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FSCA Sustainable Finance Consumer Risk Report and Roadmap 2024

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FSCA
Financial Sector Conduct Authority

Contents

1. PURPOSE OF THE DOCUMENT

The FSCA in March 2023 published its Statement on Sustainable Finance[1]. The 2023 Statement put forward the following programme of work:

1. Taxonomy	2. Disclosure, reporting and assurance	3. Market development	4. Active ownership	5. Consumer education
Capacity building				
Research and stakeholder engagement				
Regulatory and supervisory framework development				
Coordination and cooperation with other stakeholders				

Part A of this document contains research undertaken by the FSCA in relation to risks posed to financial customers in the sustainable finance landscape. It forms part of the cross-cutting 'research and stakeholder engagement' activity of the FSCA's programme of work, and findings will feed into pillars as appropriate.

Part B of this document then provides an update on the programme of work itself. In considering preferred sector and customer outcomes, as a market conduct regulator it is clear that the FSCA has a vital role to play in improving the availability of credible and consistent information in the South African financial market. This encompasses two key and interrelated pillars of the programme of work:

1. **Taxonomy:** As has been noted, a common taxonomy will contribute significantly toward ensuring common terminology and understanding. The FSCA has undertaken further detailed examination of the South African Green Finance Taxonomy, including understanding current approaches to the taxonomy in South Africa and reviewing how other jurisdictions have approached taxonomies for sustainable finance.

2. **Disclosures, reporting and assurance:** three key matters fall under this pillar. The first is corporate entity disclosure or reporting – the information that a corporate makes available to the market. The second is product disclosure – the information that is provided directly in relation to a financial product or instrument that is marketed as sustainable in one way or another. Finally, matters of disclosure to retail customers must be considered. These are interrelated, as the information that is made available in relation to a product may rely on information disclosed at a corporate level.

[1] Available on https://www.fsca.co.za/Regulatory%20Frameworks/Temp/FSCA%20sustainable%20finance%20statement%20Final%20March%202023.pdf

Assurance is a necessary component of this pillar, as it ensures the credibility of information being provided. However, it is likely to (closely) follow the development of disclosure requirements.

The other pillars of the programme of work remain relevant, but are likely dependent on the quality of available information to investors, lenders and financial consumers. This in turn depends on the quality and comparability of public disclosure and reporting in the sustainability space (noting that additional reporting may be required to the regulator in support of its supervisory activities, like monitoring risk management practices related to climate change and other sustainability risks).

In updating work undertaken in all pillars of the FSCA's Programme of Work, this will encompass the cross-cutting activities of:

- Capacity building
- Research and stakeholder engagement
- Regulatory and supervisory framework development
- Coordination and cooperation with other stakeholders

These activities have been undertaken to differing extents in each of the various pillars. Part B also outlines key actions and activities being considered in relation to each pillar.

The FSCA aims to provide an annual update on its Sustainable Finance work in order to keep the market informed.

PART A: CONSUMER RISKS IN RELATION TO SUSTAINABLE FINANCE

1. INTRODUCTION

The financial sector is recognised for its important role in furthering sustainable development (UNFCC, 2015). Governments, regulators, and supervisors recognise sustainable finance as key to fostering a sustainable, resilient, and inclusive economy (OECD, 2023). As the demand for sustainable finance products and services grows, it is important to consider the risks that financial consumers may face.

As set out in the FSCA's 2023 Statement on Sustainable Finance, sustainability refers to growth or development that meets the needs of the present without compromising the ability of future generations to meet their own needs (FSCA, 2023; United Nations, 2015). Sustainable finance is an effort to align financial flows and products to a sustainable development pathway that considers the implications of economic development for society and the environment (OECD, 2023). National Treasury (2021) defines sustainable finance as financial models, services, products, markets, and ethical practices that deliver resilience and long-term value in each economic, environmental, and social aspect, contributing to sustainable development goals and climate resilience.

Part A explores the risks posed to financial customers by sustainable finance products and services and related consumer protection tools and responses. It reviews policy considerations to guide consumer protection in the context of sustainable finance. This study draws upon insights from the 2023 OECD report, titled "Financial Consumers and Sustainable Finance: Policy Implications and Approaches", along with a review of related literature on sustainable finance and consumer protection.

2. CONSUMER BENEFITS, DEMAND AND CHALLENGES IN SUSTAINABLE FINANCE

Consumers engage with sustainable finance for various reasons. One reason is their exposure to the negative impacts of unsustainable activities, leading them to prioritise consumption that focuses on mitigation and adaptation strategies. According to the International Financial Consumer Protection Organisation (FinCoNet), to achieve this, they require information that is transparent, reliable, accurate, relevant, concise, and comparable.

2.1 Consumer benefits of sustainable finance

Sustainable finance products allow consumers to integrate their values and priorities concerning social, environmental, and governance issues into their financial decisions. This integration supports various initiatives, such as energy transition, climate change mitigation, and funding for specific social causes. Sustainable products can also enhance individual financial stability and resilience, helping consumers meet their financial goals (OECD, 2023).

Depending on their design, these products may offer consumers the potential for higher financial returns and avoid financial risks linked to non-ESG-compliant financial products (OECD, 2023). Many markets are witnessing an increase in financial products aimed at helping consumers adapt to climate change-related factors and protect their assets from physical or transition risks, meeting the needs of individuals arising from climate-related events that traditional financial products may not address. Potential synergies between sustainable finance and financial inclusion may also be associated with social goals that promote inclusive economic growth and help individuals enter the formal financial sector (OECD, 2023).

2.2 Consumer demand for sustainable finance

Studies have found a growing demand for sustainable finance products and services among retail financial customers[2]. These consumers viewed themselves as key players in driving positive change.

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[2] See, for example, Simon Kucher & Partners (2021) and 2 Degrees Investing Initiative (2020)

A report by the International Organisation of Securities Commissions (IOSCO,2022) found that young people prefer sustainable investments more than other age groups. FinCoNet (2022) attributes the growing consumer interest in sustainable finance to an increased exposure to the negative externalities of unsustainable activities and an increased awareness of climate risks. The increase in demand for sustainable finance products signifies a societal shift towards environmentally responsible and ethical investing. As consumer awareness grows, consumers are driving the financial sector towards sustainability. However, a 2022 report from IOSCO states that there is limited data on consumer knowledge, attitudes, preferences, and behaviours about sustainable finance. This is particularly true for developing countries. The report further states that there is little evidence of the factors consumers and investors consider when selecting sustainable finance products.

