

PORTFOLIO COMMITTEE ON ENVIRONMENT, FORESTRY AND FISHERIES

Carbon Tax Policy Update and Sustainable finance initiatives

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national treasury

Department:
National Treasury
REPUBLIC OF SOUTH AFRICA



NATIONAL TREASURY OBJECTIVE AND TEAM

- TWO KEY TREASURY INITIATIVES DISCUSSED TODAY
 - Carbon Tax
 - Sustainable Finance
- Treasury team presenting today
 - ISMAIL MOMONIAT
 - CHRIS AXELSON
 - SHARLIN HEMRAJ
 - MEMORY MACHINGAMBI
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BACKGROUND

- Carbon tax forms an integral part of **climate change** response policy package under the **National Climate Change Response Policy (NCCRP) of 2011**, and in **National Development Plan (NDP)** as an important cost-effective instrument
- **The Carbon Tax policy was developed over a 10-year period** following extensive stakeholder consultations after a **Carbon Tax Discussion paper published in 2010**, and the **Cabinet approved Carbon Tax Policy Paper, published in 2013**, setting out the policy rationale,, design considerations and outlining proposals for the imposition of the carbon tax.
- This was followed by further **consultations on two versions of the Carbon Tax Bill and tabling of the 2018 Carbon Tax Bill**:
 - Publication of an initial draft Carbon Tax bill for public comment in November 2015
 - Second Draft Carbon Tax Bill was adopted by Cabinet and approved for submission to Parliament in August 2017
 - The 2018 Carbon Tax Bill, a refinement of the 2013 Carbon Tax Policy Paper, the initial 2015 Draft Carbon Tax Bill and 2017 Bill was tabled on in November 2018 and submitted to the Standing Committee on Finance for finalisation.
- **The Carbon Tax Act No 15 of 2019 was signed into law by the President in May 2019.** The carbon tax came into effect on 1 June 2019.
- **The Carbon Tax Act gives effect to the polluter-pays-principle** and helps to ensure that firms and consumers take these costs into account in their FUTURE production, consumption and investment decisions. Assists in reducing GHG emissions and ensuring SA will meet its NDC commitments as part of its ratification of the 2015 Paris Agreement.
- **The Carbon Tax was introduced at a very low effective carbon tax rate with significant tax-free emission allowances** ranging from 60 per cent to 95 per cent to provide current significant emitters time to transition their operations to cleaner technologies through investments in energy efficiency, renewables, and other low-carbon measures.

CARBON TAX CONSULTATION PROCESS - TIMELINE

Environmental
Fiscal Reform
Policy Paper

2006

LTMS

2007

Carbon Tax
Discussion
Paper

(80 comments)

Dec 2010

NCCR- WP

2011

Carbon Tax
Policy Paper
(115
comments)

May 2013

Carbon
Offsets Paper
(77 comments)

April 2014

Draft
Carbon
Tax Bill
(91
comments)

1st Draft
Regulations
on Carbon
Offset

(65
comments)

2015-16

Revised
Carbon Tax
Bill published

Dec 2017

(59 comments)

2nd Draft
Regulations on
Carbon Offsets

Nov 2018

(26 comments)

Submission &
Tabling in
Parliament

2018

**Carbon Tax
Act**

1 June 2019

Carbon Offset
Regs

Dec 2019

Regulations on
GHG Emissions
Performance
Benchmarks

Regulations on
Trade Exposure

Renewable
Energy premium
notice

19 June 2020

RATIONALE FOR CARBON TAX AND DESIGN CONSIDERATIONS

- **Policy rationale for a carbon tax directly related to saving SA and the world from adverse climate change**
 - “The introduction of a carbon price will change the relative prices of goods and services, making emission-intensive goods more expensive relative to those that are less emissions intensive. This provides a powerful incentive for consumers and businesses to adjust their behaviour, resulting in a reduction of emissions
 - Although this option does not set a fixed quantitative limit to carbon emission over the short term, a carbon tax at an appropriate level and phased in over time to the “correct level” will provide a strong price signal to both producers and consumers to change their behaviour over the medium to long term.
 - A carbon price / tax will influence future investment decisions and reduce the price-cost differentials between fossil fuel-based electricity and renewable energy.
 - A carbon tax that is implemented gradually and complemented by effective and efficient revenue recycling can contribute to significant emission reductions;
- **First mover competitive advantage gains among developing countries** creates incentives:
 - To leapfrog development via early adoption of low carbon technologies through research, development, innovation;
 - To access global green climate financing;
- **Minimise potential adverse impacts on low-income households and industry competitiveness** through targeted revenue recycling;
- **A reduction of GHG emissions also improves air quality** hence environmental quality.

