Martens Impact Advisory

REPORT – TIPS JUST TRANSITION FINANCE ROADMAP WORKSTREAM: COMMUNICATION, AWARENESS & OUTREACH

PREPARED FOR TIPS

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Executive Summary

This report presents the findings of the Communication, Awareness and Outreach (CAO) workstream of the TIPS led Just Transition Finance Roadmap (JTFR) project.

The CAO workstream was initiated as a mechanism for stress-testing a range of TIPS' findings from theoretical research and analysis against real-world conditions. This was achieved through a focused engagement of stakeholders involved in South Africa's financial services sector, with particular emphasis on those engaged in (or with the potential to engage meaningfully in) Just Transition finance activities.

Interviews were conducted with the express purpose of ascertaining first-hand accounts of the experiences of these stakeholders in relation to Just Transition finance in South Africa, with the ultimate aim of identifying practical recommendations for systemic change that could unlock, catalyse and/or accelerate Just Transition finance in the country.

Interviews reveal a number of areas of constraint for catalysing and accelerating investment into projects aligned to the ambitions of South Africa's Just Transition.

At the same time, discussions conducted with these stakeholder groups present an overarching consensus that the South African market does in fact possess what it needs to 'get going' on Just Transition finance. Further, interviews have yielded a number of valuable recommendations for actions that could work to 'unlock' appropriate financing. Recommendations presented range from short term investor actions to systemic level policy guidance (see table below).

It is the hope of the paper's authors that a selection of the presented recommendations might be further investigated and ultimately implemented, and that Just Transition finance might flow more freely as a result.

Notable constraints	Key recommendations
A lack of clarity on the definition of the Just Transition.	• Refining the definition of the Just Transition for the local market, coupled with public support for this definition by policymakers.
Policy uncertainty.	• Policymakers should make clear the national ambition and strategy. • Establishment of a special entity focused exclusively on financing the country's transition.
Insufficient project pipeline.	• Increased investment in improving capacity and competence amongst policymakers, investors and project developers. • Development of specialised vehicles for project incubation and aggregation. • Working with existing project portfolios to effect change.
Inadequate tools and frameworks.	• Reformation of financial institution and financial sector incentive structures, reporting, benchmarks and project valuation frameworks. • Improved flexibility of public sector financing frameworks.
Reputational risk.	• Improved social safety net provision by public sector bodies. • Public confirmation of roles and responsibilities of public versus private sector stakeholder groups. • Increased use of appropriately designed blended finance vehicles, to allow for government involvement to act as a risk mitigant.
A lack of effective collaboration.	• Constructive, solutions-focused collaboration between stakeholders both across the private and public sector as well as within each sector.

1. Introduction

"In meeting the 21st century's most pressing call to simultaneously meet the challenges of climate change, Agenda 2030 and the desire that the transition to net zero is just - the global financial sector may be facing its most complex historic response yet." – TIPS (2021)

As discussed in the TIPS Working Paper on South Africa's Just Transition[1], the financial system plays a critical role in the facilitation of structural transformation of economies in response to pressing global need.

The challenges and opportunities presented by the need for a swift and just transition to low carbon, sustainable and inclusive economies in South Africa presents significant need for such a restructuring. To better understand the nature of what is at stake, TIPS is currently preparing a Just Transition Finance Roadmap for South Africa (JTFR).

This particular report presents the findings of the Communication, Awareness and Outreach (CAO) workstream of the JTFR project.

The CAO workstream was initiated as a mechanism for stress-testing a range of TIPS' findings from theoretical research and analysis against real-world conditions. This was achieved through a focused engagement of stakeholders involved in South Africa's financial services sector, with particular emphasis on those engaged in (or with the potential to engage meaningfully in) Just Transition finance activities[2].

The project comprised interviews with these stakeholders, including representatives of international development finance institutions (DFIs), local policymaking bodies, advisory bodies, banks and investors. Interviews were conducted with the express purpose of ascertaining first-hand accounts of the experiences of these stakeholders in relation to Just Transition finance in South Africa, with the ultimate aim of identifying practical recommendations for systemic change that could unlock, catalyse and/or accelerate Just Transition finance in the country.

The key findings and recommendations of the interviews conducted are presented in the section which follows.

[1] See paper by Lowitt (2021) here: https://www.tips.org.za/just-transition

[2] Full list of participating organisations presented in report appendix.

2. Key findings and recommendations

This section of the report presents key findings and recommendations stemming from stakeholder engagement conducted as part of the CAO workstream of the JTFR project. Where appropriate, quotations from interviews have been included for emphasis, though no attribution has been provided as per the agreement made with interview participants.

2.1. What is the Just Transition?

"We would love to contribute more to the Just Transition. If only someone could tell us what that means."

"If you ask me, we have completely overcooked this thing."

"We are working toward a more sustainable and inclusive economy. Why overcomplicate things?"

"At the end of the day, these projects are no different from anything else we've ever done. They are just packaged differently."

Each interview conducted began with a simple question along the lines of "How comfortable would you say your organisation is with the concept of the Just Transition?". The responses were varied, but the vast majority of interviewees expressed a lack of ease with the terminology used and the appropriateness of any single definition of the Just Transition for the South African context. The idea of what is "just" being subjective was raised often, and conflation of Just Transition finance, climate finance, sustainable finance, responsible investment and even impact investment was common among respondents.

Interviews revealed that those stakeholders that are involved in international initiatives and working groups have a much greater level of comfort with the concept of the Just Transition than is the case for those who operate exclusively locally. In particular, certain asset owners interviewed reported that much of their understanding of the concept of the Just Transition was gained from conversation with investors from other markets, with these discussions providing much needed and valuable "practical insights", while discussions with local stakeholders, including policymakers and peers, remained "stuck at a theoretical level".

Several investors did however note that the definition of the Just Transition made no real difference to their investment approaches, arguing that approaches built on investment into 'good' long-term projects would naturally lend themselves to involvement with transition financing.