2.3 Challenges faced by consumers

Consumers can face difficulties when making financial decisions or choosing financial products relating to sustainable finance. Studies from the OECD (2023) and IOSCO (2022) attribute these difficulties to several factors, which have been observed across different regions and countries and which are, in many instances, interrelated:

- **Complexity in sustainable finance**: The range of financial products that may be offered and unclear definitions make it difficult for consumers to make informed decisions.

- **Limited consumer knowledge**: Consumers often struggle to understand and differentiate sustainable finance products from conventional ones. This is due to the absence of universally accepted definitions for terms like 'sustainable finance', 'ESG finance' or other environmental, social, or governance terms.

- **Need for financial education**: Even individuals with high financial literacy often exhibit low levels of sustainable financial literacy. Financial education is essential to help consumers navigate sustainable finance products and understand the new risks they bring.

- **Inconsistent sustainability disclosures**: There is inconsistency in sustainability-related disclosures across companies. This inconsistency results from the voluntary nature of sustainability-related disclosure and reporting frameworks in many jurisdictions.

- **Inconsistent metrics and methodologies**: Consistent and comparable metrics or methods are lacking. This hinders a reliable understanding and comparability of what constitutes a green, low-carbon, sustainable, or ESG product or investment strategy.

3. CONSUMER RISKS IN SUSTAINABLE FINANCE

As the demand for and availability of sustainable finance products and services grows, it is essential to consider the role of financial sector regulators in promoting informed consumer choices, mitigating consumer risks, and formulating strategies to ensure fair treatment of consumers (FinCoNet, 2022).

3.1 Risks common to all financial products

The following are examples of risks that are common to *all* financial products, which include sustainable finance products, as highlighted by the OECD (2023):

- Product design and quality.
- Inadequate or misleading information disclosure.
- Market misconduct.
- Low levels of financial literacy.
- Consumer biases.

The above risks could result in consumers engaging with sustainable finance products and services that do not align with their preferences, goals or expectations. This could result in a loss of trust in sustainable finance products generally (OECD, 2023).

As these risks are present in relation to traditional financial products and services, it also means that financial sector regulators may be able to rely on existing powers and regulatory tools to address the risks, rather than develop new requirements.

3.2 Specific risks associated with sustainable finance products

There are also risks unique to sustainable finance products, notably “greenwashing”, “social washing”, and “impact washing”. While greenwashing and social washing can occur with any financial product or service marketed as sustainable, impact washing is specific to investments (OECD, 2023).

Greenwashing:

Greenwashing is a deceptive marketing strategy where financial products are misleadingly presented as environmentally friendly. This can involve false claims about a product's environmental impact or exaggerations about a company's sustainability efforts. The risk of greenwashing exists in any financial product that makes unclear environmental claims, which can mislead consumers and distort the information needed for informed financial decisions (OECD, 2023).

Greenwashing can harm individual consumer interests and reduce overall consumer trust. Regulatory bodies and policymakers are taking steps to address this issue to improve market accountability. For instance, misleading advertisements have been removed, and "greenwashing reviews" of certain financial products have been conducted. These actions highlight the importance of clear labelling, defining sustainability terminology, and explaining how sustainability is integrated into investment strategies. Companies making false or misleading sustainability-related statements face enforcement actions, indicating increased scrutiny of greenwashing practices in the financial sector (OECD,2023).

Social Washing:

Social washing refers to companies falsely claiming commitment to social responsibility initiatives or seeking profit under the pretence of such projects. This issue arises when there is a gap between a company's stated commitment to social issues and its actions. As consumers and investors have become more aware of social issues and how companies handle them, the risk of "social washing" has increased (OECD,2023).

This risk occurs when companies mislead consumers and investors about the socially responsible aspects of their products, or the "S" in ESG (Environmental, Social, and Governance). Like "greenwashing", "social washing" can distort the information consumers and investors need to make informed decisions about financial products or services that align with their social values. This distortion can potentially mislead them. Developing globally accepted reporting standards for the 'S' aspect of ESG may take time. Frameworks such as those recently developed by the

International Sustainability Standards Board (ISSB)[3], the Sustainability Accounting Standards Board (SASB)[4] and the OECD Guidelines for Multinational Enterprises could serve as a basis for future global standard setting (OECD, 2023).

Impact Washing:

Impact washing is a misleading practice in sustainable finance, like greenwashing and social washing. It involves falsely marketing investment products as having a significant, positive impact on the real economy, where this impact is either unverifiable, immeasurable, or overstated. This can lead to a misalignment between the investments' marketed benefits and the investors' actual expectations, goals, or preferences (OECD,2023).

"Impact investments" aim to generate measurable positive social and environmental impacts alongside financial returns. However, the issue of impact washing arises when the effects promised of an investment cannot be substantiated or are inaccurately measured. However, investment is still promoted as having a significant positive impact, such as making the economy "greener" or "sustainable". This practice can lead to consumer misinformation and potentially undermine trust in sustainable finance (OECD,2023).

4. CONSUMER PROTECTION TOOLS AND RESPONSES

As the sustainable finance market continues to grow and expand, the G20/OECD High-Level Principles on Financial Consumer Protection (FCP Principles) serve as a helpful reference point for ensuring fair and responsible treatment of financial customers in sustainable finance (OECD,2023).

4.1. Financial Literacy and Awareness (FCP Principle 4)

Principle 4 of the FCP Principles underscores the critical role of financial education in protecting consumers and maintaining confidence in the financial sector (OECD, 2023). The IOSCO (2022) report offers examples of initiatives related to sustainable finance and suggests industry

[3] See: ISSB. (2023). *IFRS S1 and IFRS S2: Sustainability disclosure standards*. International Sustainability Standards Board

[4] See: SASB. (2023). *Industry-specific standards for ESG reporting*. Sustainability Accounting Standards Board

approaches for developing such education. These include educating retail investors on obtaining sustainability-related information and determining whether products align with their preferences. Furthermore, It also encourages market participants to help investors understand ESG certifications, labels and scores.

In addition to these initiatives, the IOSCO report emphasises the importance of training financial advisors on greenwashing and protecting investors against misleading sustainability claims. The OECD (2023) endorses developing and implementing national strategies for financial education and individual programmes. It suggests employing financial literacy surveys to gather insights into financial knowledge, behaviours, and attitudes.