OUTLINE OF CARBON TAX

- **Tax Base**
 - Electricity generation and fuel combustion
 - Industrial processes – cement, iron and steel, glass, ceramics,
 - Fugitive emissions – e.g. methane emissions from mining
 - Direct (Scope 1) stationary emissions
 - Direct (Scope 1) non- stationary emissions – as an add on to the fuel tax regime.
- **Marginal tax rate**
 - R134/tonCO_{2e}
- **Revenue Recycling measures**
 - Reducing other taxes and providing tax incentives
 - If revenues left over, on budget support for pro poor programmes in energy, transport sectors
- **Phased approach**
 - Phase 1: 2019 to 2022
 - Starting off the tax at a relatively modest rate, coupled with generous tax-free allowances, adjusted over time to facilitate a structural transition to a low carbon, climate resilient economy in a cost effective manner.
- **Emissions Reporting:** Business entities that engage in activities that produce direct greenhouse gas emissions are required to report under the 2017 National Greenhouse Gas Emission Reporting Regulations of the DFFE.

CARBON TAX DESIGN: TAX-FREE ALLOWANCES

	<u>GHG Emissions</u>			
	Combustion	Process	Fugitive	
<u>Tax free allowances</u>				
Basic	60	60	60	
Process emissions	n/a	10	n/a	
Fugitive emissions	n/a	n/a	10	
Trade exposed	10	10	10	Max = 10
Performance based (Z - factor)	5	5	5	Max = 5
Carbon budget	5	5	5	
Offsets	10	5	5	
Total	90	95	95	

PHASE 1 CARBON TAX DESIGN: RATE, TAX-FREE ALLOWANCES AND RECYCLING MEASURES

Tax rate and emissions allowances

Carbon tax at R134 per ton of CO₂e

60% basic tax-free threshold

Max of 10% tax-free allowance for trade exposure

10% tax-free allowance for process and fugitive emissions

Up to 5% performance allowance

5% tax-free allowance for complying with carbon budgets information requirements

5 or 10% allowance for Carbon Offsets – to reduce the carbon tax liability

- Tax-free allowances of **60-95%** - effective tax rate of

- No impact on electricity prices in the first phase

- Phase 1:
1 June 2019 to 31 Dec 2022

Revenue Recycling

Energy Efficiency Savings tax incentive

Credit against Eskom's carbon tax liability for the **renewable energy premium** built into the electricity tariffs

Credit for the **electricity levy**

Support for the installation of solar water geysers

Enhanced free basic electricity / energy for low income households

Improved public passenger transport & support for shift of freight from road to rail

PHASE 1 - REVENUE RECYCLING MEASURES

- To help sectors transition, in addition to the tax free allowances, **revenue recycling measures have been implemented as part of a package of support measures under the carbon tax** i.e. reducing other taxes, tax incentives and targeted on-budget programmes.
- For the first phase of the carbon tax (until 2022), the **introduction of the tax will have a neutral impact on the price of electricity** to cushion low income households and energy intensive industries.
 - This is achieved by providing a **credit for the payments of the electricity generation levy**; and
 - **credit for the renewable energy premium** built into the electricity tariff.
- In addition business already benefits from the **Energy efficiency savings tax incentive implemented in November 2013**.
- Analysis shows **above measures will protect vulnerable sectors** like mining and iron and steel.

UN CLIMATE REPORT – AUGUST 2021: IS WHAT WE ARE ALL DOING ENOUGH?

- **The IPCC Working Group I sixth assessment report shows that the world will probably reach or exceed 1.5 degrees C (2.7 degrees F) of warming within just the next two decades.** Whether we limit warming to this level and prevent the most severe climate impacts depends on actions taken this decade. More than 50% chance that the 1.5 degrees C target is reached or crossed between 2021 and 2040
- **Only with ambitious emissions cuts can the world keep global temperature rise to 1.5 degrees C,** the limit scientists say is necessary for preventing the worst climate impacts. Under a high-emissions scenario, the IPCC finds the world may warm by up to 5.7 degrees C (10.3 degrees F) by 2100 — with catastrophic results.
- **Human-induced climate change is already affecting many weather and climate extremes in every region across the globe.**
 - Evidence of observed changes in extremes such as heatwaves, heavy precipitation, droughts, and tropical cyclones, and, in particular, their attribution to human influence, has strengthened since AR5.
 - Sub-Saharan Africa has seen increased incidences in heat waves, heavy rainfall, fires and droughts which will continue to affect livelihoods, agriculture, water systems and ecosystems.
- **Some impacts, such as sea level rise, will not be reversible** for at least several centuries even after emissions fall.

