

SOUTH AFRICA'S GREEN FINANCE TAXONOMY PROJECT



Following a two-year consultation and development process, South Africa's first national Green Finance Taxonomy (GFT) was launched on 1 April 2022 by the Taxonomy Working Group as part of South Africa's Sustainable Finance Initiative. The Group, chaired by National Treasury and hosted by the Banking Association South Africa, included representatives from national government, financial sector regulators and the financial services sector. The GFT is welcomed as part of government's national policy to promote sustainable finance and encourage green private sector initiatives.

This document summarises the content of the GFT, which may be accessed [here](#)

Our leading cross-disciplinary teams of experts advise clients on ESG and sustainability linked issues across all sectors. We help clients to navigate regulatory developments, and policy and tax drivers in pursuit of sustainable growth in the long term whilst obtaining tax benefits. We guide clients on the relevant industry standards and risks, and bring a laser focus on supporting our clients to know their business, know their supply chain, their social responsibilities, as well as the broader ecosystem.

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GENERAL: ABOUT SOUTH AFRICA'S GREEN FINANCE TAXONOMY PROJECT

A green finance taxonomy (GFT) is a classification system or catalogue defining a minimum set of assets, projects, activities and sectors that are eligible to be defined as "green" in line with international best practice and national priorities.

BENEFITS OF A GFT:

- helps the financial sector with clarity and certainty in 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 instruments;
- unlocks significant investment opportunities for South Africa in a broad range of green and climate-friendly assets;
- supports regulatory and supervisory oversight of the financial sector; and
- provides a basis for regulators to align or reference green financial products.

“The GFT will help the financial sector with clarity and certainty in selecting green investments in line with international best practice and South Africa's national policies and priorities”

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USER GUIDANCE AND APPLICATION NAVIGATION

POTENTIAL USERS OF A GFT:

- policymakers and government agencies (to develop policy, identify areas of underinvestment etc.);
- financial market participants and regulators (to identify financial and real economy investment opportunities that align with the taxonomy and criteria; evaluate investment portfolios for taxonomic alignment and exposure etc.); and
- asset owners (to compile disclosures against the taxonomy on capital expenditure, operational expenditure and turnover; support investor and capital markets engagement, to attract financing on the basis of being taxonomically-and thematically-aligned etc.)

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HOW TO DETERMINE GFT ALIGNMENT

- Evaluate the activity against principles and technical criteria (see paragraph 4 below); and
- Evaluate the financial flows of the activity (see paragraph 5 below).

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EVALUATING THE ACTIVITY AGAINST PRINCIPLES AND TECHNICAL CRITERIA

A key part of a GFT assessment includes defining what part of a corporate's activity can be defined as green, and how that activity relates to the whole.

There is a seven-step process to evaluate an asset, activity or project as green. The result is binary – something is either “taxonomy-aligned” or not.

STEP 1:

User to familiarise themselves with the requirements of all the GFT principles

THESE PRINCIPLES ARE:

- the activity must substantially contribute to at least one of the six objectives of the GFT;
- the activity must not do significant harm to any of the other objectives; and
- the activity must comply with Minimum Social Safeguards (MSS).

STEP 2:

User to identify to which objective(s) the economic activity under consideration intends to contribute

THESE OBJECTIVES ARE:

- climate change mitigation;
- climate change adaptation;
- sustainable use of water and marine resources;
- pollution prevention;
- sustainable resource use and circularity; and
- ecosystem protection and restoration.

The GFT in its current form focuses on climate change mitigation and climate change adaptation. It recognises two distinct types of substantial contribution applicable to these two objectives:

- economic activities that make a substantial contribution based on their own performance. For example, an economic activity being performed in a way that is environmentally sustainable; and
- economic activities that, by providing products or services, enable a substantial contribution to be made to other activities. For example, an economic activity that manufactures a component that improves the environmental performance of another activity.

STEP 3:

User to evaluate whether the economic activity under consideration is included in the GFT

A catalogue is included under section 6 of the GFT. The catalogue identifies economic macro-sectors and the associated economic activities within those macro-sectors that are needed as part of the future South African green economy. Using the GFT catalogue, users must find the macro-sector that the economic activity under consideration would best relate to and then navigate to the economic activity which best matches that specific economic activity.

