SUSTAINABLE BANKING NETWORK (SBN)

COUNTRY PROGRESS REPORT

ADDENDUM TO SBN GLOBAL PROGRESS REPORT

SOUTH AFRICA

Sustainable Banking Network

IFC International Finance Corporation WORLD BANK GROUP

Creating Markets, Creating Opportunities

The global SBN program is supported by the government of China through the Ministry of Finance. IFC's regional environmental and social risk management (ESRM) program is supported by the government of Switzerland through the State Secretariat for Economic Affairs (SECO).

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Federal Department of Economic Affairs FDEA
State Secretariat for Economic Affairs SECO

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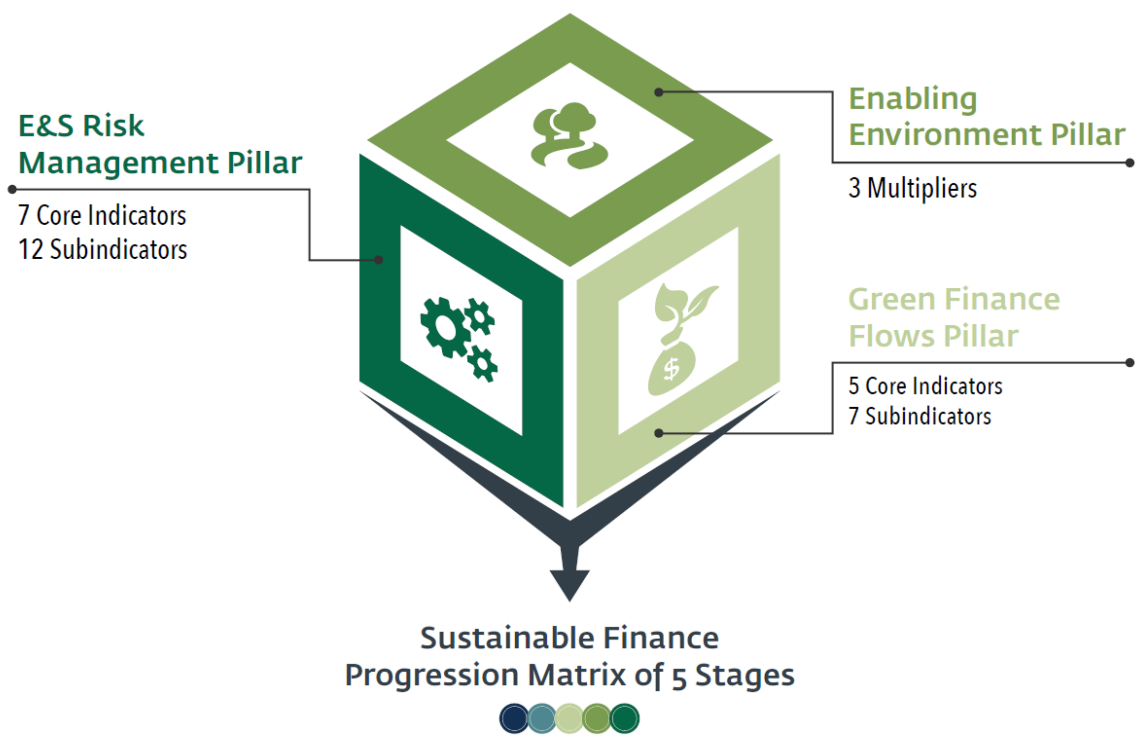
1. Introduction

Market-based sustainable finance initiatives led by members of the Sustainable Banking Network (SBN) have made significant progress in directing the financial sector toward sustainability. Established with International Finance Corporation's (IFC) support in 2012, SBN represents a community of financial sector regulators and banking associations from 34 emerging markets. SBN members now represent over US$42.6 trillion in banking assets, accounting for more than 85 percent of the total banking assets in emerging markets.

The SBN Global Progress Report is based on a unique measurement framework, the first of its kind to assess sustainable finance initiatives across emerging markets. The SBN Global Progress Report for the first time presents a systematic view of progress on sustainable finance among emerging economies that are represented by SBN. A rigorous measurement framework was developed and agreed on by members. The SBN Measurement Framework draws on international best practice as well as SBN members' experiences and innovations. This framework will be continuously applied to measure progress annually.