- Small-scale efforts won't be sufficient; we'll need rapid, transformational change.
- Need to redefine the way in which we use and produce energy, make and consume goods and services, and manage our land.
- **While achieving the 1.5 degrees C target will be difficult and will require managing trade-offs, it also provides a massive opportunity:** Transformation can lead to better-quality jobs, health benefits and livelihoods.
- Limiting the dangerous effects of climate change requires the world to reach net-zero CO₂ emissions and make major cuts in non-CO₂ gases like methane.
- it is crucial for countries to put forward stronger 2030 emissions-reduction targets and commit to reach net-zero emissions by mid-century, if not sooner

STATES AND TRENDS IN CARBON PRICING REPORT (WORLD BANK, 2021) – NET ZERO TARGETS

- As governments now look toward recovery, **building back better will be critical to ensure emissions fall rapidly and we change course to keep global temperatures from increasing more than 1.5°C.** Global economies will need to embark immediately on processes to build green, sustainable, and low-carbon systems while ensuring that social concerns are addressed to ensure that we restructure our economies and societies in a socially fair and just manner.
- **Making the right investments now can unlock short-term gains, such as promoting job creation and restoring economic growth, and deliver long-term benefits** in the form of stability and decarbonization.
- **2020 also saw growth in attention to net-zero commitments by mid-century, with initiatives like the Race to Zero and the Climate Ambition Alliance.** As of December 2020, 127 countries, 823 cities, 101 regions, and 1,541 companies have committed to decarbonizing their activities by mid-century.
- **To reach net-zero emissions, carbon pricing can play a role in reaching net-zero emissions supported by other policies** needed to drive research and development, unlock noneconomic barriers to mitigation, and target emissions reductions with very high abatement costs. **Appropriately designed carbon pricing can help play an important role by sending a price signal to incentivize low-carbon action and avoid locking in more fossil fuel-intensive investments.** Supplementary policies include energy efficiency (short-term) and technology support policies (long-term) (IEA).
- Carbon pricing instruments can also generate revenues that can be channelled to catalyze clean investment flows, ensure the shift to a sustainable and just transition in the long term, as well as soften distributional impacts and support poverty alleviation.

DOMESTIC CLIMATE POLICY CONTEXT – WHERE ARE WE IN 2021.....

- **Paris Agreement** & Nationally Determined Contributions for 2025 and 2030 – emissions targets
- **National Climate Change Response Policy (2011) and National Climate Change Bill**
- **Carbon Tax Act (2019)** – implemented on 1 June 2019
- **Integrated Resource Plan (2019)** – 2030 electricity plan
- **Energy Efficiency and Green Transport Strategies** – to be implemented
- **Low Emissions Development Strategy (2020)** – net zero emissions commitments by 2050
- **Tax incentives** for Energy efficiency, renewable energy, biofuels production, research, development and innovation and biodiversity conservation
- **Carbon Offset Administration System (2020)** – carbon offsets under the Carbon Tax
- **Mandatory National Greenhouse Gas Reporting Regulations (2017)** – basis for carbon tax and greenhouse gas emissions reporting to the UNFCCC
- **Hydrogen Masterplan**
- Sectoral Emissions Targets and carbon budgets (still in development).