4.2. Equitable and Fair Treatment of Consumers (FCP Principle 6)

Principle 6 of the FCP Principles stresses that all financial consumers should be treated equitably, honestly, and fairly throughout their relationship with financial services providers (OECD, 2023). The principle also highlights the importance of paying particular attention to consumers who may be vulnerable, as vulnerability can manifest in different ways and apply in various circumstances.

In sustainable finance, some consumers may be vulnerable due to climate-related risks. Financial services providers should consider such vulnerabilities when conducting suitability assessments for individual clients or selling financial products. This approach ensures that the financial products align with the consumers' needs and circumstances, promoting financial well-being (OECD,2023).

4.3. Disclosure and transparency (FCP Principle 7)

Principle 7 stresses the need for clear and accessible information. However, adequate disclosure is challenging due to the need to balance providing sufficient information and not overwhelming the consumer with complex data and the costs associated with disclosure (OECD,2023).

According to a study by IOSCO (2022), consumers find comparing sustainable finance products to traditional ones challenging, which could affect consumer perception or understanding of the risks and performance of sustainable finance products (IOSCO,2022)—highlighting a need for improved tools and methods to help consumers evaluate these products about their broader financial goals. Therefore, enhancing disclosure and transparency in sustainable finance is crucial to ensure consumers have the information to make informed choices.

Issues often arise in sustainability disclosure due to the current voluntary nature of reporting and diverse reporting frameworks, leading to selective disclosure. In response to these challenges, the ISSB released the IFRS S1 and S2 in June 2023. These standards aim to integrate sustainability reporting with financial reporting, ensuring companies provide comprehensive and comparable information to meet stakeholder demands. IOSCO has endorsed these standards, and numerous jurisdictions are contemplating incorporating them into their frameworks (OECD,2023).

The development and implementation of standardised, comprehensive disclosure requirements, like the ISSB, are steps towards achieving this objective. In addition to improved information due to corporate reporting requirements, disclosure should also consider information made available to retail customers when purchasing financial products or instruments marketed as ‘green’, ‘sustainable’, or ‘impact’ (OECD, 2023).

4.4. Quality of Financial products (FCP Principle 8)

Principle 8 of the FCP Principles states that financial products should align with consumers' interests and contribute to their financial well-being (OECD, 2023). This principle implies that financial services providers should ensure thorough product oversight and governance. It involves defining a target market for each financial product, conducting research and behavioural analyses to understand this market, and potentially testing the product before its launch, depending on its type, complexity, and associated risks.

4.5. Responsible Business Conduct & Culture: Suitability Assessments (FCP Principle 9)

Principle 9 of the FCP requires that financial services providers and intermediaries work in the best interest of consumers and promote their fair treatment and financial well-being. It also requires adequate training, qualification, and objectivity of financial advice. Financial product providers should undertake suitability assessments to evaluate whether the product matches a consumer's preferences, interests, and objectives, including sustainability aspects (OECD,2023).

Consumers may face challenges in defining and understanding their sustainability preferences and options. Behavioural biases may also affect their choices. To address these issues, financial services providers and intermediaries must have adequate knowledge and competence in sustainable finance and explain it clearly to consumers. Financial education for consumers and industry participants is also essential (OECD, 2023).

4.6. Complaints Handling and Redress (FCP Principle 12)

Principle 12 of the FCP Principles requires financial consumers to have access to adequate complaints handling and redress mechanisms, which are essential for resolving disputes related to sustainable finance products, especially in cases of greenwashing (OECD, 2023).

These mechanisms should enable providers to monitor and address systemic issues, supporting improved consumer outcomes. Information about consumer complaints should be available to oversight bodies for supervisory or enforcement functions. Providers and external dispute resolution schemes should consider categorising complaints related to sustainable finance products separately and making aggregated information about such complaints public. This approach would increase transparency and support the supervisory functions of oversight bodies (OECD, 2023).

5. POLICY CONSIDERATIONS

The following section outlines preliminary strategies the OECD (2023) recommended to ensure that sustainable financial products align with consumer needs and circumstances, thereby improving consumer financial well-being and protection.

Consider adopting a coordinated and holistic approach towards financial consumer protection relating to sustainable finance (all FCP Principles)

Addressing new risks will require a coordinated and holistic approach. A combination of measures such as disclosure and transparency, financial education, financial product requirements, complaints handling and redress mechanisms, and effective supervision and enforcement may be necessary to ensure adequate financial consumer protection. The FSCA supports a coordinated and holistic approach, and this is being considered both in terms of the FSCA's mandate and work in relation to traditional market conduct matters, as well as in terms of the

FSCA's programme of work relating to sustainable finance. For example, addressing risks of misleading information can be addressed in terms of existing powers of the FSCA; while bespoke disclosure requirements may also be considered in future.

Adopting a consistent definition of "sustainable finance" or supporting comparability of definitions at the jurisdiction level to facilitate consumer transparency, clarity and understanding (FCP Principle 1)

Adopting a consistent definition of "sustainable finance" to facilitate consumer transparency and understanding when comparing financial products is essential. Policymakers and oversight bodies should consider adopting a consistent definition or supporting comparability at the jurisdiction level. Definitions need to be supported by well-defined ways to assess the sustainability of financial products and underlying assets and by granular and consistent data. The FSCA's 2023 statement on sustainable finance proposed an initial definition of sustainable finance, building on the definition provided by the National Treasury.

Collect evidence and data and monitor market developments to inform evidence-based responses (FCP Principle 2).

Regular market monitoring will help identify risks and regulatory framework gaps in sustainable finance. Understanding consumer attitudes, behaviours, and experiences about sustainable finance is crucial given the rapidly evolving market. This understanding will assist in developing consumer protection approaches and identify gaps in consumer understanding of sustainable finance products. The FSCA has undertaken stakeholder engagements on sustainable finance matters. It has also undertaken surveys of particular market segments (notably investment providers and ESG ratings agencies), findings of which will be shared when available.

Consider the opportunities of sustainable finance to promote access and inclusion for excluded or under-served populations (FCP Principle 3)

Sustainable finance can significantly promote financial inclusion, contributing to inclusive economic growth. Policymakers and financial service providers should consider how sustainable finance products could support underserved or excluded populations. These products may also address needs arising from climate-related events. This can form part of the FSCA's market development pillar.

Consider developing targeted financial education initiatives to promote awareness and understanding of sustainable finance products (FCP Principle 4 and Recommendation on Financial Literacy)

Developing targeted financial education initiatives can promote awareness and understanding of sustainable finance products. These programmes can enable appropriate financial decisions by empowering consumers with knowledge, awareness, and skills. The FSCA's programme of work contains a pillar dedicated to consumer education.

