CONSULTATION RESPONSE

DRAFT NATIONAL GREEN FINANCE TAXONOMY, SOUTH AFRICA

14 July 2021

INTRODUCTION

The Principles for Responsible Investment (PRI) is the world's leading initiative on responsible investment. The PRI is now a not-for-profit company with over 4,000 signatories (pension funds, insurers, investment managers and service providers) to the PRI's six principles with over US $100 trillion in assets under management.

The PRI supports its international network of signatories in implementing the Principles. As long-term investors acting in the best interests of their beneficiaries and clients, our signatories work to understand the contribution that environmental, social and governance (ESG) factors make to investment performance, the role that investment plays in broader financial markets and the impact that those investments have on the environment and society as a whole.

The PRI works to achieve this sustainable global financial system by encouraging adoption of the Principles and collaboration on their implementation; by fostering good governance, integrity and accountability; and by addressing obstacles to a sustainable financial system that lie within market practices, structures and regulation.

The PRI welcomes the opportunity to respond to this consultation on the draft National Green Finance Taxonomy of South Africa from the National Treasury of South Africa.

PRI expertise on taxonomies

PRI has significant experience in the development of taxonomies worldwide. Working as a contributor to the High-Level Expert Group on sustainable finance and a member of the Technical Expert Group (TEG) on sustainable finance, the PRI helped shape the course of the EU Taxonomy regulation and technical screening criteria. In late 2019, the PRI organised the Taxonomy Practitioners Group in which investors, both EU and non-EU based, shared tools and experiences to help understand, and overcome, barriers to implementation of the Taxonomy. PRI published a report summarising the findings of 35 case studies in September 2020, including recommendations from the group to policy makers and supervisors who would oversee the implementation and development of the EU Taxonomy. The opportunity to provide expert advice on behalf of our signatories and in support of scientific expertise continues with the PRI's Chief Responsible Investment Officer, Nathan Fabian also working as Chair to the European Platform on Sustainable Finance.

Recently, PRI published an investor briefing on the EU Taxonomy which incorporates the Taxonomy climate delegated act published 21 April 2021. The PRI has also responded to consultations about sustainable finance taxonomies in Singapore, Russia and China.

ABOUT THIS CONSULTATION

The National Treasury with the support of the International Finance Corporation (IFC), part of the World Bank Group, is leading a project to develop a national green finance taxonomy (GFT) for South Africa. This project has been implemented by National Business Initiative (NBI) and the Carbon Trust and responds to recommendations in the draft Technical Paper on Financing a Sustainable Economy, published in May 2020.

The draft GFT draws on the detail and guidance provided by the EU Technical Expert Group on Sustainable Finance final report on the EU Sustainable Finance Taxonomy published in March 2020, as well as the EU Taxonomy regulation and EU Taxonomy Climate delegated act.

The project working group aims to create a GFT which:

- Helps bring clarity and certainty to the financial sector when selecting green investments in line with international best practice and South Africa’s national policies and priorities.
- Reduces financial sector risks through enhanced management of environmental and social performance.
- Reduces the costs associated with labelling and issuing green financial instrument.
- Unlocks significant investment opportunities for South Africa in a broad range of green and climate-friendly assets.
- Supports regulatory and supervision oversight of the financial sector.

For more information, contact

Elise Attal

Head of EU Policy

Elise.Attal@unpri.org

Hazell Ransome

Policy Analyst

Hazell.Ransome@unpri.org

KEY RECOMMENDATIONS

The PRI welcomes the draft Green Finance Taxonomy (GFT), its alignment with the EU Taxonomy and the detail it provides to help investors understand key concepts and undertake taxonomy disclosures. Taxonomies of sustainable economic activities defined by common, science-based, technology neutral technical screening criteria are a critical tool for sustainable finance[1]. They set a common language between investors, issuers, project promoters and policymakers, and help investors assess whether investments meet robust sustainability standards and are consistent with sustainability goals, such as creating a net-zero, resilient and sustainable economy.