If no economic activity relates to the economic activity under consideration, this means that the economic activity does not yet exist in the current version of the GFT, or has been disqualified because its traits are inconsistent with development fundamentals. In either case, taxonomy-alignment assessment is not possible.

In this respect, see Part 8. Notably, if a user is of the view that a specific excluded activity is consistent with development fundamentals, the GFT recommends that an application is made to the designated agency (that is yet to be determined) for consideration and further development of the GFT to provide extended coverage for the economic activity under consideration.

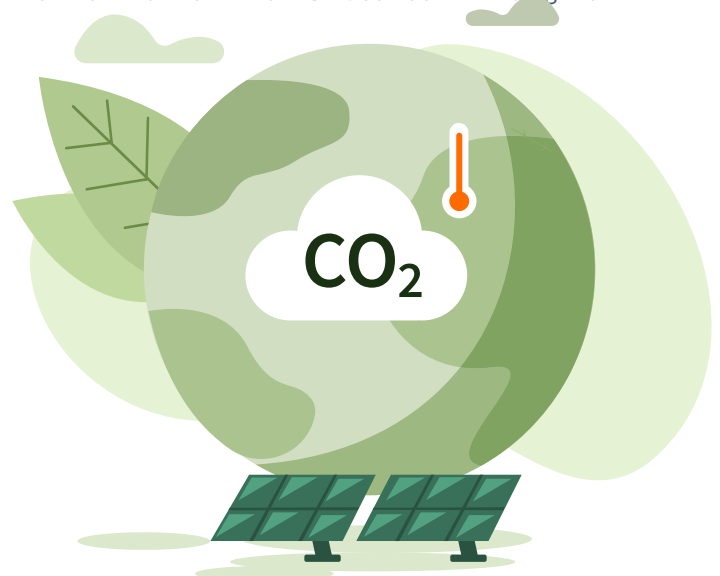
STEP 4:

User to evaluate the economic activity's performance against technical screening criteria related to the environmental objective to which the economic activity under consideration intends to contribute.

Once the economic activity is identified in the catalogue, the user must evaluate its performance against technical screening criteria (TSC). The TSC are set out in section 7 of the GFT.

Testing alignment to the TSC requires quality and granular data. A combination of third-party data providers and in-house research can ease the process.

Notably, TSC have only been developed in respect of climate change mitigation and climate change adaptation. Contribution to the other objectives therefore cannot be assessed using the current version of the GFT. Users are encouraged to



identify these objectives and note them, but, at this stage, an activity can only be formally “taxonomy-aligned” if it at least contributes to climate change mitigation and/or climate change adaptation.

STEP 5:

User to evaluate the remaining objectives (excluding the objective that the economic activity under consideration intends to substantially contribute to) against the Do No Significant Harm (DNSH) criteria.

The DNSH criteria can also be found in section 7. Specific DNSH criteria can also be found in the appendices:

- climate change adaptation: Appendix A;
- sustainable use of water and marine resources: Appendix D;
- ecosystem protection and restoration: Appendix F; and
- pollution prevention: Appendix F.

The activity must also demonstrate climate change resilience. To demonstrate climate change resilience, physical climate risks that are material to the activity need to be identified from those listed in Table 4: Classification of climate-related hazards, by performing a robust climate risk and vulnerability assessment.

The climate-related hazards considered are limited to the potential occurrence of a weather-and climate-related natural physical event or trend. The climate-related hazard classification comprises four major hazard groups, with hazards related to water, temperature, wind and mass-movements. All groups include acute (extreme) and chronic (slow-onset) hazards, as adaptation must account for both rapid as well as gradual changes in the weather and climate to take the appropriate adaptation measures and avoid maladaptation.

STEP 6:

User to evaluate the economic activity’s performance against the MSS.

The user must evaluate whether the activity is aligned with South African labour laws and the standards in International Labour Organisation core labour conventions; OECD Guidelines on Multinational Enterprises; and UN Guiding Principles on Business and Human Rights. Appendix C of the GFT contains a full list of the applicable MSS.

STEP 7:

Disclose results.

If the economic activity under consideration fully conforms to steps 2 – 6, taxonomic-alignment can be declared. 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.

At this time, reporting templates are not provided for this

purpose. Users should consider international examples relevant to their purpose, or develop simple formats communicating all salient aspects of the evaluation process, key assumptions and results.

