SA-EU JUST TRANSITION FINANCING ROADMAP: TECHNICAL PEER-TO-PEER COUNTERPART KNOWLEDGE SHARING

TIPS
TRADE & INDUSTRIAL POLICY STRATEGIES

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WEBINAR 3 of 3:

THE CHALLENGES FACING COMMERCIAL AND INVESTMENT BANKS IN FUNDING A JUST TRANSITION

14 OCTOBER 2021 – 09h15-10h30

REPORT

The TIPS webinar was held on Zoom. It was open to anyone to register. Only registered participants could join the webinar on the day.

Attendees

There were a total of 116 attendees and 9 panelists. The attendees were mostly South African from a combination of banking and financial services companies, such as: Investec, Standard Bank, Rand Merchant Bank, Nedbank, Old Mutual, Momentum, Laurium Capital, DBSA and Deloitte. We were also joined by companies who advocate climate change such as WWF, Sasol, Sustainability Matters, GIZ, GreenCape.

Summary of presentations

Dipak Patel from the Presidential Climate Change Commission opened up the presentations by highlighting key issues that need to be considered and addressed in the transition. These include: prudential and regulatory risk environment, fiscal and economic environment, public policy, technological development, Return on Investment (ROI) and investment mandates, and Environmental, Social and Governance(ESG) frameworks. In terms of prudential and regulatory risk environments, Dipak argued that commercial banks need to consider climate risks and exposure to fossil fuels. South Africa's severe debt and fiscal constraints need to be considered as well. In this case, the transition needs to be within the fiscal envelope and make a contribution to economic development.

Dipak pointed out there is a need to harmonise different governmental mandates to ensure policy cohesiveness. Furthermore, South Africa needs to ensure that it develops its technological capabilities and not become the taker of technology in the transition. With regards to investment returns, Dipak argued that the conventions around the rate of returns and project viability needs to be redefined. This is because there is a cluster of projects around Just Transition that need an entirely new financing mechanism. Lastly, Dipak pointed out that environmental and social factors are reasonably integrated within the governance framework. However, further work needs to be done to deepen and strengthen ESG in commercial banks.

Gert Kruger from FirstRand Bank highlighted six challenges that the investment and commercial banks in South Africa encounter in financing the Just Transition. Firstly, multiple transitions are happening between industries, and their sequencing is an issue. Gert argued that to fund these sub- transitions, there should be a common fact based on their sequencing. Secondly, there are two extremes of concentrations in the transition - large concentration and micro transitions. Large transitions with anchor industries such as Eskom are not possible to be financed by one bank. This is mainly due to the sheer scale of finance required. On the other hand, the effort to understand micro-transitions (typically happen with the SMEs space) and the scale of financing needed is not in sync.

Thirdly, ESG pricing is a challenge in the country given that international examples are in investment-grade while South Africa and Africa are in sub-investment grade. Furthermore, international examples capture the environmental elements while placing less emphasis on social elements.

The fourth challenge is related to debt capacity. In this regard, Gert pointed out that sovereign support is limited in terms of the just transition. Fifthly, Gert pointed out that not enough time has been placed on emerging industries that could replace industries that are no longer viable. The sixth challenge is related to the financing scope. Gert highlighted that commercial banks are open to funding the commercial aspect of the transition (infrastructure and electricity grid); however, the banking sector may not be able to finance the social aspect of the transition. This is where blended finance becomes key.

Sanaa Mehra from Citigroup presented products that are available to finance just transition strategies. Sanaa indicated that issuers have found it difficult to finance transition assets through green bonds in the past. This is because green bonds have stringent exclusion criteria while transition assets, on the other hand, may still be based on fossil fuel. However, over the past year, sustainability linked loans and bonds have emerged as a new product to finance transition strategies as opposed to transition assets. Sanaa pointed out that this helps clients communicate their transition strategies. Additionally, Sanaa pointed out that investors are demanding ESG engagement as opposed to narrow credit engagement with their clients.

Kevin Anderson from Climate Fund Managers presented on the energy transitions with blended finance. Kevin began the presentation by introducing the climate fund managers set up by Entrepreneurial Development Bank in the Netherlands and Sanlam in South Africa. Climate fund managers have set up investor one fund, which focuses on energy, and investor two fund, which focuses on water and sanitation as well as oceans. The blended finance is made of a variety of investors, including the donor community and institutional investors. In terms of the blended finance approach, Kevin pointed out that financing is divided into three stages, the development fund, the construction–equity fund, and the refinancing fund. The development finance provides working capital to risky projects to ensure that they reach a financial close. Once they have reached a financial close, the project is moved to equity fund and then moved to refinancing fund. The reason behind this approach is to avoid projects not seeing life because they take too long.

Karel Nierop from Triodos Investment Management presented on the Triodos Bank investments in sustainability. He indicated that Triodos has focused on sustainability solutions for over 40 years. The bank has made over EUR 20 billion in funds. In terms of structure, the bank is divided into retail and business banks, investment management and blended finance.

Karel pointed out that energy transition is the biggest challenge that also presents the biggest opportunity. The bank started off investing in windmills and has invested EUR 2 billion in renewable energy so far. Furthermore, Triodos has grown to become a global lead arranger of renewable energy deals in the past six years. In concluding the presentation, Karel urged that we should not wait for Superman to assist with the transition; it all starts with super ambition.

Tuomas Virtala from OP Asset Management presented on different types of funding available for sustainable development. OP is the biggest financial group in Finland. Tuomas highlighted that there are three types of funding for sustainable development. Firstly, sustainable development can be financed using the bank's balance sheet, which has the lowest probability because it has the lowest tolerance and highest barrier to regulation and capital requirements. Secondly, the bond market can also be a good source of funding if the issuer has access to the market. Thirdly, the asset management sector can provide a variety of capital, including the highest risk capital to fund just transition. More importantly, Tuomas highlighted that risk, return, and measurable impact are important determinants in attracting investment. Furthermore, Tuomas argued funding could be easily attracted with a conventional risk management framework as opposed to a new one.

George Harris from 2 Degrees Investing Initiative (2DII) presented on Paris Agreement Capital Transition Assessment (PACTA) methodology and ways it can aid Just Transition. PACTA is an open-ended source that allows financial institutions to measure their alignment to climate change scenarios. George outlined that PACTA compares actions needed to happen in climate-relevant sectors to minimise global temperature rises, with financial institutions' exposure to companies in these sectors. Furthermore, George pointed out that PACTA can assist financial institutions in their just transition approach because it has connection to the real economy. PACTA also allows for regional considerations and assists financial institutions to identify and engage with clients.

Key points from the discussion:

- Gas will become an intermediary solution in the decarbonisation process. There is a consensus that natural gas will become part of the transitory energy mix.
- There is a need for an intermediary fund to manage small projects that might not necessarily be the forte of global asset managers.
- South Africa's need to quickly participate in new emerging technology such as Green Hydrogen.

To view the presentations, click below:

https://drive.google.com/drive/folders/1QVVGp1mqNJTz-iZDKIgGfXFWsLDKM7Oq

To view the recording, click below:

https://us06web.zoom.us/rec/share/vmcj01VJddpQuEVekVc9KgaztDBMexyudzUtuGIBEtSgmGVYwRB3fM2nJ3Z5cK0y.t09gckVPBZDprtgA

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