The Global Progress Report draws on the findings of **15 individual country progress reports prepared for members, including this report.** These 15 countries, with US$38.3 trillion in banking assets, account for more than 76 percent of emerging market banking assets.

Country-specific progress reports were prepared for 15 SBN members with sustainable finance initiatives. These reports contain a thorough analysis of the country's policy or principles in relation to the environmental and social (E&S) risk management and the green finance flows, as well as a contextual analysis of the local policy landscape and the enabling environment. Country reports detail each country's good practice and highlight areas of focus in order to support and encourage members to further accelerate sustainable finance.

All SBN member countries are advancing sustainable finance at differing stages of development. Countries are mapped to five different stages of their development, from initiating to mature.

SBN Progression Matrix with Assessment Results, based on progress up to and as of June 2017

* Pakistan launched its policy in October 2017, after the cut off date of June 2017 for the report

2. Executive Summary

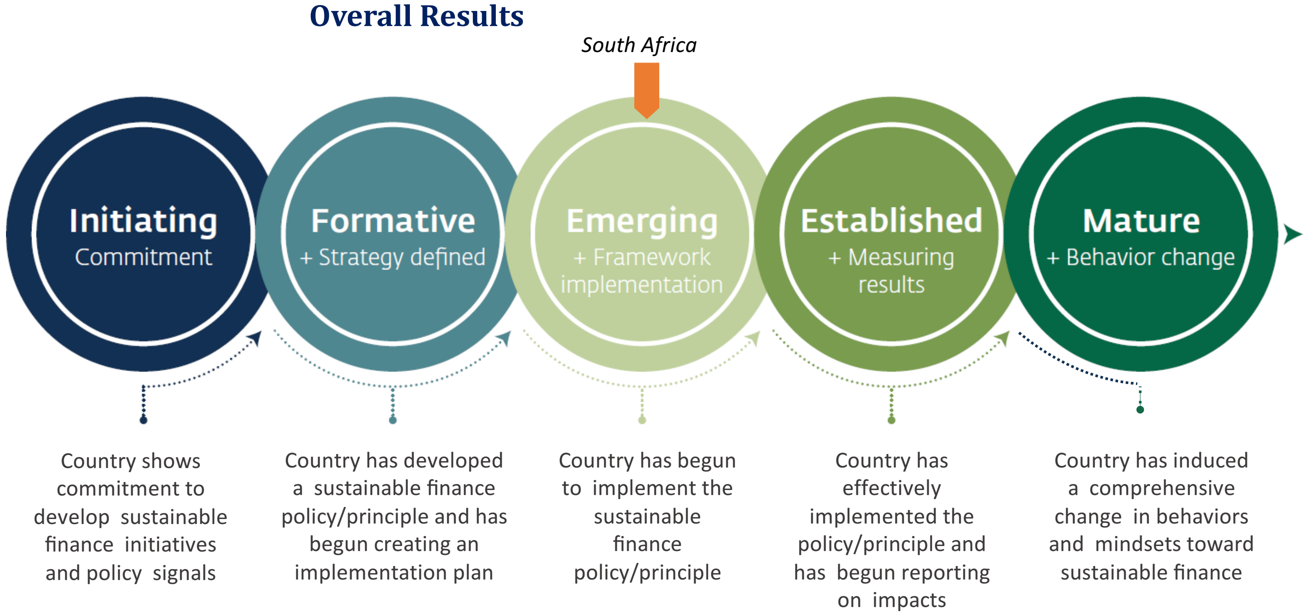
South Africa has been engaged in promoting a greener economy for many years. The country's sustainability journey began as early as 2011, with the issuance of the **Green Economy Accord**, which promotes green finance flows. The UN Environment Programme Finance Initiative (UNEP FI) views South Africa as the key country in Africa where banks have been at the forefront of introducing best practices in environmental and social (E&S) risk management and helping to drive change on the continent. South Africa's four largest banks were among the earliest emerging market signatories of the Equator Principles (EPs).

Regulatory requirements for sustainable finance have thus far focused on the pension fund sector, through the revised Pension Funds Act (2012), which requires consideration of environmental, social, and governance (ESG) risks as part of fiduciary responsibility. The regulation is supported by the voluntary Code for Responsible Investing in South Africa (CRISA), which is now embedded in the King IV Code of Corporate Governance. King IV applies to all South African organizations and is mandatory for listed companies. King IV sets out an integrated approach to organizational risk management and disclosure, including social, human, and natural capital dimensions.