The PRI's key recommendations are:

- **Maintain consistency with the EU Taxonomy and more importantly scientific evidence.** The consistency of the draft GFT and EU Taxonomy, at both framework and technical screening criteria level will strongly benefit investors. It will eliminate the burden of developing a knowledge base of the functioning of two taxonomies and reduce costs in developing analytical techniques to assess taxonomy alignment. Consistency between frameworks is needed and alignment with scientific evidence is crucial, particularly for future development, as both taxonomies expand to consider transitional activities and social aspects.
- **Clarify the ambition of the GFT and consider a mandatory framework in the future.** We welcome the adoption of the EU Taxonomy's definition of "climate change mitigation" and its link to the Paris Agreement. However, we encourage the National Treasury and IFC to be more precise about the overall target of the GFT and specify that "*in line with international best practice and national priorities*" means aligned with the Paris Agreement and South Africa's updated NDC. Furthermore, while a voluntary framework is a reasonable starting point, we encourage the National Treasury to consider a mandatory GFT in the near future to accelerate growth of sustainable investment practice and further encourage international alignment of taxonomy frameworks.
- **Increase usability of the draft GFT by clarifying the seven-step process, the climate adaptation and vulnerability assessments and the methodology for taxonomy alignment disclosures.** The sustainable finance taxonomy is a relatively new concept and so investors will welcome the granular step-by-step implementation process of the draft GFT. However, the current description and detail of some steps could be further clarified. Given that disclosure is voluntary, GFT implementation needs to appear as simple as possible. Therefore, we recommend presenting a more concise approach which only sets out key principles and definitions and examples of how to use the Taxonomy matrix. Further detail should be provided in the latter half of the document. In terms of disclosure, to provide comparability for consumers and clarity for investors, we recommend using a pie-chart format to disclose taxonomy alignment. Also, in addition to the clear examples provided, we recommend stating explicitly that all investments should be included in the denominator of taxonomy alignment disclosures, even those that cannot be judged against the Taxonomy (i.e. sovereign bonds).
- **Ensure future additions to the GFT have robust, science-based technical screening criteria.** We support the decision to remain aligned with the EU Taxonomy Climate Delegated Act and remove certain economic activities from the draft GFT. We also welcome the consideration of other activities that are not in the EU Taxonomy but relevant to South Africa, such as eco-tourism and

[1] See PRI's and the World Bank's policy toolkit: How policy makers can implement reforms for a sustainable financial system | Reports/Guides | PRI (unpri.org)

wildlife management. Taxonomies must reflect local needs and transition pathways. As the taxonomy is expanded in the future, new economic activities and thresholds must be aligned with a robust NDC.

- **Do not sacrifice ambition for the sake of practicality; instead, work to improve data availability.** A green taxonomy has a very specific role and purpose: to help investors identify, report on and ultimately finance activities with sustainable levels of environmental performance. Therefore, even though investors may face initial challenges with finding sufficient data on whether their investments are aligned with the technical screening criteria in the GFT, the ambition should not be lowered. Investors will need access to reliable and comparable data to enable them to disclose Taxonomy alignment. Therefore, the National Treasury should create a bridge between the GFT and the corporate disclosure requirements that already exist in South Africa. In the meantime, reporters should be encouraged to state the limitations of the data they have used and/or proxies they have relied on.
- **Be clear about targets and transition.** Uncertainty and reluctance towards taxonomies often originate from misunderstandings about their purpose. For example, some may argue that the ambition of the draft GFT is too high and thus does not sufficiently capture activities which support the low-carbon transition. To avoid misunderstandings, we recommend the National Treasury and IFC make the definition of transition activities more precise in the draft GFT (i.e. instead of “low carbon”, say “aligned with limiting global temperature rise to 1.5°C by 2050”) and clearly explain the role of the GFT in the broader transition policy framework and in the context of South Africa’s updated NDC. Other policy instruments, including real-economy policy reforms, are also needed to support the transition.
- **Re-assess the presentation of minimum social safeguards.** We welcome the reference to the ILO, OECD and UNGPs in the minimum social safeguards. However figure 11 on page 22 of the *User Guidance to the Draft Green Finance Taxonomy* requires clarification; firstly, the ILO core labour conventions, although international, are solely focused on the workforce; secondly, the OECD Guidelines and UNGPs covers workforce-related issues and all affected stakeholders including, for example, communities and consumers. The UNGPs should also be listed below figure 12 on page 23 of the *User Guidance* alongside the OECD guidelines as the primary established international standards. Nevertheless, we strongly support the local references to the South Africa labour law and other local laws and the the intension of the National Treasury and IFC to consider social objectives in a future expanded sustainable finance taxonomy

In our detailed response we follow the requested structure adding a first initial point about international consistency and local context. PRI stands ready to further engage with and support the National Treasury, IFC, NBI and Carbon Trust in the development of the GFT and provide insights on investor needs.