Consider vulnerabilities in the context of fair and equitable treatment of consumers and responsible conduct (FCP Principle 6 and FCP Principle 9)

Financial consumers may face vulnerabilities due to climate-related risks, such as asset loss or value reduction, increased indebtedness, and reduced financial resilience. Financial service providers and intermediaries should account for these vulnerabilities when providing or advising on financial products or conducting suitability assessments, ensuring fair treatment, and acting in the best interests of consumers. This is an aspect that the FSCA can consider addressing in terms of traditional requirements on financial advisors and intermediaries. The FSCA is also developing an approach to consumer vulnerability to better address consumer vulnerabilities – including but not limited to vulnerabilities as a result of climate-related risks.

Consider the adequacy of disclosure standards and quality of financial products, and support transparent sustainability reporting (FCP Principle 7 and FCP Principle 8)

Clear disclosure standards can facilitate adequate consumer disclosure and support transparent sustainability reporting practices. Clear definitions, terms, and plain language can help consumers understand sustainable financial products and make informed decisions. A balance should be struck between providing all relevant information without overloading consumers with complex information or imposing undue burdens on reporting firms. This is further discussed in terms of the FSCA's programme of work, and specifically the disclosure pillar.

Monitor disclosure and advertisements to understand how sustainable finance products are promoted, and watch for misleading representations (FCP Principle 2 and FCP Principle 7)

Given the risk of greenwashing and other misleading representations, oversight authorities must monitor disclosure statements and advertisements for sustainable finance products to ensure that all claims are accurate and honest. This is another aspect that the FSCA can consider addressing in terms of traditional requirements, but also ties in closely with improved disclosures which will drive the availability of more consistent, credible information being made available in the market.

Harness complaints handling and redress mechanisms (FCP Principle 12)

Complaints handling and redress mechanisms are crucial in resolving consumer complaints and disputes related to sustainable finance products. Financial service providers and external dispute resolution schemes might consider categorising complaints related to sustainable finance products separately. They could also consider publicising aggregated information regarding such complaints or publishing relevant case studies. Again, the FSCA can consider addressing such concerns in terms of traditional requirements relating to complaints handling and redress, but may consider further regulatory or supervisory developments in this regard. The financial sector ombuds also have a role to play in relation to this.

Encourage the appropriate training of financial services providers and intermediaries about sustainable finance products and services (FCP Principle 9)

Financial services providers and intermediaries should be appropriately trained and qualified. They should have a good understanding of sustainable finance products and be able to undertake an appropriate assessment of climate-related financial risks to ensure good consumer outcomes. The FSCA already has fit and proper requirements that apply to financial service providers and intermediaries, and these can be bolstered in relation to sustainability considerations.

Engage in international collaboration and coordination, which are vital, especially in exchanging good practices (Principle 2)

Given that climate and social risks affect many, if not all, countries, and considering the cross-border nature of many financial products, there is a significant need to continue promoting co-operation and dialogue at an international level. This is particularly important as many jurisdictions worldwide are developing regulations related to sustainable finance. Therefore, sharing good practices related to sustainable finance is crucial. The FSCA participates in many international forums for the purposes of staying abreast of international best practise. This includes the G20

OECD Task Force on Financial Consumer Protection; FinCoNet; IOSCO; the IAIS; IOPS; all of which have taken sustainable finance into consideration in their programmes of work.

6. PART A: CONCLUSION

Given the FSCA's commitment to mitigating risks and ensuring fair treatment of customers in designing and selling financial products and services, this section of this document delved into the potential risks posed by sustainable finance products and services to financial consumers and the consumer protection tools and responses available to policymakers. While fostering a resilient, inclusive, and sustainable economy, sustainable finance presents challenges due to its complexity, a wide range of options, and a need for standardised terms and definitions. Hence, there is a call for the standardisation of definitions, improved financial literacy, and the implementation of effective educational programs.

Consumer protection tools and regulatory responses are crucial to mitigate risks associated with sustainable finance products, including greenwashing and social washing. This necessitates a thorough evaluation of the impacts and risks tied to sustainable finance to promote informed choices, mitigate risks, and ensure the fair treatment of customers. Policy considerations suggest adopting a holistic approach to financial consumer protection, emphasising the importance of clear and consistent definitions of sustainable finance, enhanced disclosure standards, and quality of financial products.

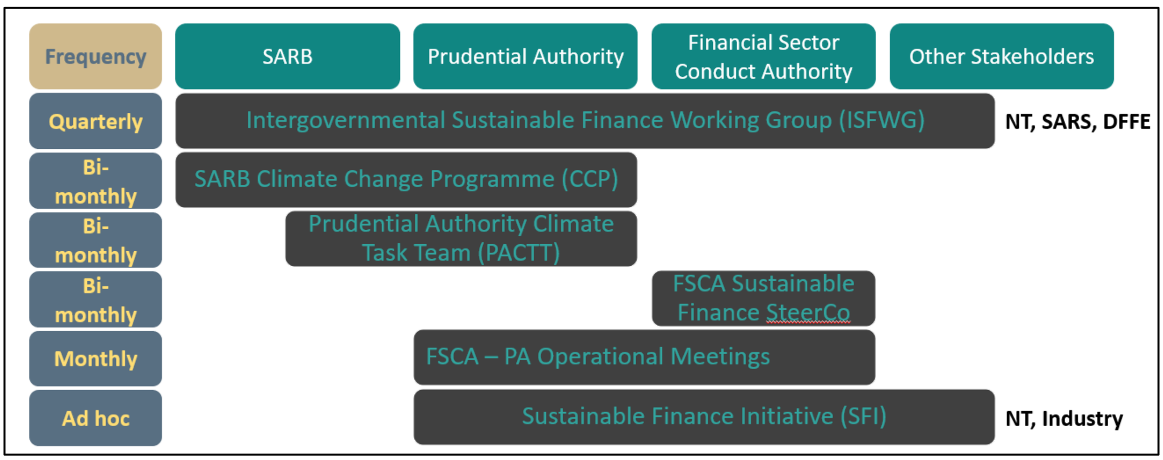
Targeted financial education initiatives are needed to improve consumer awareness and understanding of sustainable finance, ensure fair treatment, and promote financial inclusion. Additional measures include monitoring of market development, proper training of financial services providers, and international collaboration to share best practices. Addressing these challenges and leveraging the opportunities presented by sustainable finance can promote transparency, enhance consumer protection, and promote financial literacy. This will contribute to achieving a sustainable and inclusive economic future.