The Banking Association South Africa (BASA) launched the **Principles on Social and Environmental Risk Management** in 2014. The scope of application is specified (lending and investment), and reference is made to international standards such as the EPs and UNEP FI. Other parts of the financial sector are participating in international voluntary approaches, addressing asset management (Principles for Responsible Investment [PRI]), the insurance sector (Principles for Sustainable Insurance [PSI]), and capital markets (Sustainable Stock Exchanges [SSE]). The National Treasury is now seeking to send a policy signal and establish a national shared vision on sustainable finance.

While voluntary initiatives exist and some regulations have been introduced, South Africa's framework for sustainable finance is still missing some key features, such as technical guidance, supervision, and disclosure requirements. This leads to a mixed performance in its overall results. However, the South African banking industry demonstrates a clear maturity in its approach to sustainable banking and the implementation of good international industry practices.

Overall Results



Good Practice

- The Banking Association, with the active participation of 34 South African and international banks, has developed the voluntary Principles on Social and Environmental Risk Management.

- Along with industry associations and regulatory agencies, the National Treasury is leading efforts to develop a national shared vision for sustainable finance.

- The Johannesburg Stock Exchange (JSE) is supporting innovation in green finance through the FTSE/JSE Responsible Investment Index series and through new guidance on the issuance of green bonds.

Areas for Improvement

- The banking sector Principles on Social and Environmental Risk Management do not provide technical guidelines to facilitate implementation by financial institutions (FIs), nor do they require disclosure on performance. Since current legislation prevents industry players from jointly agreeing on standards or guidelines, such an initiative would have to be taken by the Regulator.

- The banking regulators (Reserve Bank and Financial Services Board) do not yet engage with FIs on E&S risk management during supervision, which would incentivize and support improvement by FIs.

- The South African market does not yet clearly define green finance. Having these definitions would enable green bond issuance and financial product innovation by FIs. Market incentives are also lacking to promote green finance flows.

CONTEXT:

3. Enabling Environment

Country Profile

South Africa's economy is the third largest in Africa, accounting for 12 percent of Africa's gross domestic product (GDP). The country has an important supply of mineral resources and well-developed financial, legal, communications, energy, and transport sectors. South Africa has shifted to an economy driven primarily by the tertiary sector (about 65 percent of GDP). It is facing growing social unrest because of corruption, a high unemployment rate (more than 25 percent), and inequality. On the environmental side, the main issues include impacts of climate change, depletion of natural resources, water pollution and scarcity, air pollution related to mining and chemical industries, and waste.

The South African government is striving to tackle these issues, especially through enhanced efforts to transition to a low-carbon economy and a more equal society. A number of government agencies signed the Green Economy Accord (the Accord) in 2011, together with representatives of labor unions, business, and civil society. The Accord aims at turning the economy into a greener one and includes the development of green finance. The National Development Plan 2030 aims to achieve a series of environmental and social objectives by 2030. South Africa also ratified the Paris Agreement on Climate Change in November 2016. It has set an ambitious target as part of its first nationally determined contributions (NDC): 42 percent below business as usual by 2025. The Treasury is working on a Carbon Tax Bill, under which subjected emitters will have to report greenhouse gas (GHG) emissions and pay a carbon tax. The bill is expected to be released in 2018.

The South African financial sector is highly concentrated around the top four banks, representing about 83 percent of total banking assets. South Africa has one of the most sophisticated financial markets in Africa, and has earned a reputation for its sound financial market development. The country has four stock exchanges, including JSE Limited, the largest stock exchange in Africa.

Background and Strategy of the Sustainable Finance Framework

The financial industry itself has triggered sustainable finance in South Africa. In 2011, the **Code for Responsible Investing in South Africa (CRISA)** was adopted to encourage a commitment and collaborative engagement by institutional investors (mainly pension funds) and asset managers to manage environmental, social, and governance (ESG) issues in asset ownership practices. The five key Principles were inspired by the UN-supported Principles for Responsible Investment (PRI) and were strengthened by law in 2012 (Regulation 28 of the Pension Funds Act) and by the voluntary King IV Code on Corporate Governance (Principle 17) in 2016. South Africa was the second country globally, after the United Kingdom, to issue an ESG regulation for the pension fund sector.