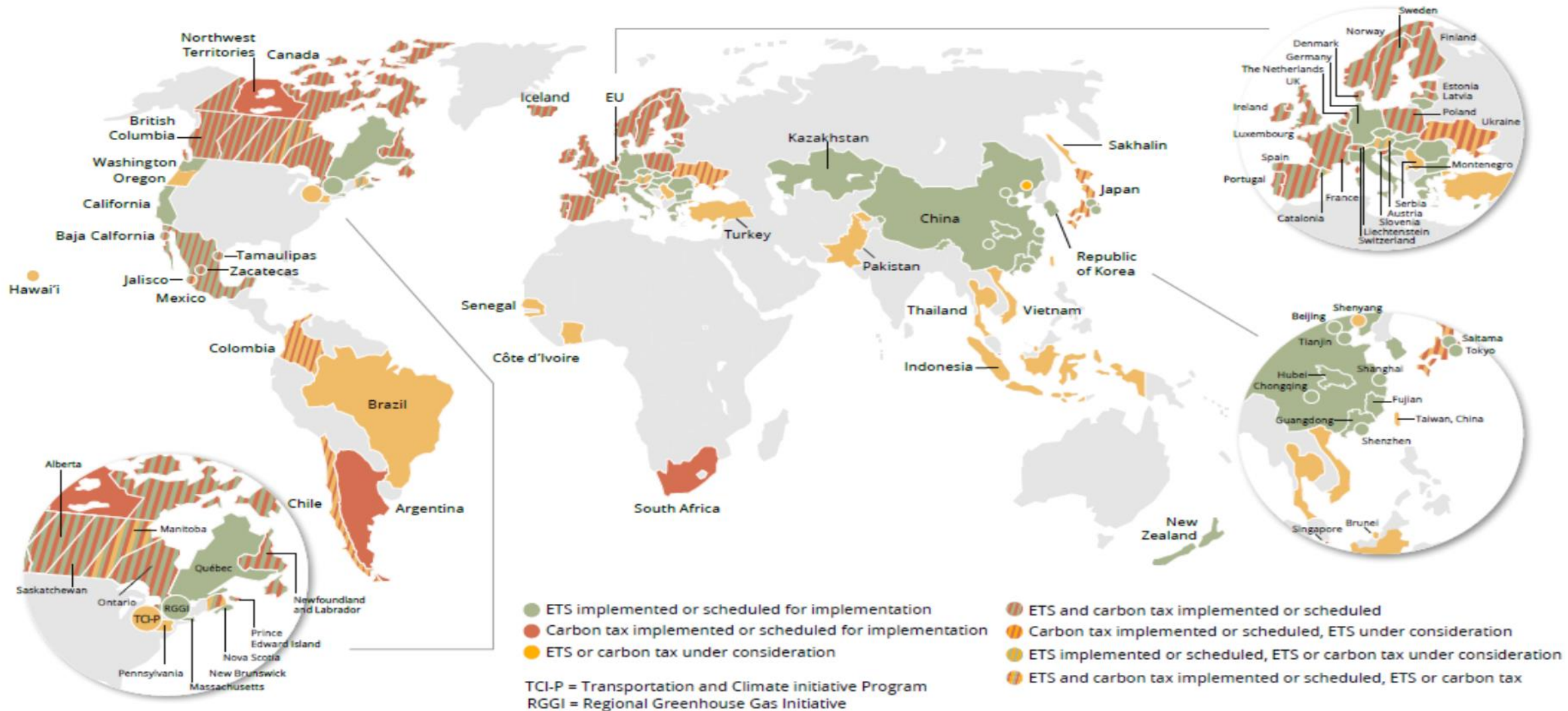
CARBON TAX AND SOUTH AFRICA'S NDCS FOR 2025 AND 2030

- **DFFE revised the NDC and has proposed the 2nd and 3rd Nationally Determined Contribution (NDC) commitments under the Paris agreement for 2025 and 2030 for Cabinet approval** ie. emissions target ranging from 398 to 510mil tonnes by 2025 and 398 to 440 MT by 2030.
 - **The proposed emissions target range ensures compatibility with the 2deg temperature goal, takes into account domestic policies, national circumstances and priorities and provides scope to cost-effectively reduce emissions through implementation of the IRP, carbon tax, and energy efficiency measures.**
- The NDC notes the **carbon tax** as an important component of our **mitigation policy** strategy to lower GHG emissions.

CARBON TAX PHASE 2 DESIGN CONSIDERATIONS

- **The High Level Carbon Pricing Commission led by Lord Nicholas Stern and Joseph Stiglitz recommended the following:**
 - **A well designed carbon price is an indispensable part of a strategy for reducing emissions in an efficient way.** Carbon prices are intended to incentivize the changes needed in investment, production, and consumption patterns, and to induce the kind of technological progress that can bring down future abatement costs.
 - **Commission concludes that the explicit carbon-price level consistent with achieving the Paris temperature target is at least in the region of US\$50–100/tCO₂ by 2030.** A carbon price could have important co-benefits – improvements in air pollution and congestion, health of ecosystems, access to modern energy.
 - **Effectiveness of carbon pricing policies will require that future paths and policies be clear and credible.** It will be important to monitor and regularly review the evolution of emissions, technological costs, and the pace of technological change and diffusion so that carbon prices can be adjusted, particularly upward, if actual prices fail to trigger the required change.

STATES AND TRENDS IN CARBON PRICING REPORT (WORLD BANK, 2021)



INTERNATIONAL DEVELOPMENTS

- A carbon tax was introduced in **Mexico** in 2014 and applies to fossil fuels.
 - It also allows for the use of offsets in the payment (only CDM).
 - The tax rate applied is set at about US\$ 3.5 / tCO_{2e} and natural gas is exempted from the carbon tax.
- **India** implements a coal tax effective from 2010, currently US\$ 6/ton coal.
- Carbon tax implemented in **Chile** at the rate of US\$5 from 2017.
- In 2008, the **Canadian Province of British Columbia** launched its carbon tax at a rate of Can\$10 per tonne of CO₂. The national government implemented a national carbon tax for those provinces that have not implemented a carbon price in line with specific national criteria (i.e. A minimum carbon price).
- **Colombia** implemented a carbon tax in 2017 on transport fuels.
- **Singapore** and **Argentina** – implemented a carbon tax in 2019.
- **Brazil** exploring a carbon price, **Senegal**, **Ivory Coast** and **Morocco** also exploring a carbon tax.

