Submission to National Treasury on the draft Green Finance Taxonomy

JUST SHARE

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Dear Ms McPhail

JUST SHARE'S PRELIMINARY COMMENTS ON THE DRAFT GREEN FINANCE TAXONOMY, SOUTH AFRICA

1. Introduction

Just Share is a non-profit shareholder activism organisation. We believe that responsible investment is required to create a more just, inclusive and sustainable economy. We use research, advocacy, engagement and activism to drive urgent action to combat climate change and reduce inequality.

Just Share welcomes the publication of the Draft Green Finance Taxonomy for South Africa ("the Taxonomy"); particularly the recognition by National Treasury (Treasury) and its project partners of the potential value for the Taxonomy in "*unlocking access to sustainable finance and stimulating the allocation of capital to support a development-focused and climate-resilient economy*". It is clear that urgent and decisive action is required to limit the worst impacts of the climate crisis – to which South Africa is particularly vulnerable – and that "*making finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development*", as required by the Paris Agreement, is integral to doing so. A suitably-robust, science-based taxonomy would help to ensure that economic activities are sustainable, and position South Africa as a resilient, competitive and low-carbon economy and society.

Before we provide some preliminary comments on the Taxonomy,[1] we address the important role of civil society in driving progress on sustainable finance, and our concern that there has been inadequate consultation with this key stakeholder group in the development of this Taxonomy.

2. Expertise and experience of civil society

Across the globe, civil society activism has been a key driver of progress on sustainable finance.

In South Africa, civil society, including and often led by Just Share, has been responsible for driving significant improvements to climate financing policies, and to the climate-related disclosures of listed companies. For example:

[1] We were heartened to hear from Ms McPhail on 9 July that there would be other opportunities to provide input on the Taxonomy.

- Largely as a result of civil society pressure, in 2019, Sasol for the first time committed to a carbon emission reduction target. Later this year, Sasol will also produce a 2050 "reduction ambition roadmap", and table a non-binding shareholder vote on its climate plans at its November 2021 AGM.

- Five of the country's major banks have adopted and publicly disclosed policies relating to fossil fuel financing,[2] and each of these banks has committed not to fund the then-proposed independent coal-fired power stations, Thabametsi and Khanyisa. This followed sustained advocacy by and engagement with civil society.

- Numerous climate risk-related shareholder resolutions have been filed at JSE-listed companies that have caused the companies to commit to – and produce – improved climate-related disclosures and strategies. Again, this followed significant pressure from civil society. Just Share co-filed or otherwise assisted with various of these resolutions.

- Just Share, together with UK-based legal charity ClientEarth, commissioned a legal opinion setting out the clear fiduciary duty of South African pension fund trustees to factor climate change risks into their investment decision-making processes.

This progress would not have occurred without the bold action of civil society. It is indisputable that civil society has played, and continues to play, a major role in shaping and driving the just transition to a low-carbon economy. It is therefore unfortunate and concerning that, despite previous inputs by Just Share to this effect,[3] the "stakeholder consultation" carried out in preparation of the Taxonomy, seemed to neglect involvement of civil society, labour, and affected communities.

We therefore appeal to Treasury and its project partners to ensure that these stakeholders are included in the future development of this – and related – work, including early engagements on the intended transition taxonomy.

Just Share's comments on the Taxonomy are set out below. In Part 1, we outline our general comments, and in Part 2, we have focused only on key concerns we believe must be addressed before significant progress can be made towards the achievement of any sustainable finance objectives, namely:

- The voluntary nature of the Taxonomy;
- The absence in the Taxonomy of clear commitment to a particular science-based target;
- The link between the Taxonomy and corporate disclosure requirements;
- Greenhouse gas (GHG) emissions accounting methodologies;
- Hydrogen production;
- The standards applied to minimum social safeguards; and
- Issues relating to the transition taxonomy.

We reiterate that our comments are provisional and that we seek to be included in further consultation processes in relation to the Taxonomy, and related work.

[2] Absa's oil and gas, and mining standards are still awaited.

[3] Refer to Just Share's previously submitted comment on the Draft Technical Paper on Financing a Sustainable Economy

3. Part 1: General comments

In the context of global proliferation of taxonomies, Just Share is encouraged by Treasury's ambition to align the Taxonomy to international best practice standards. This standardisation is an important step in ensuring that the potential impact of taxonomies is maximised in global financial markets.

We also support Treasury's goal of incorporating into the Taxonomy, as appropriate, local nuance, but note the risk that this poses for the development of substandard tools and greenwashing in the absence of clearly-defined, science-based sustainability ambitions.