PART B: FSCA SUSTAINABLE FINANCE ROADMAP 2024

This section of the document outlines recent developments and next steps in relation to the FSCA's Programme of Work on Sustainable Finance.

It is important to highlight the strong focus on cooperation and coordination amongst key stakeholders in South Africa, in relation to sustainability and sustainable finance considerations. The FSCA and PA in particular will continue to work in close cooperation, particularly as guidance and other requirements are developed for the financial sector.

Some platforms for coordination and cooperation between the FSCA, PA, SARB and other stakeholders are depicted below:



Over the course of the 2023/24 financial year, the FSCA undertook two surveys relating to sustainable finance: one on ESG practises in the investment providers industry, and one relating to ESG ratings agencies.

These surveys were broad-ranging, and touch on various aspects of the FSCA's program of work. Results of the surveys are expected to be provided in the course of 2024.

1. SOUTH AFRICAN GREEN FINANCE TAXONOMY: FSCA CONSIDERATIONS

In April 2022, the National Treasury launched South Africa's first green finance taxonomy (GFT). This is a classification or catalogue that defines a minimum set of assets, projects, and sectors that are eligible to be defined as "green" or environmentally friendly. It is intended to support national policy and voluntary private sector initiatives toward sustainable finance, by reducing the costs and uncertainty in classifying a core set of green activities.

The Presidential Climate Commission (PCC) in 2023 released its report "South African Climate Finance Landscape 2023"[5]. It noted that despite the country making progress in creating enablers for the transition to a low carbon economy, "significant barriers persist in accessing and mobilising climate finance." One of the recommendations of the paper is therefore to encourage better adoption of the GFT.

In its stakeholder engagements, the FSCA explored the views and approaches of various industry players in relation to the GFT. There were a diversity of views. Some strongly supported the GFT, and were already using the tool in relevant financing operations. Some also supported more formal regulation being introduced to drive greater adoption of the GFT. However, other views noted some of the challenges being experienced. These include:

- Uncertainty and apprehension regarding the principles requiring minimum social safeguards and the Do No Significant Harm. There were views that the GFT could do more to provide clarity on the 'just' aspects under consideration and not just green aspects.
- Some stakeholders expressed hesitancy to apply the Do No Significant Harm principle due to its subjective nature and potential consequences thereof. Some others contend that there isn't a significant degree of subjectivity in determining what constitutes "significant" harm.
- The costs of implementation and verification were also acknowledged as a challenge in implementing the taxonomy. This includes (but is not limited to) perceived significant costs and time implications of aligning with the "do no significant harm"[6] provision.
- It was noted that the application of existing frameworks in some entities added complexity to compliance with the South African GFT, contributing to low industry adoption. For example, some entities comply with the EU Taxonomy, the application of which is mandated in terms of EU law, in order to satisfy requirements of international providers of capital that must comply with EU requirements.
- There are variations in ease of application across sectors - with some noting that is it easier to apply the GFT in relation to renewable energy projects than it is for the property sector, for example.
- Challenges arise in tagging listed assets, particularly in the absence of guidance for listed equities within the GFT, or of mandatory application requirements.

The FSCA has also participated in a series of training workshops to improve understanding of green finance taxonomies in general and the South African GFT in particular. This will be further

[5] https://www.climatecommission.org.za/publications/the-south-african-climate-finance-landscape-2023

[6] The main goal of the DNSH criteria is to guarantee that an activity, while making a significant contribution, does not produce negative impacts on other environmental objectives

strengthened through running a pilot with selected participants, to study the application of the GFT to inform further actions of the FSCA in relation to the tool.

The FSCA will continue to encourage the voluntary adoption of the GFT as an important tool in South Africa's just transition. It is also becoming increasingly important for purposes of supporting the flow of international capital toward green projects. It is well-noted that the PA Guidance on Climate-Related Disclosures for banks and insurers requires that, where appropriate, institutions financing activities that are environmentally sustainable should reference the South African green finance taxonomy.

Key activities for the FSCA in the period ahead are therefore to:

- Conduct a taxonomy adoption pilot – sandbox exercise, allows industry and regulators to learn about working with data; consider taxonomy readiness / constraints; builds on learnings from other pilots that may have been undertaken.
- Support FSCA work on disclosure that relate to taxonomy alignment: including legal and regulatory analysis.
    - Assess the potential impacts on the financial industry and stakeholders.
    - Solicit public and industry feedback through consultations.
- Advise disclosure proposals relating to corporate and product reporting and disclosure, as pertaining to taxonomy adoption.
- Further support disclosure proposals by assessing industry readiness:
    - Consider a survey or industry-wide (self) assessment to gauge awareness and readiness.
    - Engage with industry associations and stakeholders for insights.
    - Analyse existing industry practices and identify gaps.

2. DISCLOSURE, REPORTING AND ASSURANCE

2.1. Corporate disclosure and reporting

The year 2023 saw some key developments relating to corporate governance and corporate disclosure guidance. For example, the G20/OECD Principles of Corporate Governance (Principles) were revised to reflect recent evolutions in capital markets and corporate governance policies and practices. This includes new and updated recommendations on, amongst others, sustainability and resilience to help companies manage climate-related and other sustainability risks and opportunities.[7] In addition to

[7] https://www.oecd.org/corporate/principles-corporate-governance/

strengthening governance, the updated Principles are also seen as supporting institutional investors by promoting stewardship codes, and the disclosure of conflicts of interest by advisory services, like proxy advisors and Environmental, Social and Governance index providers.

The Principles are presented in six chapters: I) Ensuring the basis for an effective corporate governance framework; II) The rights and equitable treatment of shareholders and key ownership functions; III) Institutional investors, stock markets, and other intermediaries; IV) Disclosure and transparency; V) The responsibilities of the board; and VI) Sustainability and resilience.

Updates made in relation to Principle IV and the introduction of Principle VI are two particular developments of relevance to sustainability considerations:

Principle **IV (Disclosure and transparency)** now provides the following:

The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, sustainability, ownership, and governance of the company.

This should be read in conjunction with Principle VI (Sustainability and resilience) which provides:

The corporate governance framework should provide incentives for companies and their investors to make decisions and manage their risks, in a way that contributes to the sustainability and resilience of the corporation.