An additional finding of interest was an apparent utopian understanding of what the transition would (or should) entail. In general, there appears to be a simplified understanding of the transition as something that should be "smooth" and "painless", with minimal loss or disruption. It is possible that this overly optimistic interpretation of what needs to take place is at least in part the result of the way in which the transition has been 'marketed' – also globally, but specifically in South Africa, where the transition is purported to be the 'silver bullet' that will solve all of the country's social and economic ills.

In this context, investors seem to struggle when confronted with the reality of what the necessary projects look like in real-life – particularly with respect to the comparatively limited returns (both financial and with respect to social / impact returns) these projects might generate. When reviewing these projects, investors reported that they often seem "insufficient" in terms of achieving the lofty goals of the completely sustainable, inclusive and 'thriving' economy that investment in the Just Transition is "supposed" to deliver.

Just Transition vs Just *Energy* Transition

A number of interviewees reported concern over the fact that there appears to have been a conflation of the general Just Transition concept and that of the Just *Energy* Transition. In general, this blurring of concepts was supported by interview content.

"There is more to the transition than *just* renewable energy investments, but that is where we are all focused for now".

In this same vein, one interview notes the importance of investing in the youth as a show of commitment by stakeholders to the Just Transition, rather than *just* the energy transition. "If we are talking about 30 year infrastructure commitments, we need continuity. Not investing in youth development now indicates a lack of such commitment."

Addressing this challenge: Picking a definition and sticking with it

Interviewees across the board recommended that the definition of the Just Transition concept be refined for the local market, with a clear role for policymakers in publicly adopting concise and appropriately nuanced terminology in this regard and providing clear guidance for financiers regarding "what counts" as contributing toward the country's transition ambitions.

In addition, there is a need for emphasis by policymakers and other standard-setting bodies of the need to be pragmatic when it comes to the short-, medium- and long-term targets and strategies adopted with respect to Just Transition finance and that these need to targets and strategies should be ambitious but also achievable and rooted in the reality of local context – *"We need to accept that [the socioeconomic situation] will probably get worse before it gets better"*.

Undeniably, there will be some mega projects which present substantial financial return and also have systemic impact, but there will also need to be investment into multiple small (often micro) projects which will deliver significantly lower return and impact, but which are equally important in ensuring that the country is able to move through the transition. It is the author's view that it is critical for stakeholders across the spectrum to understand this, if there is to be sufficient support for transition projects regardless of size – because in the end, as noted in related TIPS research[3], they do in fact all 'count'.

[3] See paper by Lowitt (2021) here: https://www.tips.org.za/just-transition

TIPS on the defining the Just Transition

Extract from TIPS Working Paper on South Africa's Just Transition (2021)

"To move thinking about a just transition in a South African context forward, the idea of developing a unifying framework of a just transition to which all stakeholders need to buy into has been rejected. Instead, a spectrum of just transition ambitions ranging from low just transition ambitions to high just transition ambitions is posited. Just as the current BBBEE system in South Africa has four levels which indicate different levels of black economic empowerment ambition and attainment as measured by agreed quantitative metrics; so the framework approach is to establish a spectrum of just transition ambitions measured by appropriate quantitative social and justice indicators. The idea behind adopting a spectrum approach is three-fold. First it negates definitional disagreement as a source of inertia and inaction and moves understanding away from a binary conceptualisation that a project either is or is not a just transition project. Second the spectrum approach includes the broadest array of projects and undertakings thereby maximizing sample size and the scale of learning and experimentation possible at this nascent stage of creating traction. Finally, a spectrum approach lays the ground work to incentivise parties to increase their levels of ambition over time."

2.2. What is South Africa's position on the Just Transition?

"No one knows for sure where we are on this as a country, and that negatively impacts risk assessment."

"We see Gwede as a rock in a river. He causes some disruption, but not enough to slow the flow."

"Policymakers have not made clear enough their commitment to these issues. The uncertainty hurts investor confidence."

"We need policy based on science and facts, not vested interests."

"This is a cross-cutting issue, but there is no cross-cutting institutional body to deal with it."

The issue of policy uncertainty and inconsistency in communication from the public sector cropped up in every single interview conducted. International stakeholders expressed particular concern over the mixed messages that are making their way into the global marketplace – specifically, with national ambitions not made explicit (for instance, the absence of an official net zero by 2050 commitment) and positive national action (like the formation of the Presidential Climate Change Coordination Commission (PCCCC)) undermined by public sector officials' support of contradictory activities, such as the expansion of investment into gas infrastructure without sufficient evidence to support this.

Local investor responses on the issue of uncertainty were mixed, with a number stating that until they had a clear understanding of what the country's ambitions were, and where financiers were expected to fit within the strategy, they would not make any proactive attempt to invest in projects aiming to support the Just Transition. Others, while agreeing that policy uncertainty was a reality, noted that this has "always been the case", and it has never been enough to stop them from making investments that they deemed to be financially rewarding – in other words, even in the absence of policy certainty, they would consider engaging in Just Transition finance if it met their risk-adjusted return criteria (see section 2.3.).

Addressing this challenge: Policy and strategy must be clear

In general, financiers, both local and international, are risk averse. Given that uncertainty is correlated with higher levels of risk, in order to catalyse investment – of any kind – it is important that this perceived risk is mitigated; essentially, that uncertainty is minimised.

Policymakers have a critical role to play in ensuring that the national ambition related to the transition is clear, and that the strategy for how we aim to achieve this ambition is appropriate in terms of its design and communication. As noted by one interviewee, "When it comes to issues of national sustainability, Government cannot overcommunicate". Though there will undoubtedly be certain instances of minor misalignment of messages stemming from various institutions, it is imperative that policymakers work to ensure that the overarching message from South Africa's national government is "consistent enough".

To this end, a handful of interviewees recommended that the South African government establish a special entity – similar to the PCCCC – focused exclusively on financing the country's transition. This 'Just Transition Financing Commission' could provide a platform for financiers to engage directly with policymakers on policy issues related to the transition, providing technical input and insight into policy development to ensure buy-in across the financial services sector. Important to note though, is that a far greater proportion of respondents expressed the view that existing bodies and structures – if used more effectively – were sufficient, and there was no need to develop an entirely new body for this purpose. More specifically, a significant number of interviewees (predominantly local investors) described a lack of appetite to engage in additional consultation, arguing instead that the government would be better off simply mandating certain investment requirements – *"We are sick of all the talking. Just tell us where we can invest and we will do it."* Further interrogation on this point revealed that the 'mandate' required was thematic, rather than prescriptive – for example, giving institutional investors a 'Just Transition Projects' allocation threshold as part of the 'alternatives' allocation in Regulation 28 of the Pensions Fund Act or implementing nationwide policy that would force investors to phase out fossil fuel investment by a certain date.