To this end, all wording of the Taxonomy should ensure that it limits loopholes or the potential for "creative" interpretation that would allow for investments that prolong the life-span of high-emitting, polluting or otherwise harmful activities, delaying the just transition to a low-carbon economy.

In this respect, we encourage Treasury to explicitly align the Taxonomy with the Paris Agreement, and to ensure that it is science-based (see Part 2).

Whilst scaling up of "green" finance is obviously crucial, the Taxonomy should also emphasise the need and urgency to scale down harmful activities. Credible Paris-aligned targets and transition plans are required, and financial flows must be redirected from polluting activities to regenerative and sustainable ones. The Taxonomy must facilitate this.

Additionally, we disagree with the intention to have the Taxonomy exist as a voluntary framework and urge Treasury to include a timeline for mandatory application of a robust, science-based Taxonomy (together with incentives for early adoption of the Taxonomy while it is still voluntary) (see Part 2).

The Taxonomy framework and Listing of Technical Criteria are generally user-friendly, though there are certain sections of the "Applying the Green Finance Taxonomy User Guidance"[4] document that could benefit from further clarity. In particular, Just Share recommends that Treasury explore further refinement of the seven-step process outlined in the document to make this more concise, and, as a result, clearer for investors. The addition to the document of a glossary of key terms and definitions would also be valuable.

[4] https://sustainablefinanceinitiative.org.za/wp-content/uploads/2021/06/Draft-Green-Finance-Taxonomy-User-Guidance.pdf

4. Part 2: Key concerns

4.1. The voluntary nature of the Taxonomy

Just Share commends the significant effort involved in producing the Taxonomy.

However, we have some concerns regarding the voluntary nature of the Taxonomy. It is abundantly clear that voluntary initiatives have not produced the results that they were intended to produce. It is also clear that lobbying efforts have the potential to dramatically slow progress on climate action. For example, sustained and well-resourced negative climate lobbying by industry – in particular through industry associations – resulted in the Carbon Tax Act being substantially delayed and diluted. The tax no longer presents the level of disincentive to high emitters that was the primary rationale for its implementation.

Furthermore, South Africa already has significant legislative and regulatory frameworks which allow for the integration of climate change-related risks and opportunities, many of which are referenced in the Draft Technical Paper from which the Taxonomy work has stemmed; including Regulation 28 of the Pension Funds Act, the Carbon Tax Act, the Climate Change Bill, King IV and the JSE Listings Requirements.

To date, such action as has been taken to integrate climate-related risks and opportunities into financial decision-making has been far from adequate. We believe that is likely that reliance on new voluntary processes is an inefficient and ineffective way to ensure that the necessary climate action is taken and with the required urgency.

In conjunction with better monitoring and enforcement of existing regulatory tools,[5] and the quick adoption of the regulatory frameworks that have already been developed in other jurisdictions (such as the Recommendations of the Task Force on Climate-Related Financial Disclosures (TCFD), Just Share recommends that Treasury include a timeline for mandatory application of a robust, science-based Taxonomy, and include a publicly-available roadmap that sets out a clear plan for integrating the Taxonomy into regulatory and supervisory activities (together with incentives for early adoption of the Taxonomy while it is still voluntary).

4.2. The absence in the Taxonomy of clear commitment to a particular science-based target

Just Share supports Treasury's decision to maintain consistency in the framework and technical screening criteria of the Taxonomy with those of the EU Taxonomy. In addition to this consistency between frameworks, it is also crucial that the Taxonomy align to scientific evidence, incorporating rapidly-evolving data into the framework and screening criteria as the Taxonomy expands. To eliminate uncertainty around the specific targets in use, Just Share recommends that Treasury replace reference to activities as "low-carbon" with reference instead to activities "aligned with limiting global temperature rise to 1.5°C above pre-industrial levels". Activities should, at the very least, be aligned with a "net zero by 2050" goal. This is a more accurate and less subjective reflection of the ambitions of the Paris Agreement and reflects the current climate science.

[5] Refer to Just Share's previously submitted [comment on the Draft Technical Paper on Financing a Sustainable Economy]

As part of this commitment to alignment with up-to-date and robust scientific evidence, Just Share encourages Treasury to increase specificity in the Taxonomy when referring to the overall objective of the framework. The current reference to "international best practice and national priorities" does not make clear that the overall target of the Taxonomy is to ensure alignment with the goals of the Paris Agreement and ensure that the Taxonomy is science-based. This should be made explicit to eliminate any room for misinterpretation.

