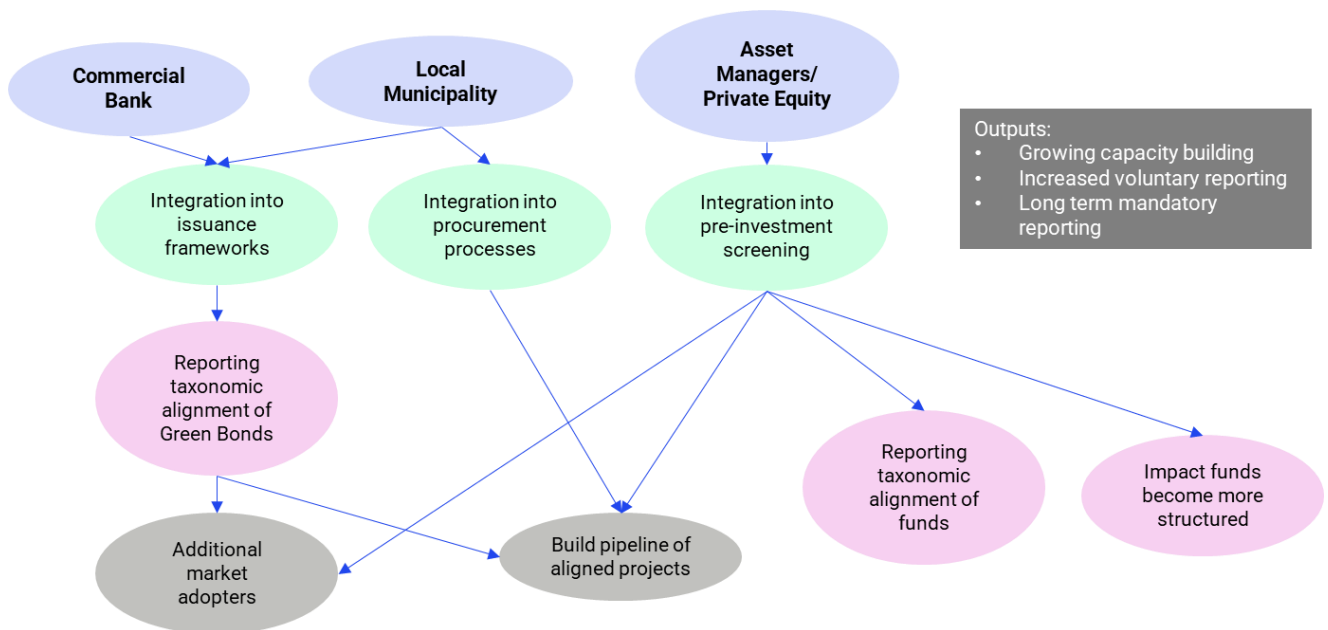


Figure 2: Indication of piloting results across sectors which may be of interest to development banks

The efforts of DFIs to embed the SA GFT into investment decision-making could increase momentum for uptake and integration of the SA GFT in the ecosystem. DFI integration will add to the signals already being sent by regulators that application of the taxonomy for green investments is key and may eventually underpin several regulatory processes.

Integration into due diligence

To be most effective, DFIs should consider integrating the SA GFT requirements into pre-investment screening processes and integrating reporting into mandatory project performance indicators. This could be done over time if needed. However, it is recommended that at a minimum Do No Significant Harm and Minimum Social Safeguard requirements are prioritised. Including:

- > Environmental due diligence assessments
- > Climate risk and vulnerability assessments (CRVA)
- > Assessment of contribution to one of the six environmental objectives in the GFT
- > Compliance with all national labour and employment laws

Enhancement and streamlining of reporting practices

Integrating the GFT into reporting processes provides an opportunity to enhance current reporting practices and streamline voluntary external disclosures. For example, the FSB Task Force on Climate-Related Financial Disclosure (TCFD) reporting requirements encourages the disclosure of climate-related risks and opportunities. The aim is to provide businesses with a foundation for understanding and addressing financial risks associated with transition and physical climate impacts, and to unlock opportunities. GFT alignment can be used as a realistic indicator of climate risk, in that the better the alignment of a project, business or portfolio, the lower the climate-related risks. Transition risk is decreased in that through GFT alignment it is demonstrated to be aligned to South African ambition for net-zero by 2050. Physical risk is reduced by demonstrating that assets are climate resilient via application of a CRVA.

Governance Disclose the company's governance around climate-related risks and opportunities.	Strategy Disclose the actual and potential impacts of climate-related risks and opportunities on the company's businesses, strategy, and financial planning where such information is material	Risk Management Disclose how the company identifies, assesses, and manages climate-related risks.	Metrics and Targets Disclose the metrics and targets used to assess and manage relevant climate-related risks and opportunities where such information is material.
a. Describe the board's oversight of climate-related risks and opportunities.	a. Describe the climate-related risks and opportunities the organization has identified over the short, medium, and long term.	a. Describe the organization's processes for identifying and assessing climate-related risks.	a. Disclose the metrics used by the organization to assess climate-related risks and opportunities in line with its strategy and risk management process.
b. Describe management's role in assessing and managing climate-related risks and opportunities.	b. Describe the impact of climate-related risks and opportunities on the organization's businesses, strategy, and financial planning.	b. Describe the organization's processes for managing climate-related risks.	b. Disclose Scope 1, Scope 2 and, if appropriate, Scope 3 greenhouse gas (GHG) emissions and the related risks.
	c. Describe the resilience of the organization's strategy, taking into consideration different climate-related scenarios, including a 2°C or lower scenario.	c. Describe how processes for identifying, assessing, and managing climate-related risks are integrated into the organization's overall risk management.	c. Describe the targets used by the organization to manage climate-related risks and opportunities and performance against targets.

Figure 3: Four pillars of TCFD disclosure (sourced from the TCFD Recommendations) and an indication of the pillars and recommendations that the GFT best integrates with in bold writing

The GFT alignment assessment and reporting process could effectively feed into the TCFD's strategy, risk management and metrics and targets reporting pillars. Furthermore, the TCFD's recommended indicators related to finance (TCFD Guidance on Metrics, Targets and Transition Plans) overlap well with GFT alignment reporting.

Challenges

Under a mandate to stimulate sustainable development, emerging market DFIs must direct finance thoughtfully. We found that while project performance indicators are informed by funders and strategy and defined by an internal reporting framework, in reality, the metrics tracked for projects are largely dictated by data availability, quality and the ability to track these indicators over time. There is a concern that stringent requirements may restrict the pool of projects eligible for funding.

E.g. While the SA GFT does not address this issue, it may assist teams in designing M&E strategies for prospective investments, so that both for deal diligence and for post-investment monitoring, a taxonomy-informed material series of performance metrics are considered. This would add to impact indicator frameworks applied.

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.



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