Further, interviewees reported that tools like the National Green Finance Taxonomy represented "a step in the right direction" and that more explicit policy support for frameworks such as the Taskforce for Climate-Related Financial Disclosures (TCFD) (accompanied by appropriate enforcement by regulators) would increase confidence in national leadership's commitment to the transition.

How can policymakers send a strong enough signal to the market?

Two very specific suggestions were made regarding the public sector's clear communication of its intentions, namely:

1) The development of a credible, co-created Just Transition plan for Mpumalanga.
2) Putting in place appropriately ambitious strategies for alleviating Eskom's debt.

Interviewees described the situation in Mpumalanga and the extent of Eskom's debt as constraints which are "severely hamstringing" the country's ability to transition – while simultaneously presenting significant opportunities for leveraging climate finance.

If the government were to take a strong lead on initiatives aimed at addressing these challenges, this would have the effect of sending an unquestionable signal to the market regarding the public sector's commitment to realising the Just Transition – which would go a long way toward unlocking climate finance (both domestic and international).

2.3. The 'problem' of pipeline

"There is definitely not a lack of finance. There is a lack of projects."

"We want big, bold, audacious projects."

"There has been so much talk about these projects, but there has been nothing tangible stemming from these talks – nothing that we can engage with as investors."

Whether the discussion is on climate finance more broadly, impact investment specifically, or Just Transition finance in particular, the challenge of project pipeline is a commonly cited one. Investors interviewed were very clear to emphasise that the supply of finance was not a constraint to Just Transition investments. Rather, the argument was made that investors cannot seem to find projects in which to invest.

Upon further interrogation, it became clear that the challenge of project pipeline is multifaceted. Specifically, since research would suggest that the absence of projects is perceived to be a far greater challenge than it truly is, the issue of pipeline would appear to be less one of project supply, and more one of a mismatch between projects and finance. In particular, this challenge would appear to involve issues related to capacity and competence, and also to tools and frameworks (see section 2.4.).

Case in point, investors noted that the challenge of securing investments was not that no projects ever came across their desks, but rather that the problem was largely related to finding projects which "met the criteria" for Just Transition finance. In particular, investors noted that many projects presented were "impactful" but did not meet the financial return requirements associated with their investment frameworks. This indicates that there is a view in the investor community that Just Transition projects must conform to their requirements rather than a view of how the financing community can accommodate and work with the needs of Just Transition programming (see section 2.4.).

The issue of “project packaging” was raised multiple times, with financiers noting that there appeared to be a lack of competence amongst project developers to compile investment memorandums that are “up to spec”. While DFIs noted that they were increasingly exploring opportunities to support project developers with technical assistance to guide them in preparing “bankable” projects, corporate investors reported that they did not view their role to be one of providing assistance in this regard. This is a view that is currently under pressure to change, given the urgent need for investors to ‘make deals’ rather than ‘buy deals’ in order to achieve Just Transition ambitions (as discussed in the previously reference TIPS working paper).

In other instances, investors noted that the nature of their investment approaches did not lend itself to financing Just Transition projects. Specifically, listed equity investors reported that the absence of their involvement in ‘project finance’ limited their ability to engage meaningfully in financing the transition (see box below and section 2.4. for counterarguments regarding listed equity investors’ contribution to the transition).

Investors more active in the alternatives space reported that projects were often not appropriate in terms of ticket size (either too large or too small to be viable) or were presented as “good ideas, rather than as good investments”. This further emphasises the need for increased project development support.

Addressing this challenge: Turning good ideas into good investments

Though the mismatch of existing projects and sources of finance is not entirely due to weaknesses only on the projects’ side (see section 2.4.), there were a number of recommendations made by interviewees regarding strengthening the pipeline of transition projects available to investors.

- Capacity development

Many interviewees noted a lack of appropriate capacity (specifically foundational knowledge and technical competence but also in terms of ‘manpower’) as a chief constraint to project development. Particular reference was made by local finance providers to insufficient numbers of ‘ESG competent’ of ‘Just Transition literate’ analysts within investment teams that would be capable of sourcing, ‘packaging’ and implementing these ‘innovative’ deals.

Calls were made for improving competence at the level of both project developers (in terms of project design and packaging) and also within financial institutions (specifically around pricing transition risk) and amongst public sector bodies (with particular regard to designing and administering blended finance vehicles). The provision of training and capacity development workshops in this regard was suggested by almost every interviewee.

A particularly strong case was also made for the incorporation of climate, transition and sustainability related concepts into finance-focused university and business school curricula.

In addition, the idea of compulsory climate (transition) competence being made a requirement for South African Directors was strongly supported – especially by local financiers.

- Just Transition Project Incubation

Overall, the role of project incubation was highlighted as a crucial and currently absent step in the Just Transition investment chain.

Despite acknowledging the importance of incubation, most interviewees argued that the responsibility for project development fell somewhere between the public sector and DFIs – private sector / corporate finance providers and investors were adamant to be exempted from this responsibility.

The idea of a platform dedicated to "turning good ideas into good investments" with respect to Just Transition projects was strongly supported by all interviewees, though there was little consensus regarding the most appropriate structure of such a platform or how it might be most effectively financed and administered.

Of those interviewed, representatives of DFIs exhibited the greatest appetite to support or develop incubation platforms – though they did note that this would require significant research to ensure appropriate design, which would imply that, in the absence of private sector (investor) support, any such platforms would be very unlikely to materialise in the near future.