STATES AND TRENDS IN CARBON PRICING REPORT (WORLD BANK, 2021) – COVERAGE INC CHINA ETS

- **This year there are 64 carbon pricing instruments (CPIs) in operation and three scheduled for implementation.** This is an increase of six instruments compared to 2020, which had 58 carbon taxes and ETSs in operation.
- **In 2021, 21.5% of global GHG emissions are covered by carbon pricing instruments in operation,** representing a significant increase on 2020, when only 15.1% of global emissions were covered.
- **This increase is largely due to the launch of China's national ETS. China's national ETS launched in February 2021, becoming the world's largest carbon market.**
 - Initially covering around 2,225 entities in the power generation industry, the plan regulates annual emissions of around 4,000 MtCO₂.
 - Regulated entities will need to surrender allowances to cover their 2019 and 2020 emissions in 2021.
 - **Penalties for the national ETS** are currently being drafted by the State Council, with interim regulations proposing fines for entities that fail to surrender sufficient allowances by the compliance deadline: CNY 100,000–500,000 (USD 15,217–76,087).
 - Trading is planned to start before the end of June 2021. The national carbon market will be a tool to promote China's commitment to peak carbon before 2030 and achieve carbon neutrality before 2060.

EU CARBON BORDER ADJUSTMENT MECHANISM (CBAM)

- The EU Carbon Border Adjustment Mechanism will be phased in gradually and will initially apply only to a selected number of goods at high risk of carbon leakage: iron and steel, cement, fertiliser, aluminium and electricity generation.
- **A reporting system will apply as from 2023 for those products with the objective of facilitating a smooth roll out and to facilitate dialogue with third countries, and importers will start paying a financial adjustment in 2026.**
- Addressing possible adverse impacts on industry competitiveness. Our trade exposed sectors such as iron and steel, cement, and other minerals should not be subjected to BCA since they already face a domestic carbon tax; prioritise support to “these hard to abate sectors” as they are major labour absorptive sectors where technology options are limited.
- Taking into account the proposals for a carbon border adjustment mechanism (CBAM) by the EU, US, UK, Japan – there is a strong case for similar measures to be considered in South Africa to cushion impacted sectors as the carbon tax rate is increased.
- ***Appropriate emissions targets and carbon pricing reduces risk of border carbon adjustments by the EU and other developed economies on domestic exports and boost the competitiveness of the South African economy by promoting lower carbon, energy efficient and cleaner production practices and emergence of new industries.***

RATE CHANGES & MODELLING

- To achieve our NDCs, net zero emissions goals and reduce the pressure on exports facing CBAMs, an increase in the headline carbon tax rate is necessary.
- Appropriateness of the rate of the carbon tax and the tax-free thresholds taking into account NDC commitments under the Paris Agreement.
- Current effective carbon tax rate for South Africa ranges from US\$0,5 to US\$3.6/tCO₂e. Inflationary increases (2022 – 4.2%; 2023 – 4.5%) – **resulting in a carbon tax rate of US\$10 (R149)/tCO₂e.**
 - High level carbon pricing commission proposed carbon tax rates ranging from \$50 to 100 by 2030
 - A global carbon price floor **of US\$25 (R375))/tCO₂e** proposed by the IMF to help achieve a 23% reduction in global emissions below baseline by 2030, enough to bring emissions in line with keeping global warming below 2°C
- Additional modelling analysis to be undertaken to help inform carbon tax rate adjustments.

CARBON OFFSETS ALLOWANCE UNDER THE CARBON TAX

- The carbon offset component of the carbon tax has a dual purpose:
 - To serve as a flexibility mechanism that will enable industry to invest in mitigation projects at a lower cost to what would be achieved in their own operations, and thereby lower their tax liability (i.e. seeks delivery of least cost mitigation).
 - To incentivise mitigation in sectors or activities that are not directly covered by the tax and/or benefiting from other government incentives, especially in transport, AFOLU, waste.
- **Expanding the scope of carbon offsets**
 - In light of developments under Article 6 of the Paris Agreement, cooperation between countries on market mechanisms can promote cost effective emission reductions.
 - Further consideration will be given to expand the geographical scope of eligible carbon offset projects for the carbon offset tax-free allowance to include projects developed outside South Africa in particular in the African region and approval of eligible local standards.
 - A framework to guide the development of local offset standards has been completed by the DMRE and will be published for consultation.

CARBON CREDITING (OFFSET) – GLOBAL TRENDS (WORLD BANK 2021) – STATUS AND GUIDING PRINCIPLES

- **The move toward net zero has triggered fresh discussions on the role of carbon offsetting in achieving long-term decarbonization.** There is increasing consensus that offsetting should be supplementary to companies' own emissions reduction as part of their corporate net-zero strategies.
- **As governments ramp up their mitigation efforts and the costs of low-carbon technologies decrease, there will be less and less space for certain project types.** Verra has discontinued the registration of new renewable energy projects not located in Least Developed Countries — currently the main project types in terms of credit traded — on the basis that they no longer need carbon finance to be viable.
- **Ensuring the environmental integrity of offsets is crucial to the legitimacy of their role in the transition to net zero.** Carbon credits should represent real, additional, verifiable, and permanent emission reductions or removals. Just as the integrity of a given credit rests on meeting these criteria, the legitimacy of offsetting as a tool relies on having sufficient trust and safeguards such that offsets on the whole live up to these standards.
- **Poorly designed credits — whether they are used voluntarily by corporations or are linked to ETSs/carbon taxes by governments — threaten to undermine the rest of a company's or government's climate strategy.** This is one of the reasons why qualitative and quantitative restrictions exist for the use of carbon credits in all carbon taxes and ETSs.