DETAILED RESPONSE

INTERNATIONAL CONSISTENCY AND LOCAL CONTEXT

As taxonomies are developed worldwide, the PRI encourages standardisation at international level to maximise their impact, considering the global nature of financial markets. We therefore strongly welcome the approach taken to closely align the draft GFT with the EU Taxonomy regulation and delegated act, as well as the advice of the EU's Technical Expert Group on sustainable finance[2]. This consistency at both framework and technical screening criteria level will strongly benefit investors. It will eliminate the burden of developing a knowledge base of the functioning of two taxonomies and reduce costs in developing analytical techniques to assess Taxonomy alignment. Despite the draft GFT being voluntary, this consistency with the EU taxonomy should strongly encourage uptake by global investors based in South Africa. The alignment of technical screening criteria is also strongly commended; investors need credible taxonomies to make informed, long-term investment decisions aligned with the 2030 and 2050 goals required by the Paris Agreement.

Local and regional differences may exist as countries and regions have different challenges and transition pathways. In this context, it is essential that as the GFT is developed, it clearly defines its sustainability goals and level of ambition. We welcome the adoption of the EU Taxonomy's definition of "climate change mitigation" and its link to the Paris Agreement. However, we encourage the National Treasury and IFC to be more precise about the overall target of the GFT and specify that "*in line with international best practice and national priorities*" means aligned with the Paris Agreement and South Africa's updated NDC. Furthermore, while a voluntary framework is a reasonable starting point, we encourage the National Treasury to consider a mandatory GFT in the near future to accelerate growth of sustainable investment practice and further encourage international alignment of taxonomy frameworks.

We encourage the National Treasury, IFC, NBI and Carbon Trust to maintain consistency with the EU Taxonomy and more importantly scientific evidence, during future development, particularly as the Taxonomy expands to consider transitional activities and social aspects.

GENERAL DOCUMENTATION USABILITY AND EASE OF NAVIGATION

The *Draft Green Finance Taxonomy* and *Listing of Technical Criteria and other Taxonomy aspects requiring further domestication review and/or development* are generally easy to use and navigate. However, certain sections of the *Applying the Green Finance Taxonomy User Guidance to the Draft Green Finance Taxonomy* document could be further clarified, in particular, the seven-step process in section 2; the descriptions of climate adaptation and vulnerability assessments; and the presentation and calculation of Taxonomy alignment.

[2] The Technical Expert Group on sustainable finance was replaced by the Platform on Sustainable Finance in October 2020. The Platform on Sustainable finance will assist the Commission in developing its sustainable finance policies, including the further development of the EU taxonomy. https://ec.europa.eu/info/business-economy-euro/banking-and-finance/sustainable-finance/overview-sustainable-finance/platform-sustainable-finance_en

Seven-step process of section 2

The taxonomy is a relatively new concept and investors will welcome this granular step-by-step implementation process. However, the current description and detail of some steps may lead to confusion, so we recommend the following changes:

- Integrate *principle 2: Meet applicable screening criteria*, into the other 3 principles.

The technical screening criteria cover both the thresholds to substantially contribute and to do no significant harm. Having a separate principle to meet the screening criteria confuses this point. We would recommend identifying 3 principles: (1) substantially contribute to at least one of the 6 environmental objectives (2) do no significant harm to the other 5 environmental objectives and (3) meet minimum social safeguards. Steps 3 and 4 would then cover principle 1.

- Make steps 2-6 more concise, adding extra detail later on in the document.

For an investor new to taxonomies, the detail and amount of the text on pages 10-13 and 16-19 may be overwhelming. Given that disclosure is voluntary, Taxonomy implementation needs to appear as simple as possible. Therefore, it would be better to present a more concise 7-step (or fewer) approach which only sets out the 3 principles (see bullet point above), key definitions and examples of how to use the Taxonomy matrix.

The latter half of the document could then go into the detail of climate change mitigation and adaptation. The flow charts on pages 11 and 12, while useful visual aids to some, might cause others to unnecessarily fear that they have to go through each of those steps rather than simply use the Taxonomy matrix. Furthermore, reflecting the approach taken for climate mitigation, it may be better to delete the tables on pages 16-18 considering they are covered in the draft GFT. Finally, a glossary of key definitions would be a useful addition.