- Project aggregation

A number of interviewees raised as a viable opportunity the need for the mass aggregation of multitudes of 'micro' projects aiming to contribute to the Just Transition. Specifically, respondents noted that commercial banks were well-positioned to prepare vehicles and products which brought together many smaller size projects and packaged these as investable products for mainstream investors. Discussions with bank representatives supported this idea, though appetite for implementation in this regard was limited, with the preference of banks consulted being that of direct engagement in larger-scale investments (such as the restructuring of Eskom or other mega infrastructure projects).

Counterpoint: Working within existing portfolios

Of all the investors interviewed, only one raised the counterpoint that investor focus is currently misplaced. Despite the fact that it was only brought up once, it is noted here, as it has significant potential to effect real change in the short term with relatively little effort on the part of investors (that is to say that in the endeavour to catalyse transition finance, it is to be considered "a low hanging fruit").

This investor noted that rather than expending energy on sourcing 'new' deals, investors should be engaging more actively with existing commitments – whether in the listed equity, fixed income or alternatives space – to catalyse development of strategies that are aligned to the objectives of the transition.

Specifically, the importance of active engagement with companies on their Just Transition strategies and the development of appropriate products (such as refinancing facilities) for supporting necessary adjustments to operational frameworks were raised as *practical steps that investors could take in the short to medium term to facilitate the transition without needing to secure any new investments.*

2.4. Using the right tools for the job

"There is a mental leap that needs to take place between our intention and the reality of how things work."

"We do want to be able to show clients and prospective clients that we offer something different. But not too different."

"Even if we wanted to, if clients aren't asking for it, we can't do it; and right now, no one is asking."

"The problem is not financing or pipeline; it is a system for matching financing to projects."

Two critical and related points were raised by every interviewee that participated in this research, namely: i) each reported that they supported the idea of investment into projects designed to advance the Just Transition, and acknowledged that these projects would include those which were 'innovative' or 'out of the box', while also ii) noting that their respective institutions were not currently 'set up' to support projects that did not fit firmly within their investment teams' current assessment tools and frameworks.

The implication is a significant misalignment between the ambitions or intentions of these investors and the tools at their disposal to realise these goals. Important to note though, is that not all investors shared a desire to make any changes to existing systems *within their own organisations or industries*. While policymakers, international associations, DFIs and players with more systemic roles were quick to identify the mismatch of intentions and systems *and* to suggest that the changes needed would have to be made internally, the vast majority of local investors both acknowledged the mismatch and very quickly pointed to amendments to external systems as the solution. Investors' focus was largely on changing the views, systems and practices of *others* (policymakers, customers, companies) rather than any kind of largescale retrofitting of internal approaches. The implication in this instance being that the constraints facing investors in terms of their approach were not subject to change.

As an example, investors who noted that they were on the lookout for "big, bold, audacious projects" quickly conceded that should such a project arrive on their desk, it would in fact be unlikely to receive financing, as it would likely struggle to 'tick the boxes' of the investment committee's checklist – *"In truth, the innovation we need would probably be too 'out there' for us to get involved with right now"*. This is because despite the investor's stated intentions to 'finance disruption' as required for the transition, the evolution of the organisation's internal frameworks had been slow, constraining the investment team to supporting only projects that pass the 'tried and tested' test. This situation was perceived less as an opportunity to evolve, and more as a dead end, with no solution forthcoming.

Similarly, a number of investors acknowledged the importance of blended finance vehicles for supporting just transition projects – with an emphasis on the crucial role to be played by public sector finance. At the same time though, those with experience in such vehicles reported that public sector financing structures – such as the Public Finance Management Act (PFMA) – counteracted progressive objectives, leaving projects exposed to excessive administrative burden and bureaucratic red tape. In these instances, the suggestion put forward was that Government's own intentions are undermined by its financial management frameworks and that this meant that the public sector should amend *its* approach and tools.

Additional instruments currently in use that were reported to counteract the objectives of transition finance include internal incentive structures and reporting frameworks, stock market indices, and company-level Just Transition indicators and benchmarks. Proposed recommendations with respect to these instruments are outlined below.

Addressing this challenge: Rethinking tools and frameworks

Interrogation into claims that project pipeline is a constraint to investing in alignment with South Africa's Just Transition objectives revealed that in many cases, it is not in fact a lack of projects which is the challenge, but a lack of appropriate tools and frameworks for identifying and supporting these projects, coupled with a lack of sufficient motivation for investors to make any substantive changes to these tools and frameworks.

- Project valuation and assessment

At present, investors are not able to comfortably and comprehensively integrate environmental, social and governance factors into their risk-adjusted return calculation frameworks. Those investors who are attempting to do so, find that their ability to do so effectively does not extend to the incorporation of real-world impact due to limitations posed by both available frameworks and internal competencies. When it comes to the transition, which is inherently focused on real-world impact, this presents a crucial shortcoming in investment decision-making processes.

In addition, institutional investors require that projects meet strict liquidity criteria, which interviewees report is largely absent in the 'green' or 'transition' focused projects with which they are most often presented.

The result is that investors – even those with stated intention to support Just Transition projects – feel that they are unable to adequately assess and value projects that 'do not fit the mould'.

Consequently, especially in the absence of any serious push to try to stretch existing tools and frameworks beyond their comfort level, many potential investments do not make it past the first round of assessment checks by 'mainstream' investors.

Further, while impact investors tend to have a broader assessment lens and are better equipped to support these projects, they often have substantially smaller pools of capital at their disposal than mainstream (and particularly institutional) investors, which presents its own limitations to financing Just Transition projects.

- Incentive structures and reporting frameworks

The challenge presented by the nature of existing ('traditional') incentive structures and reporting frameworks for financial services institutions was raised in a number of interviews – including those with representatives of banks, investment managers and regulators.

According to respondents, financial services institutions (and the individuals operating within these institutions) currently operate according to frameworks designed to encourage shorttermism in the overall approach to investment. In almost all cases, investment performance (in terms of both external and internal performance reviews) is reviewed quarterly, with decisions on mandate award most often made on an annual basis. This incentivises investors to deliver maximum returns over minimum timeframes. This is counterintuitive to the approach most appropriate in the context of the transition, which requires a focus on long-term risk-adjusted return.