Another key and related development was the publication in June 2023 of the International Sustainability Standards Board (ISSB) inaugural standards – IFRS S1 and IFRS S2. The Standards aim to create a common language for disclosing the effect of climate-related risks and opportunities on a company's prospects. IFRS S1 provides a set of disclosure requirements designed to enable companies to communicate to investors about the sustainability-related risks and opportunities they face over the short, medium and long term. IFRS S2 sets out specific climate-related disclosures and is designed to be used with IFRS S1[8]. The South African Institute of Chartered Accountants (SAICA), in collaboration with the JSE, hosted the South African leg of the global launch of the ISSB's Standards on 29 June 2023.

[8] https://www.ifrs.org/news-and-events/news/2023/06/issb-issues-ifrs-s1-ifrs-s2/

The ISSB standards represent an important step in creating a global baseline for corporate sustainability reporting. They have been endorsed by the International Organisation of Securities Commissions (IOSCO) and fully incorporate the recommendations of the Task Force on Climate Related Financial Disclosures (TCFD). The European Commission, European Financial Reporting Advisory Group (EFRAG) and the ISSB have worked jointly to improve the interoperability of their respective climate disclosure standards. As noted by the ISSB, this has resulted in “a very high degree of alignment, reduced complexity and duplication for entities wishing to apply both the ISSB Standards and European Sustainability Reporting Standards (ESRS)”, which were issued in July 2023.

South Africa is considering the application of the ISSB standards, including through sustainability reporting roundtables hosted by Companies and Intellectual Properties Commission (CIPC) in partnership with the ISSB and other stakeholders such as SAICA and the Independent Board of Auditors (IRBA). The FSCA has actively participated in these discussions.

More recently, as noted above, the PA has published its Draft Guidance on Climate-Related Disclosures for banks and insurers. The guidance “builds on domestic and international initiatives on climate-related disclosures, specifically the standards developed by the International Sustainability Standards Board (ISSB)”.

The FSCA anticipates releasing similar voluntary disclosure guidance for non-bank and non-insurance financial institutions, such as collective investment schemes, retirement funds, and listed companies. As noted above, there will need to be close alignment between the work done in relation to the GFT and disclosure requirements (as also discussed further in section 2.2. and 2.3).

Next steps that the FSCA is considering relating to sustainability disclosures for financial and non-financial corporate entities within its jurisdiction therefore includes:

- Confer with the PA and align approaches to corporate-level disclosure for entities within their purview, to the extent practical and upholding principles of proportionality:
  - Issue voluntary corporate disclosure guidance for non-PA regulated institutions, aligned to (informed by) the PA guidance and ISSB standards, to the extent practicable. The guidance is likely to begin with retirement funds given that Regulation 28 already requires funds to consider ESG in their investment policies.
- In consultation with exchanges and issuers in the capital markets, develop voluntary guidance for listed entities aligned to the ISSB standards. This should consider amongst others:
  - the size of entities to which the guidance would apply; a focus may be on larger listed entities with a primary listing in South Africa, with specific thresholds to be defined;
  - existing requirements on listed entities;

    - existing voluntary disclosure guidance issued by the JSE;
    - CIPC developments, to avoid duplication;
    - approaches endorsed and guidance given by relevant international standard setting bodies;
- The disclosure guidance that will be developed by the FSCA should also take into account:
    - options for green finance taxonomy alignment and the implications for disclosures (it is noted for example that different jurisdictions have followed different approaches to mandating taxonomy-aligned reporting – for example, the EU approach vs the Association of Southeast Asian Nations (ASEAN) region approach vs the approach taken to apply the taxonomy only in relation to products in Columbia);
    - relevant requirements in the proposed Joint Standard on Culture and Governance, being developed by the FSCA with the PA, including references to the King Code.

- In parallel, there will be consideration to assess regulator and industry readiness for future adoption of ISSB aligned standards on a mandatory basis, including what mandatory would look like, the timing of this, and identifying **which entities** should be compelled to comply and the **implementation time period**:
    - Survey financial institutions (including exchanges) and issuers to determine their familiarity with and adoption of these standards, based on the existing guidance in place;
    - Assess the costs and challenges associated with adopting these standards, as well as the related considerations relating to any assurance requirements;
    - Consider whether research is required taking into account research that has already been undertaken by parties including exchanges;
    - Promote capacity building for the regulator, regulated entities and affected parties.

The FSCA survey on ESG ratings agencies will also provide useful insights into the services provided in relation to ESG-related information in the South African market.

Consultation, engagements and lessons learnt will inform policy proposals for further consultation with stakeholders.

2.2. Product disclosures

Within the realm of disclosures, consideration also needs to be given to disclosure and reporting requirements applicable to financial products and instruments that are designed, marketed and sold as sustainable in some way (e.g. green, impact investment, etc).

This is closely related to both the GFT and corporate-level disclosure consideration. Products that are eligible to report under the GFT should provide information relating to their alignment with the GFT provisions. Corporate level disclosure is also important as this allows for product providers to be able to collect and use consistent corporate information to feed into underlying product information.

Product disclosures would also need to consider the level of information provided depending on the type of customer to which the product is provided. Bespoke financial products offered through, for example, corporate and investment banking relationships, would require different disclosures to products sold to retail customers and investors. Retail disclosure is considered more fully below.

Some results of the survey on investment providers may be useful in providing insights on products that are currently available.

2.3. Retail disclosures

Information made available to retail customers requires specific consideration. Information can be provided in relation to a specific product or service, but may also be provided in relation to the sustainability of a financial institution in general.

Retail customers may therefore be impacted by buying specific products that do not meet their sustainability expectations. They may also be impacted by doing general business with a financial institution that purports to be sustainable in its operations but is in reality not aligned with the customers sustainability preferences. The prevalence of this type of practice could cause a loss of confidence in the role of the financial sector in financing a just transition.

For consistent and comparable information to be provided in relation to sustainability objectives, it is important that consistent information is provided in the market in general. Therefore, an element of retail disclosure relies on consistent and effective corporate disclosure.

However, it has also been noted that retail disclosures in relation to sustainability relies on the same principles as traditional disclosures to retail financial customers.

The G20/OECD Principles on Financial Consumer Protection (discussed in more detail in Part A of the this document), were revised in 2022 to include cross-cutting themes, one of which is sustainable finance. As cross-cutting themes, they are relevant to and should be considered in relation to all the Principles. Part A explains particular policy considerations in relation to sustainable finance and consumer protection, including considerations in relation to disclosure and transparency.