Descriptions of climate adaptation and vulnerability assessments

- Re-asses the description of climate change adaptation.

The section *Defining substantial contribution to climate change adaptation on pages 11-13* should be rearranged. Currently, figure 6 is presented before adapted activities or enabling activities are defined and before the screening criteria A1, A2, A3 and B1 are described. Furthermore, the methodology to identify an economic activity that substantially contributes to climate change adaptation in the section *Guidance for substantial contributions to climate change adaptation,* could again overwhelm or confuse some investors. We recommend moving this detail to the latter half of the document, after defining climate adaptation and associated screening criteria and providing examples of how to find such activities in the Taxonomy matrix.

In addition, the first section of *Guidance for substantial contributions to climate change adaptation* on page 13 should say 'The economic activity reduces all material physical climate risks *to the extent possible and on a best effort basis*' in alignment with criterion A1. Further, investors would benefit from guidance defining "robust climate data" as set out in criterion B1.1.

- Clarify the requirements for the climate risk and vulnerability assessment.

The description and scope of the climate vulnerability assessment, described on pages 19-21 of the GFT User Guidance is confusing at times, particularly how requirements differ for new activities and/or activities upgrading or altering existing assets or processes compared to existing/new activities using existing physical assets. Investors would also benefit from a clarification of when it is appropriate for a climate risk and vulnerability assessment to be undertaken by an independent external expert.

Presentation and calculation of taxonomy alignment

Section 3 is clear and provides many useful examples of how to calculate taxonomy alignment. However, the disclosure format in appendix A is a bit sparse. To provide comparability for consumers and clarity for investors, we recommend using a pie-chart format to disclose taxonomy alignment. Close ended questions should also be added to the appendix to ensure the reporter meets the three requirements set out in the draft GFT: to assess and disclose the contribution to different objectives; to disclose the significance of finance that is "taxonomically-aligned", per environmental objective; and to avoid double counting. Finally, step 7 states a *'declaration should include the final collective result with all supporting assessment results for each assessment as well as relevant supporting details and impact indicators'.* Investors will need further clarification of what is meant by 'relevant supporting details and impact indicators' and how much information is needed to meet this requirement.

Furthermore, we recommend stating explicitly that all investments should be included in the denominator of taxonomy alignment KPIs, even those that cannot be judged against the Taxonomy (i.e. sovereign bonds)[3]. Otherwise, there is a risk that the calculations for products containing a substantial proportion of such instruments become skewed. Investors and consumers need clarity that Taxonomy alignment disclosures give a complete and comprehensive picture of sustainability performance.

TECHNICAL DETAILS OF TECHNICAL SCREENING CRITERIA

We welcome the overall alignment between the technical screening criteria of the draft GFT and the EU Taxonomy, and the decision set out in *Listing of developmental aspects for explanations of key issues for consideration* to remain aligned with the EU Taxonomy Climate Delegated Act and remove certain economic activities (Growing of perennial crops and growing of non-perennial crops; Livestock Production; Electricity generation from gaseous and liquid fuels) from the draft GFT. As stated in the first section, international standardisation of taxonomies, consistent with global sustainability goals, is needed by investors.

Improvements were made in the final April EU Taxonomy Climate Delegated Act, compared to the original draft EU proposal in November 2020, and it provides a good starting point for the South African draft GFT. As the inclusion of these activities is considered in the future, we encourage the National Treasury, IFC, NBI and Carbon Trust to follow the original TEG recommended thresholds for these activities and take a robust, science-based approach.

We welcome the consideration of other activities that are not in the EU Taxonomy but relevant to South Africa, such as eco-tourism and wildlife management. Taxonomies must reflect local needs and transition pathways and new economic activities should be included provided they are aligned with a robust NDC.

[3] PRI made the same recommendation in response to the European Commission's consultation on Taxonomy-related disclosures for NFRD undertakings as defined under Article 8 of the Taxonomy regulation. The final Article 8 delegated act does exclude sovereign bonds from the denominator, but this will be reviewed in 2024. We recommend the South African Taxonomy does not follow this approach and includes all investments in the denominator of taxonomy alignment calculations.