The role of remuneration committees

On the point of appropriate incentives, many interviews raised the failure of remuneration committees (and remuneration consultants) to effectively advise on competence and performance assessment criteria for positions of corporate leadership.

"The RemCo is supposed to ensure that the Board is competent – including on these issues – but they are more focused on making sure packages are attractive."

- Active ownership and appropriate benchmarks

For listed equity investors, the 'investable universe' is limited – especially for investors bound to majority domestic portfolios. In addition, investment performance is measured in relation to the chosen stock exchange benchmark or index. At present, many South African listed equity investors are measured against indices which heavily weight companies that could be described as operating in ways that are not aligned to the objectives of the Just Transition. The challenge for investors in this case, is that portfolio construction which is significantly different to that of the index could reflect as poor performance – which would put at risk client mandates.

As such, translating intention to increase positive contribution toward the country's Just Transition into action for these investors is heavily reliant on engagement with listed entities. Engagement of this kind requires, amongst other things, significant time and resources and ideally involves collaboration with other investors. In any event, it is a lengthy process and results are unlikely to be achieved at the pace necessary to meet Just Transition targets.

An example of active ownership in action: Climate Action 100+
See https://www.climateaction100.org/

Climate Action 100+ is an investor-led initiative to ensure the world's largest corporate greenhouse gas emitters take necessary action on climate change. More than 615 investors, responsible for over $55 trillion in assets under management, are engaging companies on improving climate change governance, cutting emissions and strengthening climate-related financial disclosures.

Climate Action 100+ tracks the progress of focus companies against a number of key indicators through regular progress reporting and benchmarking (*see box on Climate Action*

100+ Just Transition Benchmark). Annual progress reports also provide key information about the evolution and operation of Climate Action 100+.

South African company involvement: Both Eskom and Sasol are included in the initiative, with these particular engagements led by international investors, with minimal support provided by a severely limited number of South African investors. Engagements to date have not resulted in notable success, with a strong argument to be made for increased local presence in the conversation.

In addition to increased engagement with listed entities, one recommended action that could prove significantly beneficial for listed equity investors is the adjustment of the mainstream benchmark. Creation of a benchmark[4] more aligned to the goals of the transition (aligned, for instance to a national carbon budget) and acceptance by the market of investors' use of this benchmark as a reference point for performance assessment[5] has the potential to catalyse substantial shifts in investment behaviour away from companies with disproportionately negative impacts on transition objectives.

The use of climate benchmarks: Recommendations from the EU Technical Expert Working Group (TEG)

Taken from the TEG Final Report on EU Climate Benchmarks and Benchmark ESG Disclosures (2019): *https://ec.europa.eu/info/sites/default/files/business_economy_euro/banking_and_finance/documents/190930-sustainable-finance-teg-final-report-climate-benchmarks-and-disclosures_en.pdf*

The agreement reached by the European co-legislators on the regulation amending Regulation (EU) 2016/2011, as part of the Commission's Action Plan on Financing Sustainable Growth, resulted in two essential measures regarding investment benchmarks. The first is the creation of two types of climate benchmarks, i.e. the 'EU Climate Transition Benchmark (EU CTB) and EU Paris-aligned Benchmark (EU PAB)'. The second measure is the definition of Environmental, Social and Governance (ESG) disclosure requirements that shall be applicable to all investment benchmarks.

The main objectives of the new climate benchmarks are to (i) allow a significant level of comparability of climate benchmarks methodologies while leaving benchmarks' administrators with an important level of flexibility in designing their methodologies; (ii) provide investors with an appropriate tool that is aligned with their investment strategy; (iii) increase transparency on investors' impact, specifically with regard to climate change and the energy transition; and (iv) disincentivize greenwashing.

While conceptually, the two types of climate benchmarks are closely linked to the objectives of the Paris Agreement, the TEG wants to clearly acknowledge the fact that the current state of methodologies and available issuer-level data does not allow for an evident and irrefutable conversion of climate scenarios into detailed and informed portfolio construction methodologies at the time of writing this report. In order to ensure the highest level of ambition

[4] Usually the responsibility of stock exchanges or publishing houses

[5] Investors are required to measure performance against an appropriate benchmark as a way of contributing to consumer protection

for climate benchmarks, the TEG therefore largely relies on already available proxies and currently evolving methodologies, sometimes already used by market participants. In this context, the TEG also strongly recommends a review of all minimum standards after a three-year period to ensure the highest level of ambition for climate benchmarks in accordance with potential future enhancements in the state of the research and practices around scenario analysis applied to investment strategies.

A climate benchmark can serve as:

- Underlying for passive investment strategies;
- An investment performance benchmark for GHG emission-related strategies;
- An engagement tool;
- A policy benchmark to help guide strategic asset allocation (SAA).

While benchmarks incorporating constraints or objectives related to GHG emissions have primarily been built around a (tail) risk10 reduction objectives, EU CTBs and EU PABs have broader ambitions. Investors using these new types of benchmarks not only intend to hedge against climate transition risks (Risk objective) but also have the ambition to direct their investments towards opportunities related to the energy transition (Opportunity objective). Note that only transition risks and opportunities are considered as part of the minimum standards for both indices. The physical risks associated with climate change are however included in the disclosure recommendations.

- Just Transition indicators

One instrument mentioned by investors as exhibiting significant potential for positive impact is a Just Transition indicator that could be applied to assessments of particular companies and/or projects. The idea would be to use this tool as a way to compare projects and/or companies in terms of their approach to and/or progress in terms of the Just Transition. While such tools currently being explored, their use remains nascent.

Interviewees presented a range of recommendations regarding what they felt would be the most appropriate use of such a tool. A number of investors noted the value of such a benchmarking tool for application to investment decision making processes – with ‘company Just Transition scores’ be used as an additional layer for investment valuation.

For other investors, the idea of relying solely on the score itself seemed overly simplistic, with their preferred approach being to use the components of such an indicator as the ‘pillars of engagement’ with investee projects and companies.

Further still, many investors argued that they would be hesitant to adopt any particular indicator or framework and would prefer alignment of existing frameworks, tools, benchmarks and indicators. For instance, the Climate Action 100+ Just Transition Indicator (see box below), was raised as a pre-existing indicator that could be applied with an acceptable degree of comfort to investments in South Africa, which would save time and avoid duplication of efforts and the confusion that might be generated as a result from the development of an entirely new indicator for the local market.