PERFORMANCE TAX-FREE ALLOWANCE (1)

- The performance allowance seeks to encourage firms to reduce the carbon intensity of their production processes relative to their peers, taxpayers that perform better than an approved industry GHG emissions intensity benchmarks qualify for a performance allowance of up to five per cent of their total emissions, structured as graduated relief;
- Formula to determine the level of allowance firms would qualify for takes into account the actual emission intensity of the firm for the tax period (B) relative to an approved emission intensity benchmark (factor A):

$$Z = (A/B - C) \times D$$

where:

- Z is the percentage to be determined and must not be less than zero
 - A is the agreed measured and verified sector or sub-sector greenhouse gas emissions intensity benchmark (including both direct and indirect emissions) as prescribed by the Minister or zero if no value is prescribed;
 - B is the measured and verified sector or sub-sector greenhouse gas emissions intensity benchmark (including both direct and indirect emissions) of a firm in the tax period C is the number one; and
 - D is the number 100.
-
- **The National Treasury published the Regulations for the Greenhouse Gas (GHG) Emissions Intensity Benchmarks** for purposes of section 11 in terms of section 19 (a) of the Act for public comment **in June 2020**. The GHG Emissions Intensity Benchmark Regulations sets out the proposed emissions intensity benchmarks for these sectors and subsectors.
 - A review of ~17 benchmark methodologies and approaches was undertaken with support from the World Bank NDC Support Facility. The key recommendations from this study will help inform adjustments to the current emission intensity benchmarks – overall there is scope for revision of benchmarks.

RECOMMENDATIONS FROM AN INDEPENDENT SECTOR EXPERTS REVIEW OF PERFORMANCE BENCHMARKS

- An overall evaluation is provided for each benchmark
 - Most benchmark approaches fall in between adequate / not-adequate
 - Issues are described, with recommendations for improvement
 - Balance is needed between technical and political drivers, as well as feasibility
- Several cross sector issues were identified including:
 - inclusion of scope 2 emissions – inconsistency across and within sectors and omitted by many sectors;
 - product definition – there were deviations from product benchmarks to input, refining and mining benchmarks;
 - Stringency – average weighted by production, averaged by installation, linear regression, percentage reduction from average, international (regional) reference;
 - cross boundary energy – production of energy for use outside of the benchmarked process;
 - data consistency - variation in reference values used e.g. Grid electricity factor, Net Calorific Values (NCVs) of fuels, Global warming potential (GWP) 3rd or 4th assessment report;
 - Different tiers as basis for Scope 1 emissions factors;
 - Uncertainty analysis rarely done so the accuracy of the benchmark values is unknown.
- **11 sector benchmark approaches were acceptable, 5 were potentially acceptable** with some consideration and only **one benchmark** was considered **not acceptable**.
- National Treasury is considering the recommendations for adjustments to the benchmarks as part of the second phase of the carbon tax review.

CARBON BUDGET AND CARBON TAX

- The carbon budget tax-free allowance of 5 percent was implemented for the voluntary carbon budget phase (2016 – 2022) to promote participation in the system and provision of data to government
- The DFFE is currently working on the methodology for the determination of mandatory carbon budgets, as a supportive tool to a tougher and higher carbon tax. If and when such a system is mandatory, the above incentive will fall away, expected to be 1 January 2023
- To ensure alignment between carbon tax and a mandatory carbon budget – agreement in principle, is that emissions within the carbon budget will be taxed at a lower rate (all tax-free allowances applicable).
- A higher tax rate will be applied on emissions above the carbon budget where the carbon budget will serve as the maximum level of emissions allowed.
- The mandatory carbon budgets regime will be introduced in a way that is fully-aligned with the carbon tax, and designed to ensure no double penalty.

SUSTAINABLE FINANCE

How the financial sector and listed companies are disclosing more relevant climate-related information to investors.

SUSTAINABLE FINANCE TECHNICAL PAPER (2020)

- NDP and Just Transition: recognising Climate Change as a Social Justice Issue
- Treasury and SARB **financial stability mandate** is to protect SA economy and citizens from shocks to the financial system, building resilience through solvency and effective risk management
- Climate risk is a financial risk
- For financial institutions- this requires identifying, managing and disclosing environmental and social risks in their portfolio through strengthening the regulatory framework and uptake of best practices
- Treasury initiated a process in 2016 which culminated in the publication in May 2020 draft technical paper Financing a Sustainable Economy
 - South African Reserve Bank , Prudential Authority, Financial Sector Conduct Authority
 - Department of Environment Affairs, Forestry and Fisheries (DEFF)
 - South African Insurance Association (SAIA); Banking Association of South Africa (BASA)
 - Association for Saving and Investment South Africa (ASISA); Johannesburg Stock Exchange (JSE)
 - Batseta – Council for Retirement Funds
 - SA Development Finance Institutions (DFIs) and Department of Monitoring and Evaluation (DPME), SAICA, SAVCA, PRI have since been included in the working groups to take forward recommendations