It is possible that "national priorities" might be interpreted to mean alignment with the country's nationally determined contribution (NDC) – an approach we have seen adopted by Sasol. While it is important that taxonomies take into account context-specific requirements and transition pathways, these should be included only in the event that they are aligned with the goals of the Paris Agreement. South Africa's NDC is currently insufficient for meeting the goals of the Paris Agreement and, as such, cannot be used as a standard for the Taxonomy. Explicit clarification of ambitions to meet the goals of the Paris Agreement would eliminate the potential for this misinterpretation.

4.3. The link between the Taxonomy and corporate disclosure requirements

While Just Share appreciates that there may be challenges for investors in implementing the Taxonomy initially, stemming from limited access to credible, decision-useful data, we encourage Treasury to see this not as a reason to excuse limited application of the framework (or a failure to use the framework at all), but rather as an opportunity to support improved corporate disclosure requirements to enable efficient and effective use of the Taxonomy. To this end, we also recommend that the Taxonomy specify which data should be made available to the market to enable collective planning for a just transition to a low-carbon economy.

Specifically, we strongly recommend that Treasury link the Taxonomy to mandatory TCFD-aligned reporting for listed companies. This will support investors in making effective use of the Taxonomy, by ensuring that they have relevant, credible data at their disposal.

4.4. GHG emissions accounting methodologies

The Taxonomy provides choices regarding the methodology used to account GHG emissions, which creates real problems for comparability, consistency and reliability. This needs to be addressed to (a) avoid the risk of Taxonomy users selectively choosing the GHG emissions accounting methodology that provides the most desirable results, and (b) ensure comparability and consistency in the use of the Taxonomy. We recommend that Treasury require the consistent use of GHG accounting methodologies which makes use of a harmonised way of carrying out a life cycle assessment.

4.5. Hydrogen production

The Taxonomy does not exclude fossil and non-renewable manufacture of hydrogen. It is also not clear whether upstream emissions (i.e. fugitive methane emissions) are taken into account and how. We recommend that the Taxonomy explicitly excludes hydrogen manufactured with non-renewable power, and requires that upstream emissions be taken into account according to a standard methodology.

4.6. The standards applied to minimum social safeguards

It is encouraging to see Treasury incorporating international standards and frameworks on the protection of human rights into the Taxonomy.

However, there is a need for the User Guide to provide more clarity on which standards are to be applied and at what levels. Figure 11 on page 22 requires further explanation – specifically, since certain frameworks indicated as applicable to "community and wider society" do also, in fact, apply to workers, and vice versa in relation to the Bill of Rights and the Protection of Personal Information Act (which apply also to "community and wider society"). It is important to ensure clarity on the application of these frameworks to ensure that all people – including workers, community and wider society – are equally protected.

4.7. Issues relating to the transition taxonomy

4.7.1 The urgency to develop a robust, science-based transition taxonomy

We note that a transition taxonomy is planned to be undertaken as a subsequent design and development process, and that work to expand the Taxonomy will include: "*Developing and integrating social aspects and just transition models into the green finance taxonomy, Developing a chapter of the taxonomy specifically addressing transition, Deepening and broadening the catalogue of South African-specific green activities and innovation needs, and Integrating principles and guidance concerning climate-risk and low-carbon incompatible activities*".

Such transition taxonomy will clearly be a critical tool and we call for it to be as robust and consultative as possible. Failing which, it will risk losing credibility – or worse, exacerbate South Africa's already substantial socio-economic challenges. It appears that further work to expand the Tanxonomy is planned to be delivered by February 2022, will be lead by the National Business Initiative and supported by the Carbon Trust, and "*will continue to work with the financial sector, industry associations, regulators and national and sub-national government throughout*". We reiterate that civil society should be included in these processes; including labour and affected communities.

There are significant benefits and opportunities in a just and equitable transition from an extractive economy to a regenerative economy, and the transition taxonomy should address these, and the tools required to promote the just transition. Building resilience to climate change includes the need to restore ecological integrity. As set out in the International Labour Organization's "Guidelines for a just transition towards environmentally sustainable economies and societies for all":

"*Environmental protection: 'The greening of economies will enhance our ability to manage natural resources sustainably, increase energy efficiency and reduce waste, while addressing inequalities and enhancing resilience…Greening all enterprises and jobs by introducing more energy and resource efficient practices, avoiding pollution and managing natural resources sustainably leads to innovation, enhances resilience and generates savings which drive new investment and employment*".[6]

Transition assets must be linked to clear science-based timelines (with capex plans) and strategies aligned with the goals of the Paris Agreement. We strongly oppose the addition of "transitioning" activities that could allow for polluting and/or otherwise climate-harmful industries to benefit from the framework.