Most controversial was the idea of using such indicators as a tool for incentivising action at the level of company leadership, with the suggestion that executive remuneration (particularly in listed companies) being tied to company performance according to Just Transition metrics.

Climate Action 100+ and the Just Transition Indicator

See https://www.climateaction100.org/

Climate Action 100+ is working with leading experts to develop 'just transition' related indicators, which will be introduced in the next assessment cycle.

Engagement on the development of indicators has to date included incorporation of views from academics, investors and other technical experts, with a number of organisations interviewed as part of this project involved in the process. Reports from these stakeholders emphasise the potential value of such an indicator in guiding engagement with portfolio companies in developing and implementing appropriate strategies for realising the goals of the transition.

- Public sector finance disbursement mechanisms

While every interviewee acknowledged the need for public sector involvement in Just Transition projects, many expressed frustration with public sector financing frameworks (particularly the PFMA) which they described as presenting significant constraints to effective financing of integrated development projects.

Those interviewees with experience working on blended finance vehicles associated with dual mandates for achieving both financial return as well as social or environmental outcomes, reported that the bureaucratic nature of public sector finance structures often resulted in a "dilution effect", with a greater proportion of investment dedicated to administration than to project finance.

Refining public sector financing frameworks could go a long way to smoothing the path for blended finance arrangements, which are critical to achieving the country's transition ambitions.

2.5. Reputational risk

"Of course, we're involved in these kinds of investments, but we would never call them that."

"We can't take the lead in this area at the expense of keeping up in others."

"Investors need to realise that in this case, perfection is the enemy of good enough."

Investors interviewed recognise that investing in innovative, new, or 'out of the box' ideas will form a crucial component of the transition to sustainable and inclusive economies. At the same time though, they report that the nature of the South African market does not allow for experimentation. Investors describe the market as “small”, “highly competitive” and “illiquid” – characteristics which limit risk taking. The result is that institutional investors are hesitant to ‘take the leap’ and support untested concepts for fear of being perceived as reckless and losing clients as a result.

Further, investors reported an identified risk associated with claiming to be investing in alignment with the objectives of the transition, only to have such claims ‘ripped to pieces’ by civil society organisations that would accuse investors of ‘greenwashing’ should the investments in question not meet specific requirements (of which investors claimed they did not have sight). In these instances, it was perceived as less damaging to reputation to avoid these projects entirely or if engaged in such investments, to avoid in any way referring to (or labelling) them as ‘Just Transition’ projects. Presumably, in the event that investors could very clearly ‘prove’ alignment to the ambitions of such projects – through use of, for example, a nationally agreed and supported definition or list of criteria available through something like the Green Finance Taxonomy – they would be less intimidated by this particular perceived risk.

Venture capitalists would traditionally be associated with a greater risk appetite and a willingness to support projects at concept or pilot stage. Interviews suggest though that the venture capital market in South Africa is severely underdeveloped (at least, in relation to the support required). To counter this, many interviewees proposed an increased role for DFIs in the provision of support to these kind of projects – specifically with respect to small and growing businesses (SGBs).

The South African Venture Capital Market: Snapshot

Taken from SAVCA VC Survey, 2021 (https://savca.co.za/wp-content/uploads/2021/08/SAVCA-VC-Survey-2021.pdf)

- South African early-stage fund managers invested only R1.39bn into just 122 entities in 2020.

- One quarter of investments were into existing holdings, with three of the top five large and established Fund Managers making no new investments in 2020, opting rather to set aside capital for assistance to existing portfolios.

- The Public sector remains a major investor, holding 28.1% of all active portfolios by value of deals.

- More than 60% of venture capital firms have a team of five or fewer people, implying severely limited capacity to source and adequately assess deals.

It is worth noting that several interviewees dismissed the notion that reputational risk was a ‘real concern’, arguing that investors had more to gain than to lose by being ‘first movers’ in the transition finance space (a view most commonly noted by financiers, including banks and institutional investors, with greater exposure to international markets and higher levels of participation in global initiatives). Investors citing concern over reputational risk, it was argued, were doing so merely as a ‘stalling tactic’ while they waited for someone else to ‘work out the details’ of this new investment approach. From the interviews conducted, it became clear that those investors referencing fear of reputational risk were in most cases the investors who had by far less progressive views on and had made comparatively less progress (if any) with respect to their exploration of involvement in transition financing.

Addressing this challenge: Creating a safe space to think outside the box

- Just Transition Fund

Multiple respondents recommended the establishment of a special purpose vehicle in the form of a designated Just Transition Fund (JTF) that would exist as a mechanism for institutional investors to engage with transition financing in a way that satisfied risk sharing criteria. Specifically, it was argued that such an instrument would allow investors to make the argument to their clients that support of such projects was not something that was unique to their respective institutions, but part of a collective effort by institutional investors to further the Just Transition in South Africa.

Views on how the fund would be structured, who should 'lead' or 'administer' it and how it should function were wildly disparate. These specific details would need to be refined through more granular research.

The Green Outcomes Fund, the Jobs Fund and the Presidency's Infrastructure Investment Fund / Unit were mentioned as examples to review in putting together such a vehicle – with investors noting that there were both strengths and weaknesses to each of these examples.

At the same time, it is critical to note that many respondents – including some who initially or partially supported the JTF concept – noted that existing institutions and structures were likely to be just as, if not more, effective at performing the role of the JTF if only they were to be more efficiently managed. In this regard, the overarching sentiment of discussions conducted is that it is unadvisable to initiate the development of new structures in the absence of a thorough review of the applicability to the cause of those already established.

- Concessional finance for impactful projects

Investors reiterated the need for additional risk mitigation by the public sector and DFIs to encourage engagement with pioneering investments that might result in negative perceptions of investors' understanding of risk adjusted return. In this regard, the role of government guarantees was once again emphasised, as was the importance of concessional finance from DFIs and even from commercial banks as appropriate.