On the banking side, in 2014 BASA members adopted the **Principles on E&S Risk Management** (the Principles). BASA has 34 member banks, which include both South African and international banks.

The Principles apply to all financial activities, but implementation is not mandatory. Although no specific guidance has been developed, a Sustainable Finance Committee within the Banking Association discusses the implementation of the Principles and shares good practice. In addition, BASA provides E&S risk assessment (ESRA) training, which is available on demand. The intent is to provide all frontline staff with an understanding of Sustainable Finance, including the importance of E&S risk management. While not mandatory, the Principles are supplemented by a national regulatory framework that is quite prescriptive with regard to good governance and environmental compliance.

More generally, the **King IV Report and Code on Corporate Governance for South Africa (King IV)**, published in 2016, provide principle-based guidelines for better corporate governance practices of all South African organizations, including financial institutions. King IV is globally recognized as a leading approach and features integrated consideration of environmental and social dimensions. Although King IV is voluntary, the Johannesburg Stock Exchange (JSE) has made its compliance mandatory for listed companies.

Support from Regulators

Sustainable banking in South Africa relies on voluntary initiatives, and the Reserve Bank and Financial Services Board do not supervise the implementation of the BASA Principles. Until recently, sustainable finance initiatives in different parts of the financial sector were largely disconnected. In early 2017, the National Treasury convened a Working Group of financial sector regulatory agencies and industry associations to develop a framework document on sustainable finance. This initiative seeks to align the whole financial sector (such as institutional investors, asset managers, bankers, insurers, and stock exchanges) with national sustainability goals by creating an overall vision and policy environment that encourages sustainable finance adoption.

RISK:

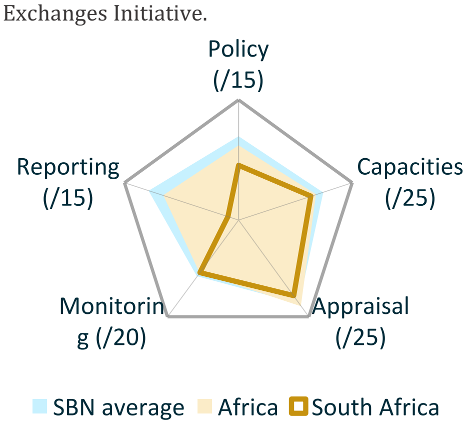
4. Environmental and Social Risk Management

The South African banking sector is comprised of 17 registered banks, two mutual banks, 14 local branches of foreign banks, two cooperative banks, and 43 foreign banks with approved local representative offices. It is a highly concentrated sector, with the top four banks representing about 83 percent of the total banking assets. Although the application of the Principles on E&S Risk Management is not required, all 34 members of the Banking Association are committed to applying them. The main areas of improvement for the current framework include the requirement for FIs to formalize an E&S policy and to disclose information on their E&S risk management.

The development of a strategic Sustainable Finance Framework, via the working group composed by the National Treasury initiative, is bound to deepen the involvement of South African banks regarding sustainability practices.

The largest financial institutions in South Africa are already actively aligned to international standards and best practice in sustainable finance. South Africa's main FIs are listed and consequently must comply with the King Code of Corporate Governance, which includes directions for sustainability governance and disclosure. Only four small specialist banks are either not affiliated to international parents or not registered on the stock exchange, and they collectively represent less than 1 percent of products and services afforded by the sector.

Five large FIs have adopted the UN Global Compact and seven FIs are active members of UNEP FI, such as through co-chairing, working committees, task forces, or training for African banks. 8 asset owners and 35 asset managers are signatories to UN-supported Principles for Responsible Investment (PRI), the largest number across SBN members. Two insurers have signed the UN Principles for Sustainable Insurance (PSI). The JSE is a founding member of the Sustainable Stock Exchanges Initiative.