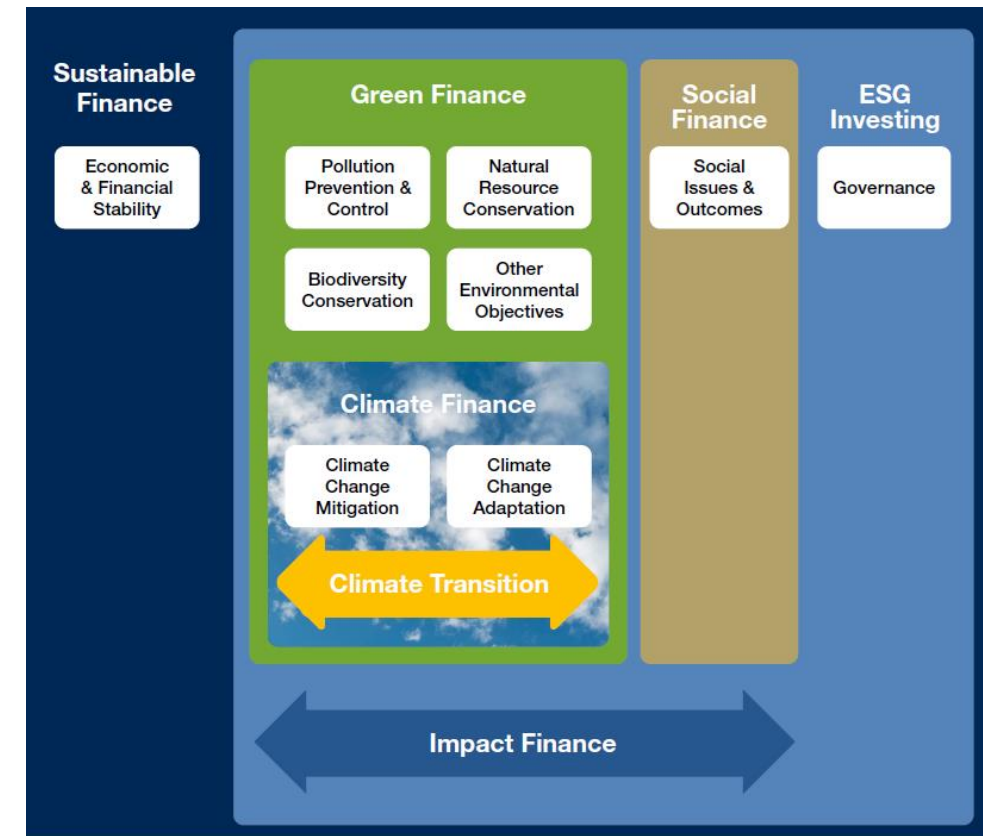


OBJECTIVES

- The technical paper includes recommendations on sustainable finance initiatives to be undertaken in **financial services industry**: Banks, Retirement funds, Capital Markets, CIS, Insurance, Private Equity and Venture Capital
- Objectives
 - Define sustainable finance (mainly related to climate change mitigation) for all parts of the South African financial sector
 - Take stock of the global and national financial sector policy, regulatory and industry actions taken to date in dealing with environmental and social (E&S) risks and opportunities
 - Identify market barriers to sustainable finance and the implementation of E&S risk management best practices.
 - Identify gaps in the existing regulatory framework and recommend actions required of regulators, financial institutions and industry associations.
- Released in May; comments received & paper being updated
- Climate Risk Steering Committee established with 5 working groups
- Website updated: <http://sustainablefinanceinitiative.org.za/>

SUSTAINABLE FINANCE DEFINITION

- **Sustainable finance** encompasses financial models, products, markets and ethical practices to deliver resilience and long-term value in each of the economic, environmental and social aspects and thereby contributing to the delivery of the **sustainable development goals** and **climate resilience**
- This is achieved when the financial sector: Evaluates portfolio and transaction-level environmental and social risk exposure and opportunities, using science-based methodologies and best practice norms; discloses and mitigates these risks and links these to products, activities and capital allocations
- An evolving area and emergent global practice and trend
- Starting with **climate risk**
- Recognises opportunities for attracting green and social finance to build a more sustainable, low carbon, green economy
- The paper encourages a voluntary approach to sustainable finance initiatives



Source: International Capital Markets Association, May 2020

KEY RECOMMENDATIONS

Develop a taxonomy for green, social and sustainable investments

- Starting with Green
- Financial classification, common language
- Coordinated and consistent approach to determine eligibility
- EU adapt and adopt
- Transitional activities and social disclosures