While there is definitely substance to the argument for the de-risking role of DFIs and public sector funding, this suggestion should be assessed in the context of stubborn investor frameworks for calculating risk-adjusted returns (see section 2.4.). Amendment to these frameworks may in fact negate the need for (as significant levels of) intervention by external institutions in the provision of finance as a method of risk mitigation.

- Ensuring appropriate expectations

A number of investors reported that the lack of clarity regarding the role and responsibilities of investors in realising the Just Transition was a hindrance to action.

An example raised was that of an investment which had positive financial and social return, but which did (directly or indirectly) cause displacement of people (either physically or in terms of employment). In such an instance, investors reported that it was likely to be an undue expectation from policymakers, civil society and the public in general that investors be responsible for 'taking care of' the victims of displacement. Instead, it was argued, this should be the responsibility of government – policymakers should ensure that appropriate social safety nets are in place to protect those not made instantly better off by transition projects. Investors noted that this inappropriate expectation increased the risk of reputational damage associated with engagement in transition projects, with a number of investors reporting that such risk was understood to be severe enough to justify avoidance of these projects altogether.

It was suggested that policymakers especially be clear on and make public the respective roles and responsibilities of various stakeholder groups, so that investors are not put under unfair pressure "to solve for all social ills".

2.6. Can we work together?

"Unless there is significant public sector skin in the game – like a substantial government guarantee – we're not touching that project."

"If public sector is involved, we're out."

"We can contribute to the same project, but I wouldn't go as far as to say we would collaborate. At the end of the day, we're competitors."

"The transition is not government's problem. And its not investors' problem. Its all of ours. Our inability to work together is risking the quality of our transition."

"Sure, collaboration is important, but it takes forever."

"Private sector paternalism does not mix well with public sector's refusal to accept technical assistance."

"Vision alignment amongst stakeholders is key and this only comes from consultation."

While every interviewee acknowledged that solving for the Just Transition would require unprecedented levels of collaboration across a variety of stakeholder groups, participants presented a range of views related to working with others – not only across, but also within stakeholder groups.

Certain interviewees expressed a strong preference for partnership with the public sector – stating that the absence of public sector participation would be interpreted as increasing the risk measure associated with the project. Others expressed with equal fervour the contradicting view: that public sector participation was in fact a deterrent to their consideration of involvement in investments. While the former view tended to be prevalent in listed equity focused investors, the latter view was expressed most often in the context of fixed income investors.

Within the private sector, institutional investors were quick to argue that involvement in projects by the country's Big Four Banks would act as endorsement of project integrity, given the 'stringent due diligence processes' of these institutions, and would provide a certain level of comfort for these investors to consider involvement in said projects.

Collaboration between investors was viewed less favourably. In general, the argument presented was that, if the project was large enough and the vehicle for financing it designed appropriately, multiple investors would of course participate. But interviewees were quick to point out that this would not be understood as any kind of true collaborative effort. It is a disheartening finding of this research that, despite the acknowledged need for partnership in achieving national Just Transition ambitions, the vast majority of investors interviewed were characterised by an extremely limited appetite to collaborate with their peers in terms of engagement with companies, policymakers or the market more generally. There was limited interest expressed in engagement through industry associations or other purpose-driven bodies, with the overall atmosphere one of 'every man for himself' in the context of a small and highly competitive market.

Addressing this challenge: Constructive collaboration

There is a general acceptance amongst the survey group of the need for increased and improved collaboration between all stakeholders in order to achieve the ultimate objectives of the Just Transition. The key consideration in this regard now becomes understanding the roles and responsibilities of various stakeholder groups and ensuring that these are effectively implemented.

- Public sector involvement as a de-risking mechanism

A recommendation raised multiple times throughout interviews was that the public sector focus on effectively performing its role as a mitigator of investment risk. This includes not only the provision of concessional finance or direct government guarantees, where appropriate, but also establishing and implementing appropriate social, environmental and economic policies and regulations (see notes on social safety nets and investor expectations in section 2.5.).

- Leveraging private sector expertise

A further recommendation specifically related to mitigating the risk of blended finance or special purpose vehicles was presented by a number of investors who suggested that public sector should seek to establish mechanisms for leveraging the technical expertise of private sector players.

Specifically, investors recommended that financial services institutions be brought on board not only once vehicles are finalised and looking to attract investment, but at the outset of the design of these vehicles.

In general, the view reported was that financial sector experts are interested in providing insight and input to ensure that the vehicles established for financing the transition are fit for purpose. (Refer again to the 'Just Transition Finance Commission' concept noted in section 2.2.). That said, in the context of the lack of support by investors regarding their role as project developers (see previous sections), it became clear that this provision of technical insight would be conditional – specifically, that it should be 'rewarded' with preferential access to resulting 'bankable' projects.

- Focused consultation

Interviewee views on consultative vehicles were as mixed as those on collaboration in general. While a number of respondents supported the idea of increased consultation between public and private sector entities in the development of the country's Just Transition strategy, a comparable number expressed frustration with the concept of 'pointless' protracted consultation and stated a preference for direct instruction (or at the very least, clear direction) from policymakers (refer to section 2.2.).

A pragmatic way forward in this regard would be to ensure that any consultation is undeniably focused – in terms of the purpose, timing and nature of the consultation. Structured in this way, a consultative process would be more likely to maximise the value to be gained from involving a diverse range of stakeholders without allowing engagement to slow down action.

3. Implications for communication, awareness and outreach

"Transition finance is a whole new ball game; the old rules don't apply."

This research has allowed for the expression by key stakeholders of a range of views and perceptions – including both those which are shared as well as many which are polarising. The implications for strategies of communication, awareness and outreach are many. Key findings in this regard are presented below.

3.1. Communication

As is always the case, when it comes to Just Transition Finance in South Africa, communication is key. There is an undeniable need in the market not necessarily for more, but for more effective communication on specific key issues related to the country's Just Transition ambitions and strategy.

For policymakers: communication on the national ambition should be clear and consistent and as far as possible should be based on science and accompanied by concrete targets and metrics for measuring progress. Conceptual definitions and investor expectations should be refined, publicly endorsed and regularly reiterated. Communication to international stakeholders, who might be less comfortable with existing levels of inconsistency in policy messaging, should be especially clear and credible.