Subpillars	Comments on good practice and areas for improvement
Policy	- The BASA Principles on E&S Risk Management recognize FIs' need to take E&S risks into consideration through dedicated processes. They recommend setting up systems, but they do not require the formalization of an E&S policy. - Going further, banks could be required to formalize a climate-risk management policy or develop a climate strategy aligned with South Africa's climate commitment.
Capacities	- The Principles state that risk management systems and specific training should be implemented. They do not require FIs to define roles, responsibilities, and competencies.
Appraisal	- The Principles state that FIs should set up internal processes to identify high risk industries, where additional due diligence is required, and ensure that through their credit and risk management policies they will give due recognition to E&S risks when making lending decisions. - Requiring FIs to incorporate E&S provisions and investment conditions into their legal agreements, which is not currently prescribed, would reinforce the impact of the E&S risk assessment.
Monitoring	- The Principles state that FIs should develop and implement systems and procedures that identify, measure, and monitor E&S risks during the life cycle of project finance agreements and require clients to do the same. - The process could be strengthened by including periodic portfolio reviews and regular onsite visits of high-risk projects, as well as taking into account climate risk in lending decisions.
Reporting	- While King IV, enforced by JSE listing requirements, requires listed banks to report on E&S risk management, the Principles themselves do not require E&S disclosure.

OPPORTUNITY:

5. Green Finance Flows

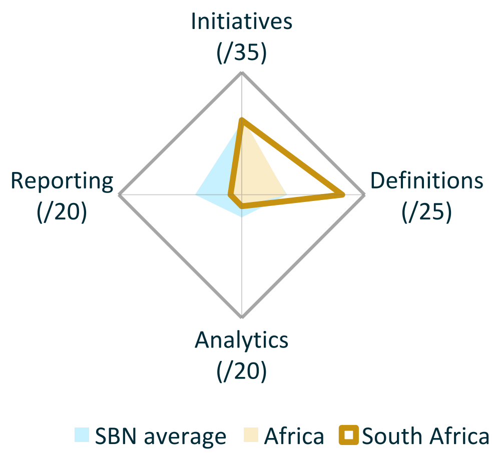
The existing framework for sustainable finance in South Africa does not set requirements or standards regarding the development of green finance flows. However, the South African government is committed to turning the economy into a greener one and sees business opportunities, as well as job creation potential, from increased green finance flows. Indeed, there was a commitment at the country level to develop green finance in 2011, through the Green Economy Accord, which is part of the national “New Growth Path.” Within this Accord, Commitment 2 is dedicated to “investment in the Green Economy”. As the commitment did not lead to specific measures, work is currently underway to determine the barriers to develop green finance within the country.

In addition to the national commitment, major banks have taken some voluntary initiatives. For example, Nedbank Capital headed a consortium that led to South Africa's first institutional green bond being issued by the Industrial Development Corporation (IDC) in November 2012. The funds raised (about US$300 million) were earmarked to finance the growth of green and energy efficient industries and will have a lifespan of 14 years. Subsequent green bond listings include the City of Johannesburg (June 2014), IFC (Dec 2015), and the City of Cape Town (March 2017).

The JSE is supporting green finance innovations in capital markets. It launched a new FTSE/JSE Responsible Investment Index series in 2015, whose constituents include a dozen South African FIs. It also released the Debt Listings Requirements for the Green Segment in August 2017, which reference the International Capital Market Association (ICMA) Green Bond Principles for defining green bonds.

In line with the National Development Plan 2030, social priorities are now top of the agenda. Any sustainable finance initiatives that focus on climate and environment will also be expected to consider social priorities, such as poverty, job creation, or "transformation" (addressing social inequality created by South Africa’s political past).

Lastly, BASA is in the process of implementing the UNEP FI Positive Impact Finance Principles, which includes the creation of an independent data dashboard. Progress updates will be made publicly available.



Subpillars	Comments on good practice and areas for improvement
Initiatives	- There are policy-led (Green Economy Accord) as well as voluntary initiatives (green bonds issuance by municipalities and FIs) to mobilize green finance flows and encourage innovation. - There are currently no significant financial incentives that could foster green finance in South Africa.
Definitions	- While there are no specific definitions of green sectors and projects, some official documents give a clear view of key sectors to be financed in South Africa (Green Economy Accord and Renewable Energy Independent Power Producer Procurement Program). - On Green Bonds, JSE lists the requirements and refers to the Green Bond Principles. This good practice could be expanded to other green assets (such as green credit or green real estate).
Analytics	- There are currently no requirements in terms of calculating and monitoring environmental benefit. - BASA is currently implementing the UNEP FI Positive Impact Finance Principles (Sustainable Development Goals focus), which will include the creation of independent data dashboards, to be made publicly available.
Reporting	- There are currently no requirements in terms of green finance flows reporting and disclosure. Guidelines encouraging reporting and disclosure regarding the banks' green finance performance would positively impact the development of green financing flows.