A Draft Application Paper on Market Conduct issued by the IAIS in 2023 notes the following:

> *"Greenwashing is not a new risk category but rather an element of existing conduct principles and related risks; hence, jurisdictions should consider whether new tools, policies, or regulations are required to address greenwashing or whether existing requirements, such as providing fair and not misleading information or preventing misselling, are sufficient to tackle greenwashing in their market."*

The increasing risks posed as a result of climate change also necessitates considering the information being provided to customers in relation to existing financial products and services. The IAIS paper notes that customers may face poor outcomes as a result of a "lack of sufficient clarity in the terms and conditions (specifically, which events are covered), and delays in claims handling processes at times of extreme [natural catastrophe] NatCat events, when there are large numbers of claims."

As the work programme in relation to the GFT and disclosure and reporting at a corporate level unfolds, it will therefore be important to remain cognisant of retail disclosure requirements, and the need for potential cross-referencing across the various requirements. However, the FSCA will also provide guidance on how existing conduct requirements may be applied from a sustainability perspective.

3. MARKET DEVELOPMENT

3.1. Investment for a just transition

Increased climate variability and extreme climate events lead to significant economic and human losses. The current global emissions trajectory means falling short of the Paris Agreement temperature goal, translating into an estimated 10% fall in global GDP by 2050.[9] Failing action, temperatures could rise to 3.2°C by 2050, implying an even greater 18% fall in global GDP.

Prevention is more effective than cure.[10] Investments in climate adaptation measures are significantly less expensive than repairing loss and damage from extreme weather events after the fact, highlighting the importance of adaptation finance.[11]

in 2023, the Presidential Climate Commission (PCC) released a report, "The South African Climate Finance Landscape 2023"[12], which noted the following:

> *"Despite South Africa's considerable progress in creating enablers for the transition to a low carbon economy, significant barriers persist in accessing and mobilising climate finance, with a lack of funding for small to mid-sized projects, especially those that are viewed as high risk or are seeking to move from early development to commercialization."*

The PCC also put forward a paper "Draft Scaling Finance To Support A Just Transition: The Potential Of A Just Transition Financing Mechanism"[13], which seeks to assess the challenges

[9] Swiss Re (2021), *The economics of climate change: no action not an option*, Swiss Re Institute, Zurich.
[10] Prevention means decarbonizing and investing in zero-emission technologies and infrastructures.
[11] Research by the Global Commission on Adaptation considers that investing $US 1.8 trillion globally in five key areas between 2020 and 2030 could generate $US 7.1 trillion in total net benefits (2019).
[12] https://www.climatecommission.org.za/publications/the-south-african-climate-finance-landscape-2023
[13] https://www.climatecommission.org.za/publications/draft-jtfm-for-comments

regarding financing just transition projects, the existing financial architecture and ecosystem, and provides options for a Just Transition Financing Mechanism.

Within this programme of work, it is imperative for the FSCA to assess where further research may be required to gauge where market or regulatory barriers may exist that compromise this investment flow, especially those barriers that fall within the purview of the FSCA.

Initial scoping research may consider:

- Sustainable finance trends and opportunities, internationally and in South Africa, considering both the demand and supply side.
- The regulatory landscape and possible gaps.
- Interventions and incentives that are already in place to promote sustainability/sustainable finance, or that are being considered.
- International developments.
- Mapping the linkages described above more clearly, from a market conduct perspective.

In parallel, the FSCA sees an advocacy and awareness role, engaging with financial institutions and investors to support a shared journey of improved understanding of the sustainability and sustainable finance landscape, for instance by:

- Hosting industry conferences, seminars, or webinars on sustainable finance.
- Creating a platform for financial institutions to showcase sustainable products.
- Providing incentives or recognition for institutions that actively support sustainability.

3.2. Confronting climate related risk protection gaps

Climate related protection gaps are a global concern. Natural disasters claimed more than 30000 lives in 2022, impacting 185 million people.[14] Insured losses were recorded at an estimated US$120 billion, substantially below the estimated US$270 billion losses suffered.

In South Africa, weather related claims are rising significantly. SAIA's Annual review 2023 highlights climate change and infrastructure degradation due to natural disasters as major outlook risks. For example, the KwaZulu-Natal floods in April 2022 are estimated to have cost the country upwards of R25 billion, with much of the damaged infrastructure yet to be repaired. These trends may amplify service delivery challenges by municipalities.

[14] https://www.oecd.org/climate-action/ipac/the-climate-action-monitor-2023-60e338a2/chapter-d1e1621

The IAIS notes a number of risks to financial consumers as a result of increasing risks of natural catastrophes (NatCat), brought about by the physical impacts of climate change. These include[15]:

- Low awareness of the risks posed by NatCat-related events to home/property, resulting in consumers not having sufficient NatCat insurance protection;
- Low awareness of available insurance coverage options or limited awareness of price, resulting in consumers not buying coverage even when needed or being unable to access insurance that covers their needs;
- Low awareness of insurance coverage options as there is a belief governments should intervene or there is general trust that governments will intervene;
- Lack of affordability or sudden price increases due to the increased frequency and scale of NatCat events;
- Low awareness of the content, coverage and limitations or exclusions of the existing insurance they have purchased, resulting in the fact that there may be a mismatch between what consumers believe is covered and actual coverage – including as a result of changes made due to the increase in frequency and magnitude of NatCat events; and
- Limited understanding of insurance products, coverages, limitations and deductibles can result in unintended coverage gaps.

In responding to protection gap challenges, the FSCA is collaborating with industry to address contract certainty for exclusions that exacerbate protection gaps. This should be supported by financial education interventions (see **Section 6**).

In relation to policy issues around disaster risk financing, the FSCA and PA continue to support industry dialogue with the National Treasury.

3.3. Developing a South African carbon credit market

Carbon markets have been identified as a key tool for governments and private sector institutions seeking to achieve climate change objectives. These markets contribute to the reduction of carbon footprints and have the overall objective of mitigating climate change. They do so by pricing carbon emissions, which in turn promotes the reduction of CO2 emissions into the atmosphere or allows for the offsetting of emissions using climate change mitigation projects.[16]

Carbon credit markets are trading systems in which carbon credits are sold and bought. Carbon credit represents the level of green gas emissions that participating companies and individuals are permitted to emit. Companies or individuals, especially those exceeding their emission targets, can use carbon credit markets to offset their greenhouse gas emissions by purchasing

[15] https://www.iaisweb.org/uploads/2023/11/Draft-Application-Paper-on-climate-risk-market-conduct-issues-in-the-insurance-sector.pdf
[16] https://www.iosco.org/library/pubdocs/pdf/IOSCOPD740.pdf

carbon credits from entities or projects that have removed or reduced greenhouse gas emissions, and thereby contribute to the net reduction of carbon emission.

