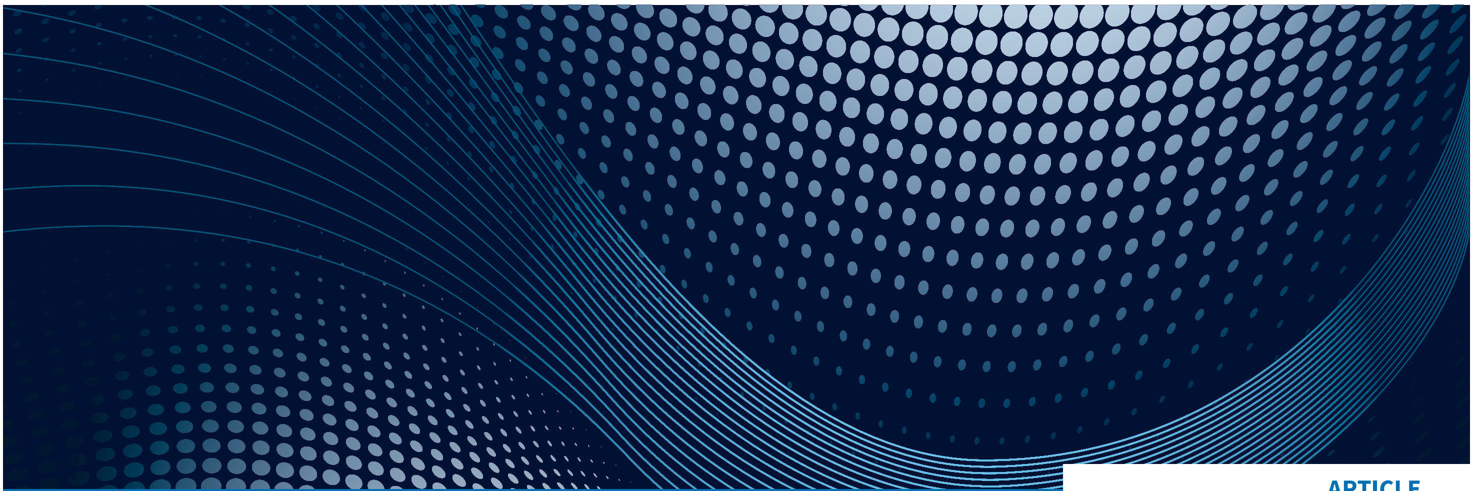

ARTICLE

The mainstreaming of ESG investing through policymaking

ESG, Sustainable Finance, Green Investments — some of the biggest buzz words in finance the last years. What used to be a niche topic has now taken centre stage. Investors' almost insatiable appetite and legislative innovation will keep it there for quite some time to come. Staying on top of local developments is not enough, reading the international trend tea leaves will be the only way for investors to answer; what next?

On the global stage, the EU has positioned itself as the Sustainable Finance frontrunner. Boasting the world's first ever climate law, an action plan on sustainable finance already in 2018, and its recent unparalleled green bond issuance, the EU green agenda has been travelling at a rate of knots. As seen with other high-profile initiatives, the EU is 'setting the standard'. EU data protection and privacy laws (the famous GDPR) are a prime example, where versions have appeared across the continent, with SA's Protection of Personal Information Act (POPIA) epitomising this trend.

With the green transition as a top priority, the EU is possibly pushing even harder to drive the progress on Sustainable Finance, through numerous international fora and initiatives. With EU's Green Taxonomy already disseminating, it appears to work. Local models of the Taxonomy are emerging in the US, UK, China and of course SA (which has relied heavily on EU legislation). Let's take a look at what is going on in the EU, and why we should care.

The EU ESG investing case study

The strong EU regulatory framework is the primary reason for the EU's global leadership the ESG space The EU laid the first brick in the Sustainable Finance foundation with its Green Taxonomy. It is a tool to determine if activities are environmentally sustainable, based on clear science-based criteria. Investors and investee companies are subject to comprehensive and standardised disclosure rules on their activities and sustainability performance, building on the classifications. Standards and labels acting as a quality label — e.g. an EU Green Bond Standard — will form the third pillar. Combined, these measures aim to prevent greenwashing and remedy the acute ESG data shortage in the market.

The next EU phase is already taking shape, aiming for inclusion of sustainability considerations into every aspect of finance. ESG integration in prudential frameworks and easier data access are high on the agenda. Two horizontal tracks are already active: Firstly, an EU Social Taxonomy which through classification, aims to direct capital to entities and activities which operate with respect for human rights, good corporate governance and support social objectives. Secondly, an overhaul of director's duties and due diligence is to come later this year, possibly integrating remuneration tied to ESG performance and incorporation of ESG considerations and stakeholder interests (e.g. of workers and civil society) into business decisions and oversight.

Alongside EU legislative developments, private institutional investors are increasingly emerging as a key driving force for Sustainable Finance. Institutional investors will continue to probe companies on their ESG approach. They see a positive correlation between ESG performance and company valuation — investee companies too will need to swiftly demonstrate sustainability leadership or at least transition efforts. With increased scrutiny of governance and supply chain processes, transparency alone is not enough to guarantee long-term growth. Markets being global, these considerations are already having a significant spill over effect on other jurisdictions, leading to tangible ESG business transformations to attract investors.

South Africa carving its own path

As more organisations recognise the need to integrate ESG at the heart of business strategies, industry is helping lead the way. In SA, the industry's influential voluntary standards and innovative initiatives such as the JSE's sustainability index are and will continue to be indispensable in local standard setting.

Globally - and especially amongst emerging economies — SA has impressive Sustainable Finance credentials. Alongside the significant sector efforts, the Treasury's plans in 'Financing A Sustainable Economy' would likely increase work on classification, ESG integration and disclosures. In short, this will provide the building blocks for a more robust and comprehensive Sustainable Finance Framework.

With the immediate direction of travel more or less mapped out, naturally the question for the industry is; what comes next? Here upcoming EU initiatives on Directors Duties and the development of a Social Taxonomy, classifying activities by social impact, could be particularly interesting as inspiration. SA already has social-focused legislation in place — Broad-Based Black Economic Empowerment (BBBEE) a key and unique example.

Nevertheless, the EU work could provide ideas and structures, with a tremendous potential for adaptation to a local context. With SA's unique socio-economic background, keen interest in Sustainable Finance and in light of President Ramaphosa's recent comments indicting an upcoming BBBEE Review, an increased focus on the Social and Governance elements of ESG appears to be a natural next policy step. A social Taxonomy could be a strong starting place. A tool which redirects capital to reach social objectives would have the potential for tangible social transformation. As such, this could prove highly attractive to government, civil society and investors.

ESG will evidently only continue to grow in importance with new industry and legislative initiatives continually emerging. Staying on top of these developments with one eye on the global horizon is therefore the only way to remain competitive.

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