Determining taxonomy-aligned finance

Usually, a breakdown of the following is required:

- turnover (or revenue): this is the primary way of aggregating from an economic activity to a company level. Turnover gives an indication of where a company currently is relative to the taxonomy. Turnover allows investors to assess and report on the percentage of their funds invested in taxonomy-aligned activities.
- capital expenditure: this may provide a sense of a company’s direction of travel. Aside from helping investors analyse a company’s investment in its existing and new fixed assets, capital expenditures can give an indication of a company’s strategy for improving environmental performance and resilience.
- operational expenditure: same as above.

Users should therefore assess how a taxonomy-aligned activity, asset or project translates financially in respect of the business as a whole. This enables users to determine “portfolio” or “aggregate” taxonomy-alignment.

This plays an important role in green debt instruments where the proceeds of the debt instrument are earmarked for taxonomy-aligned activities / projects. It also enables green bond issuers and green loan financiers to verify the “green credentials” of respective transactions or offerings.

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SUSTAINABLE DEVELOPMENT PERFORMANCE AND IMPACT REPORTING

The GFT encourages transparency through disclosure, and especially disclosure of social impact performance of taxonomically-aligned activities. It does not undertake to provide harmonised specification for environmental and social performance and impact indicators that should be disclosed but encourages users to consult various international resources in this respect.

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GENERAL CHALLENGES AND CONSIDERATION IN APPLYING THE TAXONOMY

THE BIGGEST CHALLENGES ARE:

- aligning the types of investment or finance to a specific economic activity as identified by the GFT, especially where the use of proceeds is unspecified. For example, general credit facilities in the form of general-purpose loans or revolving credit facilities cover diverse corporate expenditures and are not solely related to specific investments, making alignment with taxonomic economic activities challenging; and
- the availability of quality data and information to assess alignment with TSC of the GFT. Granular data to evidence alignment with TSC is typically not publicly available. It can often be complex and requires sustainability expertise to adequately assess alignment.

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APPLICATION GUIDELINES

The intention is not at this time to apply the GFT extraterritorially, although users may find the taxonomy principles useful if they wish to do so. International investors are encouraged to consider jurisdiction-appropriate taxonomies and apply diligence that is at least as strict in substance as the GFT.

Currently, there is no regulating agency in South Africa on taxonomy-alignment, whether initial or ongoing. The GFT is a voluntary tool, and its use is subject to decisions and agreements between parties to transactions. Monitoring performance and taxonomy-conformance default should be addressed contractually between parties.

As this is the first edition of the GFT, for historic or existing programmes, it must be shown, directly or through alternative methods, that all the requirements of the GFT have been met (i.e. no “grandfathering” is possible at this stage).

The use of proxies must be shown to have completely addressed all requirements or must be supplemented to close diligence gaps. Where proxies show alignment, these proxies can be put forward to the governance mechanism for formal recognition as taxonomy-aligned approaches.

Users should narrow down the economic activities that are aligned to the GFT at the beginning of the assessment. This may mean prioritising company activities based on materiality. Users should start simply, by selecting specific activities where quality granular data is readily available.

The information required by the GFT can be complex and it may be useful to involve sustainability expertise to assist in the interpretation and assessment of the data.

A bottom-up approach should be adopted to fairly assess company alignment with the GFT. Where data is not available or is unreliable, a precautionary approach must be adopted that should be clear on data limitations.

In general, adaptation-related information is more difficult to find than mitigation-related information, as carbon emissions data now has a significant track record. Therefore, projects making a substantial contribution to climate change mitigation are more likely to have the data needed to test alignment to the taxonomy.



APPENDIX G: LISTING OF TSC AND OTHER TAXONOMY ASPECTS REQUIRING FURTHER DOMESTICATION REVIEW AND/OR DEVELOPMENT

The table below distinguishes between different economic activities. Those in columns C and D have been excluded from the GFT. As such, no taxonomy-alignment assessment is possible in respect of these activities. The activities in column A and B have been included in the GFT. However, no TSC have been developed

for the activities in column B to date. Even though the GFT does not expressly exclude these activities, it will not be possible to conduct a full taxonomy-alignment assessment until TSC are developed. At this stage, taxonomy-alignment assessments can therefore only be conducted in respect of those activities listed in column A.