We have particular concerns regarding the role of fossil gas, which is addressed next.

[6] Page 4.

4.7.2 Inclusion of economic activity ‘Production of electricity, heating and cooling from gas’ in the Listing of developmental aspects.

Just Share agrees that the above activity should be excluded from the Taxonomy. However, we are opposed to its inclusion in a future transition taxonomy. There is no place for “electricity generation from gaseous and liquid fuels” in any sustainable taxonomy (green finance or transition), given that (a) fossil gas is a highly potent fossil fuel, (b) the availability of zero-carbon alternatives, and (c) the urgency of the climate crisis.

Gas as a transition fuel

The role of gas as a transition fuel is a highly contested idea. Current energy modelling shows that, until other flexible generation options are cheaper, we may need some gas to complement the large-scale deployment of renewable energy (which is cheaper than gas and easier to distribute in rural, energy-poor areas). But we certainly do not need to embark on the development of new gas projects when there is surplus gas in the global market.

In fact, doing so would be disastrous for the country’s ability to meet its obligations under the Paris Agreement. While burning fossil gas releases about 55% of the carbon dioxide (CO_2) of burning coal, it is still very much a fossil fuel. Fossil gas is also made up of 95% methane, which is a GHG more than 84 times more potent than CO_2. In addition to the effects of burning natural gas for power, there are also significant climate impacts from the release of methane into the atmosphere — both accidental and deliberate — during oil and gas extraction and transport.

The International Energy Agency’s (IEA) “Net Zero by 2050” roadmap, aligned with the urgent goal of limiting global warming to 1.5°C, is very clear that “*there is no need for investment in new fossil fuel supply in our net zero pathway*” and that “*beyond projects already committed as of 2021, there are no new oil and gas fields approved for development in [this] pathway, and no new coal mines or mine extensions are required*.” The IEA pathway demonstrates that there is no carbon budget for new gas projects, and no time for a “gas bridge” in the power sector, either in advanced or emerging economies. The IEA says the “clearest case” for using gas to replace coal is “*when there is the possibility to use existing infrastructure to provide the same energy services with lower emissions*”.

Building new gas infrastructure risks “locking in” emissions and crowding out the policy and financing space for the mass construction of least-cost renewable energy.

Even in the most efficient regulatory environment, it can take a decade from the discovery of gas reserves until first production. By the time South Africa’s gas discoveries become operable, it is highly likely they will already be regarded as stranded assets.

Global context of gas as a transition fuel

The Intergovernmental Panel on Climate Change states the world must be half-decarbonised by 2030, and fully decarbonised by 2050, if we are to hit the target of limiting global warming to 1.5°C. Yet, even if we burn the fossil fuels from already operating or under-construction oil and gas fields and coal mines, we will not even hit a 2°C target. There is simply no space in the global carbon budget for new fossil fuel exploration and production, for either “developed” or “developing” economies. Even if there were, as the world's 12th-largest carbon emitter, SA cannot justify any claim for increased carbon budget space.

5. Conclusion

The Taxonomy is a positive step in South Africa's sustainable finance policy plan. There remain, however, a number of areas that require attention in order to ensure that the Taxonomy can deliver on its potential for "*unlocking access to sustainable finance and stimulating the allocation of capital to support a development-focused and climate-resilient economy*".

As in our previous submissions to Treasury, we would like to emphasise the need for urgency in this process. If we do not act fast, it will be too late to address climate change, and, as a result, too late to address the many other social and environmental challenges which climate change will exacerbate.

Although we need to act quickly, this work must also be done in a way that takes relevant input into account. Treasury's intervention will play a significant role in determining whether we are able to successfully achieve a just transition, meet our international commitments, and avoid the worst impacts of climate change. This requires much more meaningful consultation with relevant experts in civil society, labour, and affected communities, to ensure that the transition does not serve the interests of a small section of our society alone.

Just Share thanks Treasury and its project partners for the opportunity to comment on this Taxonomy, and we look forward to further engagement on the next steps for making sustainable finance a reality in South Africa.

Kindly let us know should you have any questions about this submission.

We would also appreciate an update on the status of the draft Technical Paper on Financing a Sustainable Economy.

Yours faithfully
JUST SHARE

per:

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