For investors: house views on and strategies regarding transition finance should be made clear to key stakeholders, with investment strategies clearly explained – including justifications behind investment decisions related to transition projects (an opportunity to communicate real – and/or perceived – limitations to engaging in transition finance). Constraints – in the event that there exists any intention to address these – should be raised with relevant regulatory authorities and/or industry associations.

3.2. Awareness

This research has revealed limitations in levels of awareness and understanding regarding Just Transition Finance-related concepts. An opportunity exists to raise awareness (and as a result, increase competence) amongst South African financial institutions regarding Just Transition Finance and the opportunities it presents for local investors.

Research such as that currently underway by TIPS will prove an invaluable resource in raising awareness amongst the country's financial sector – as well as policymakers and other stakeholders – around key concepts, misconceptions, challenges and opportunities. This will be crucial to 'get everyone onto the same page' in terms of the realities involved in financing South Africa's Just Transition ambitions – a critical first step in accelerating the transition.

3.3. Outreach

A key finding from this research is that very few local financial institutions are taking it upon themselves to build their understanding of or increase their involvement in Just Transition Finance. The fact that many institutions are awaiting impetus from outside before they 'move' suggests a need for outreach in this regard – in this case, the mountain must go to Mohammed.

Active outreach aimed at raising awareness and distributing clear, consistent communication on key issues related to South Africa's Just Transition will be a critical input into catalysing the introspection and consequent action needed to transform the country's financial sector into one that is 'fit for purpose'.

4. Conclusion

"There is no reason why we cannot get going <u>right now</u>."

"If we wait any longer, we risk missing the window to fundamentally restructure the economy."

This paper has summarised the findings of key stakeholder interviews conducted as part of the CAO workstream of the JTFR project.

Interviews reveal a number of areas of perceived constraint for catalysing and accelerating investment into projects aligned to the ambitions of South Africa's Just Transition.

Further, interviews have yielded a number of valuable recommendations for actions that could work to 'unlock' appropriate financing. Recommendations presented range from short term investor actions to systemic level policy guidance.

A lack of clarity on the definition of the Just Transition was raised often as a constraint to action by investors. While it is possible that refinement of the definition of the Just Transition for the local market, coupled with public sector support for this definition by policymakers might go some way to alleviating this issue, it is important to keep in mind that simply understanding what the concept means is in no way a guarantee of changes to investment decision-making behaviour. Arguably, uncertainty around conceptual definitions exists more as a constraint to accurately labelling an investment than to actually making that investment. Regardless, it would do far more good than harm to achieve some consistency in terminology across the market.

Interviews reveal that policy uncertainty remains a comparatively more significant concern for international investors than for local financiers, with the latter most often operating relatively comfortably amidst 'the noise'. Nonetheless, increased clarity and consistency in communication from policymakers could go some way to improving levels of (foreign and domestic) investor confidence in public sector strategy, which is likely to positively impact investment flows.

While many respondents raised the issue of insufficient project pipeline as a constraint to investment in Just Transition projects, it is critical to emphasise that, upon further interrogation, this argument was found to be misguided. In addition, the case is not supported by recently concluded TIPS research which instead corroborates the assertion of this paper, which is that the problem is not that there are no projects, but rather that the frameworks, tools and systems currently in use by investors for decision-making are not suited to assessing the types of projects that do exist. Crucially, discussions also reveal a lack of motivation for investors to address this misalignment through adjustment to internal systems – with the response most often that of 'others' needing to make adjustments to their operations.

An urgent need exists to re-examine the way in which investors assess opportunities for Just Transition investment. Further, it is of paramount importance that this assessment be coupled with a genuine intention to effect necessary changes to internal systems – rather than taking internal systems as a given and pushing all responsibility for change to those existing externally. This will necessarily entail a reassessment of the role and responsibility of investors, for example, with respect to project incubation – something which all interviewed stakeholders agree is a vital but absent component of the Just Transition Finance value chain.

Interviews suggest that the importance of investment in the improvement of competence and capacity with respect to Just Transition Finance-related issues – from project design and packaging to transition risk calculation and blended finance vehicle development – cannot be overstated. This is beyond debate. Effective investment decision-making rests on sufficient understanding of material issues – a base level of competence is a necessity to investment allocation. Ensuring a certain base level of competence in Just Transition Finance-related concepts amongst local financial institutions is a critical success factor for the country's transition.

Equally important to the success of the transition is the role of collaboration and partnership. There is a general acceptance across stakeholder groups of the need for increased collaboration, but there is hesitance – especially amongst local investors – on active engagement in the practice thereof. An opportunity exists for the public sector to take the lead on the effective use of solutions-oriented, focused collaborative engagements designed to leverage the experience and expertise of various stakeholder groups toward acceleration of the country's transition. This is something worth exploring further.

As an overarching sentiment, the discussions conducted as part of this research present an overarching consensus that the South African market does in fact possess what it needs to ‘get going’ on Just Transition finance, with none of the constraints noted ever identified as enough to stop investors from directing finance toward these projects should they be genuinely motivated to do so.

It is the hope of the paper’s authors that this research has gone some way to shine some light on some of the real and perceived constraints to Just Transition finance in South Africa, and that a selection of the presented recommendations might be further investigated and ultimately implemented, so that Just Transition finance might flow more freely through the local market as a result.

5. Contact

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Appendix: Research participants

Interviews took place throughout August and September 2021. Interviews were not recorded, and interviewees were assured that their individual names would be omitted from the report and that no quotations would be attributed to any organisations.

A full list of organisations represented by interviewees is provided below (in alphabetical order).

Aeon Investment Management

CDC Group

Futuregrowth Asset Management

GreenCape

International Finance Corporation

Johannesburg Stock Exchange

Just Share NPC

Meridian Economics

Momentum Investments

National Business Initiative

Nedgroup Investments

Old Mutual Investment Group

Prudential Investment Managers

Public Investment Corporation

Rabia Greening Finance

Rand Merchant Bank

South African National Treasury

Synergy Global

UN-supported Principles for Responsible Investment