Participation in carbon markets can either be compliance or voluntary based. Compliance Carbon Markets are created and regulated by mandatory national, regional, or international carbon reduction regimes, and tend to involve government. Voluntary Carbon Markets are more private markets where entities buy carbon credits to offset carbon emissions. These carbon credits are issued in relation to climate change mitigation projects or by entities who emit below their allowances. The projects are designed to mitigate climate change through either emission reduction or avoidance, for example, by investing in renewable energy or preventing deforestation, or through carbon removal and sequestration, such as planting trees or technology-based carbon capture mechanisms.

In 2023, the National Treasury commissioned a South African Carbon Market Diagnostic study by the World Bank, which is being currently finalised. Parallel to the work of the National Treasury through the World Bank, the FSCA is also conducting research that is aimed at gaining better understanding of the carbon credit market, and to ultimately make recommendations regarding the potential role that the FSCA could play in facilitating the development of the carbon credit market in South Africa and whether regulations will be necessary to protect investors and the integrity of markets.

4. ACTIVE OWNERSHIP

Responsible investment requires asset owners and stewards of client money, like investment managers, to collaborate and interact with investee entities to optimise long term value. Previously, engagement has focused on aspects like strategy, risk management and corporate governance.[17] More recently, the accelerating global drive towards sustainable finance and ESG consciousness is widening fiduciary commitments, including through voluntary[18] and statutory measures.[19] Institutional investors are encouraged to shape sustainability outcomes by more assertive engagement.

The FSCA is encouraged by evidence of increased shareholder activism in the South African financial markets. In stakeholder engagements, it is clear that there is a strengthening trend toward considering investments from a sustainability perspective. Commonly adopted principles and practices include adherence to the Principles for Responsible Investment (PRI), the Code for Responsible Investing in South Africa (CRISA), King IV and the Institute of Directors (SA), and the International Corporate Governance Network (ICGN).

[17] Enhancing Investment Stewardship – Modernising the active ownership operating model, Deloitte, Performance Magazine Issue 39 Published on 3 October 2022.

[18] See for example the UK Stewardship Code and the Principles for Responsible Investment (PRI) incubated by the UNEP Finance Initiative and the UN Global Compact.

[19] See for example the EU Shareholder Rights Directive II.

In engagements with the savings and investment industry, some stakeholders noted that was sometimes difficult to strike an appropriate balance between taking a more active ownership role and meeting traditional client expectations which focus on financial returns.

The FSCA's role in supporting active ownership is at a nascent stage. We will consider international and domestic trends, including how international standard setting bodies are incorporating active ownership principles, to identify best practice and the role of a market conduct regulator. The interplay between enhanced transparency of asset managers and asset owners in relation to their engagement activities, and more accurate and comprehensive reporting by investee firms to inform investor risk management and activism, may be considered.

5. CONSUMER EDUCATION

To complement market interventions, consumer education is an important consumer protection tool to mitigate sustainability risks for the man on the street. Informed by its deepening understanding of consumer risks (see **Part A**) and international learnings[20], activities being considered for development include:

- Clear and accessible educational materials on sustainable finance.
- Collaboration with financial institutions to disseminate educational materials.
- Consumer workshops and webinars on sustainable finance topics.
- Consumer awareness campaigns around key concepts, risks and consumer rights.

[20] See for example "Summary Report: Sustainable Finance through a Financial Consumer Protection Lens" on https://www.finconet.org/Summary-Report_Sustainable-Finance-Seminar_March-2022.pdf; the IOSCO report "Retail Investor Education in the Context of Sustainable Finance Markets and Products" on https://www.iosco.org/library/pubdocs/pdf/IOSCOPD711.pdf; OECD/INFE have are developing a key policy area relating to financial literacy and sustainable finance

6. SUMMARY PROGRAMME OF WORK 2024

	Past year - 2023	Near to medium term – 2024-2026	Longer term – From 2027
Pillar 1: Taxonomy	FSCA training and upskilling on GFT.	Encourage voluntary adoption and use of treasury's green taxonomy Conduct a taxonomy adoption pilot Develop proposals to drive stronger adoption and use of the GFT Collect information pertaining to use of taxonomy and effectiveness	Consider legislative requirements to embed the taxonomy in financial sector regulation as appropriate and aligned to broader disclosure requirements
Pillar 2: Disclosure, reporting & assurance	Engaged relevant stakeholders for purposes of ensuring consistency and coordination regarding sustainability disclosure requirements in South Africa (ongoing) Prudential Authority Draft Guidance Notice on Climate Related Disclosures for Banks and Insurers published	Consider corporate disclosure guidance for non-PA regulated institutions (including retirement funds) and listed entities, aligned to (informed by) the PA guidance, to the extent practicable. Consider industry readiness for ISSB standards adoption in close collaboration with other relevant SA stakeholders Evaluate need for specific disclosure guidance or requirements for sustainable products and services offered to retail financial customers	Formalize/strengthen and improve reporting and assurance Consider requirements for ESG rating agencies Formalize/strengthen and improve product disclosure

		Evaluate need to formalize regulatory requirements regarding disclosure Consider risk reporting of relevance to the FSCA Monitoring of international developments regarding reporting standards and assurance standards	
Pillar 3: Market development	Participate in NT project relating to development of carbon credit market	Undertake market research and industry engagements (including surveys, thematic reviews, bilateral and association engagements) to broaden understanding of sustainable finance landscape in South Africa Identify gaps in the sustainable finance market Consider regulatory actions that may support market development in identified areas Participate in NT project relating to development of carbon credit market	Consider regulatory actions that may support market development in identified areas Participate in NT project relating to development of carbon credit market
Pillar 4: Active ownership	Undertake market research and industry engagements to ascertain levels of active ownership in South Africa	Undertake market research and industry engagements (including surveys, thematic reviews, bilateral and association engagements) to ascertain	Consider whether formal requirements (similar to regulation 28) may be required for other financial institutions to encourage active

		levels of active ownership in South Africa Identify weaknesses relating to active ownership (e.g. lack of information) and consider the role of the FSCA in addressing these	ownership in investments
Pillar 5: Financial education	Research to understand the customer risks in relation to sustainable finance	Research to understand the customer awareness and understanding in relation to sustainable finance Develop initiatives to promote and provide targeted financial education initiatives, including by industry	Develop initiatives to promote and provide targeted financial education initiatives, including by industry

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