Co-develop technical guidance for disclosures as per TCFD

- Principles for disclosure
- Technical requirements
- Possible regulatory mechanisms



Develop a benchmark scenario for use in stress tests

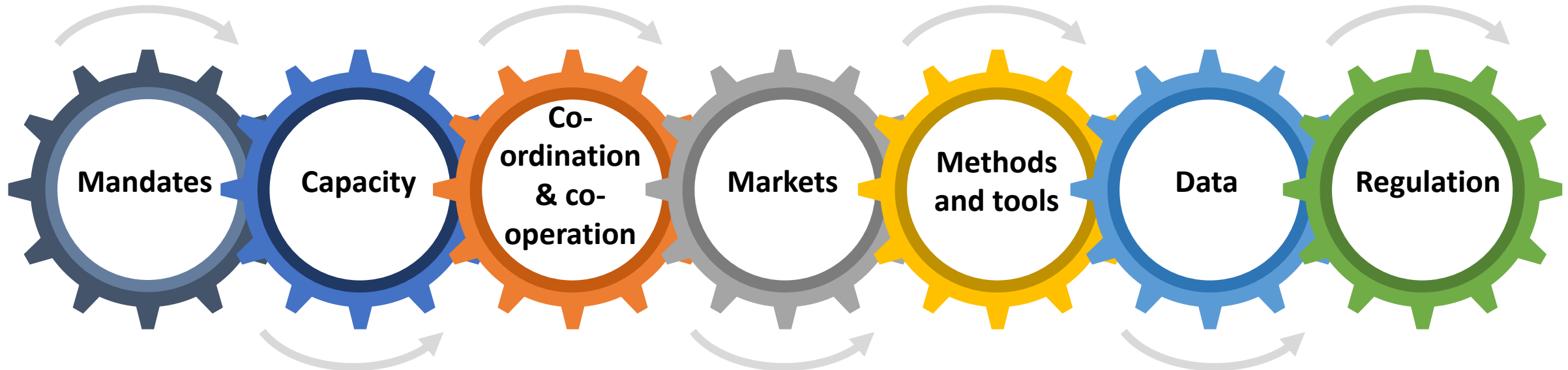
- Regulators and Treasury group at this stage
- Exploring weather scenarios; models
- Start with drought and flood
- SARB as a member of NGFS

Build sector capacity and competencies

- Training needs survey done
- General awareness raising events planned
- Starting with Fin sector and regulators
- Awareness Webinars-TCFD requirements, Governance, Financing instruments

SF is better mobilised within a coherent enabling environment

- **SF instruments do not operate in isolation**, and may not gain traction if other enabling elements are absent or deficient
- There is significant interplay and the needed actions of **different actors each pulling in the same direction**
- These **recommendations are framed in terms of enabling environment elements, and the actors** the recommendations are targeted to



PUBLICATION OF GREEN TAXONOMY FOR PUBLIC COMMENT

- **Implementation of climate policy measures and rapidly advancing low-carbon technology could lead to write-downs of carbon-intensive assets resulting in the risk of stranded assets and high debts**
- 450 public development banks jointly declared in November 2020 that they will align financing decisions with the Paris Agreement on climate change.
- **Better disclosure of exposures to climatic disasters and stress testing for financial firms can help preserve financial stability**
- The **Green finance taxonomy was released for public comments in June 2021** and is undergoing case study testing in nine financial institutions.
- **A handbook on sustainable finance methodologies** and instruments is also being finalised, together with the **Guidelines for climate related disclosures** by local financial institutions.

NEXT STEPS ON CARBON TAX

- **Well-designed carbon pricing measures provides adequate incentives for behavior change of businesses and consumers** and encourage a shift towards lower carbon and energy efficient technologies and practices in the short term, and dynamic incentives for investments in research development and technology innovation over the medium to longer term.
- **National Treasury is finalising a draft Carbon tax review paper** outlining policy design options for the carbon tax for the 2nd phase from 1 Jan 2023. This paper will be published for public comment and further stakeholder consultation later this year.
- This will inform policy **proposals on the carbon tax design which will be announced in Budget 2022.**

CONCLUSION

- National Treasury regards climate-change is the biggest risk facing human kind, and the need for globally-coordinated action
 - Good examples are steps taken after 2008 Global Financial Crisis and 2019 COVID
- Key tool is the CARBON TAX, which can still be made tougher and wider, to reduce GHG emissions to meet SA commitments to reducing GHG emissions
 - So future GHG EMITTERS be warned and do not be surprised: the carbon tax will be higher for those not making cleaner investments to reduce their emissions for the future!
- Disclosures in regulatory and capital markets will be a key focus for Treasury
 - Financial sector a key funding player, tends to take steps years BEFORE law requires, as many investors have a medium- to long-term focus
 - Listed companies will also be required to disclose more
- Many other initiatives at Treasury related to future policy and budget process, like cleaner energy, transport etc working across Govt

Thank you.