|  Economic activities identified for the GFT with technical criteria developed to date: |  Economic activities identified for the GFT without technical criteria developed to date: |
|--|--|
| <ul style="list-style-type: none"> • Forestry and land rehabilitation • Manufacture of low carbon and resource efficiency technologies • Manufacture of cement • Manufacture of iron, steel and ferroalloys • Manufacture of hydrogen • Manufacture of other inorganic basic chemicals • Manufacture of other organic basic chemicals • Manufacture of fertilizers and nitrogen compounds • Manufacture of plastics in primary form • Production of electricity, heating and cooling from solar PV, concentrated solar power, wind power and ocean energy • Production of electricity, heating and cooling from hydropower • Production of electricity, heating and cooling from geothermal • Production of electricity, heating and cooling from bioenergy • Transmission and distribution of electricity • Storage of electricity • Storage of thermal energy • Storage of hydrogen • Transmission and distribution networks for renewable and low-carbon gases • District heating/cooling distribution • Installation and operation of electric heat pumps • Production of heating/cooling using waste heat • Water collection, storage, distribution treatment and supply • Centralized wastewater treatment • Anaerobic digestion of sewage sludge • Separate collection and transport of non-hazardous waste in source segregated fractions • Anaerobic digestion of bio-waste • Composting of biowaste • Material recovery from non-hazardous waste • Landfill gas capture and utilization • Direct air capture of CO₂ • Capture of greenhouse gas emissions • Transport of CO₂ • Permanent sequestration of captured CO₂ • Commuter road, passenger rail and freight rail transport • Infrastructure for low carbon transport • Passenger cars, road commercial vehicles and road freight transport • Inland passenger and freight water transport • Data processing, hosting and related activities • Data-driven solutions for GHG emission reductions • Construction of new buildings • Building renovation • Individual measures and professional services • Acquisition and ownership • Non-life insurance | <ul style="list-style-type: none"> • Ecosystem Conservation • Fisheries and Aquaculture • Wildlife management • Eco-Tourism • Livestock production • Crop production • Manufacture of Glass • Pollution prevention and control • Re-use, redistribution, refurbishment and recycling facilities • Environmental services • Eco-efficient products and processes • Biodegradables • Mining platinum • Mining gold • Manufacture of paper • Transport: commuter road, passenger rail and freight rail transport • Production of electricity, heating and cooling from gravity potential energy • Manufacture of Biomass, Biogas or Biofuels • Water monitoring • Flood defence • Nature-based solutions • Re-use, redistribution, refurbishment, recycling storage and handling infrastructure • Water saving, recycling and re-use technologies • Pollution prevention and control • Handling and preparation • Water treatment • Aviation • Spatial planning • Enabling activities, system resilience & innovation R&D and innovation • Early warning systems • Disaster risk prevention • Sustainability certifications • Value chain activities • Capacity building • Technological solutions • Public events • Social resilience • Knowledge management |



Economic activities that have not been evaluated in the context of South Africa and on that basis have not been included in GFT at this stage:

- Restoration of Wetlands
- Manufacture of Renewable Energy technologies
- Manufacture of equipment for the production of hydrogen and use of hydrogen
- Manufacture of batteries
- Renewal of water collection, treatment and supply systems
- Renewal of waste water collection and treatment
- Electricity generation from renewable non-fossil gaseous and liquid fuels
- Cogeneration of heat/cooling and power from renewable non-fossil gaseous and liquid fuels
- Production of heat/cooling from renewable non-fossil gaseous and liquid fuels
- Operation of personal mobility devices
- Retrofitting of inland water passenger and freight transport
- Sea and coastal freight water transport
- Sea and coastal passenger water transport
- Retrofitting of sea and coastal freight and passenger water transport
- Installation, maintenance and repair of charging stations for electric vehicles in buildings (and parking spaces attached to buildings)
- Close to market research, development and innovation
- Research, development and innovation for direct air capture of CO₂
- Professional services related to energy performance of buildings
- Research, development and innovation related to nature-based solutions for adaptation
- Computer programming, consultancy and related activities
- Programming and broadcasting activities
- Engineering activities and related technical consultancy dedicated to adaptation to climate change
- Reinsurance
- Education
- Residential care activities
- Creative, arts and entertainment activities
- Libraries, archives, museums and cultural activities
- Motion picture, video and television programme production, sound recording and music publishing activities



Economic activities excluded from the GFT for further future consideration:

- Crop production
- Livestock production
- Production of electricity, heating and cooling from gas
- Manufacture of Biomass, Biogas or Biofuels

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