PRACTICALITY AND LEVEL OF AMBITION OF EACH PRINCIPLE, METRIC, AND THRESHOLD

A green finance taxonomy has a very specific role and purpose: to help investors identify, report on and ultimately finance activities with sustainable levels of environmental performance. Therefore, even though investors may face initial challenges with finding sufficient data on whether their investments are aligned with the technical screening criteria in the GFT, the ambition should not be lowered.

Uncertainty and reluctance towards taxonomies often originate from misunderstandings about their purpose. For example, some may argue that the ambition of the draft GFT is too high and thus does not sufficiently capture activities which support the low-carbon transition. The draft GFT already recognises transition activities within some sectors, but other policy instruments, including real-economy policy reforms, are also needed to support the transition. We recommend the National Treasury and IFC make the definition of transition activities more precise in the draft GFT (i.e. instead of "low carbon", say "aligned with limiting global temperature rise to 1.5°C by 2050", considering climate change mitigation is already defined to be aligned with the Paris Agreement) and clearly explain the role of the GFT in the broader transition policy framework and in the context of South Africa's updated NDC.

On data, we encourage the National Treasury to create a bridge between the GFT and the corporate disclosure requirements that already exist in South Africa. Investors will need access to reliable comparable data to enable them to disclose Taxonomy alignment. In the meantime, reporters should be encouraged to state the limitations of the data they have used and/or proxies they have relied on.

Overall, the PRI welcomes the ambition set out in the draft GFT. It will inform capital allocation to assets which need to become more environmentally sustainable and provide a basis for engagement to support investors in their transition pathways. In the short term, investors will continue to finance companies that need capital and may even allocate capital to harmful activities if they wish to do so. However, as the Taxonomy is adopted and implemented by the market, responsible investors will be able to easily identify companies transitioning to green activities and demonstrate their leadership by redirecting capital towards those activities.

PRACTICALITY OF THE "DO NO SIGNIFICANT HARM" (DNSH) CRITERIA RELATED TO THE ENVIRONMENTAL OBJECTIVES.

As stated in the previous section, the DNSH criteria must be scientifically robust and evidence-based to create a credible Taxonomy. The ambition should not be lowered. The DNSH criteria and framework is practical and investors should be able to perform DNSH assessments. Again, as stated above, the National Treasury and IFC should work to ensure an effective corporate disclosure framework to produce the ESG data needed by investors. In the meantime, reporters should still be encouraged to perform these assessments and state the limitations of the data they have used and/or proxies they have relied on.

PRACTICALITY OF THE MINIMUM SOCIAL SAFEGUARD CRITERIA

We welcome the reference to the ILO, OECD and UNGPs in the minimum social safeguards, although figure 11 on page 22 of the *User Guidance to the Draft Green Finance Taxonomy* requires clarification; firstly, the ILO core labour conventions, although international, are solely focused on the workforce; secondly, the OECD Guidelines and UNGPs covers workforce-related issues and all affected stakeholders including, for example, communities and consumers. The UNGPs should also be listed below figure 12 on page 23 of the *User Guidance* alongside the OECD guidelines as the primary established international standards.

We support the local references to the South Africa labour law and other local laws. These additions present specific requirements on top of the process-based requirements of the global frameworks, and therefore, provided they are not weaker than the global standards, bring clarity to investors on what conditions should be avoided. Social issues should be given equal consideration to environmental issues, so we support the intension of the National Treasury and IFC to consider social objectives in a future expanded sustainable finance taxonomy. PRI has significant knowledge of how investors can positively support social goals, not least through its involvement in the EU social taxonomy work and would welcome the opportunity to provide more input and advice as the GFT undergoes further development.

ALTERNATIVE PRINCIPLES, METRICS, AND THRESHOLDS WHICH SHOULD BE INCLUDED OR SUBSTITUTED

PRI makes no recommendations for alternative principles, metrics or thresholds which should be included or substituted.

ALTERNATIVE POLICIES AND SPECIFIC TECHNICAL INDUSTRY DOCUMENTS WHICH SHOULD BE REFERENCED

PRI makes no recommendations for alternative policies or specific technical industry documents to be referenced.

The PRI has experience of public policy on sustainable finance policies and responsible investment across multiple markets and stands ready to further support the work of the National Treasury to develop an effective green finance taxonomy in South Africa.

Any question or comments can be sent to policy@unpri.org.