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SOUTH AFRICAN RESERVE BANK
Prudential Authority

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To: All banks, branches of foreign institutions, controlling companies, eligible institutions, and auditors of banks or controlling companies

Proposed Guidance Note issued in terms of section 6(5) of the Banks Act 94 of 1990

Proposed Guidance on climate-related disclosures for banks

Executive Summary

The purpose of this Guidance Note is to provide guidance to banks, branches of foreign institutions, and controlling companies (hereinafter collectively referred to as 'banks') regarding climate-related disclosures, taking into consideration the recommendations of the Taskforce for Climate-Related Financial Disclosures and the International Sustainability Standards Board, under the four thematic areas of governance, strategy, risk management, and metrics and targets.

Disclosures of climate-related risks and opportunities are required to promote market discipline through the provision of meaningful information to stakeholders on a consistent and comparable basis. Climate risk management is a developing area and approaches will evolve and mature over time. It is important that financial institutions build the necessary capacity and capabilities to assess, manage and disclose climate-related risks and opportunities within their existing risk management and governance frameworks.

1. Introduction

1.1. Climate change and the transition to a low-carbon climate-resilient economy can affect the safety and soundness of banks and the stability of the financial system. South Africa is highly susceptible to climate-related risks, including droughts, flooding, and wildfires, and transition risks given our reliance on coal for electricity, export revenues, and as a key sector for employment. The South African financial sector is exposed to climate-related physical risks of assets in climate-vulnerable regions, and through exposure to businesses in transition-sensitive sectors.

1.2. Disclosures of climate-related risks and opportunities are required to promote market discipline through the provision of meaningful information to stakeholders on a consistent and comparable basis. An essential function of financial markets is to price risk to support informed, efficient capital-allocation decisions. Disclosures can enhance how climate-related risks are assessed, priced, and managed nationally and internationally.

1.3. This guidance builds on domestic and international work on climate-related disclosures, specifically the recommendations of the Task Force on Climate-related

Financial Disclosures (TCFD) and the International Sustainability Standards Board (ISSB).

2. Principles

2.1. Reporting on climate-related impacts is continually evolving as methodologies are being developed and improved. Without being prescriptive of the methodologies, the following principles provide the overarching requirements to fulfil when disclosing climate-related risks and opportunities:

2.1.1. Complete in its information. Any limitations of the data, assumptions, and estimations used should be declared.

2.1.2. Clear, balanced, and understandable to a wide audience. The language and any abbreviations should be understandable to those with limited knowledge of the institution.

2.1.3. Comparable between sectors, industries, or portfolios and an institution's reporting periods.

2.1.4. The comparability of methodologies and approaches enables better assessment by regulators and stakeholders; any deviations should be justified.

2.1.5. Provide consistency over time. Any changes in approach should be described where necessary to enable a regulator or stakeholder to understand the reasons for differences.

2.1.6. Be focused on relevant, material issues to provide stakeholders with decision-enabling data and qualitative assessments and analysis of the most material risks and opportunities.

2.1.7. Be reliable and objective. The information should be assembled and supported by methodologies and evidence that make it possible for third parties to assure or audit it.

2.1.8. Be timely and produced within appropriate time periods. Disclosure should provide information relevant to current decisions and be future-focused. As material information is legally required to be included in the primary annual report, climate-related disclosure should be produced simultaneously with the annual report, or more frequently if information of a material nature is available.

3. Supervisory expectations

3.1. Institutions should produce climate-related disclosure reports that reasonably satisfy the principles above and these supervisory expectations, as a minimum, to produce high-quality and decision-useful disclosures. Where relevant, disclosures should refer to South African-specific scenarios and transition pathways and plans, whilst still paying attention to the non-South African specific operations of supervised institutions' businesses. Further details on each thematic area are provided in Appendix A.

3.2. Governance

3.2.1. The Board of Directors should ensure that the bank discloses annually its practices and processes in maintaining appropriate oversight over climate-related risks and their impact on the financial institution.

3.2.2. The Board of Directors should ensure that the bank discloses annually the role of senior management in assessing and managing climate-related risks and opportunities.

3.3. **Strategy:** The institution should disclose annually the current and anticipated impacts of climate-related risks and opportunities on the institution's business, strategy, and financial planning where such information is material.

3.3.1. The institution should describe climate-related risks and opportunities identified by the institution as transpiring over the short, medium, and long term.

3.3.2. The institution should describe the impact of climate-related risks and opportunities on the institution's business, strategy, and financial planning.

3.3.3. Institutions are encouraged to use climate-related scenarios to inform their strategy and financial planning, and details of scenarios should be described. Disclosures on scenarios should focus on what the institution is doing in response to what it has learned through the scenario analysis and how this aligns with its risk appetite and strategic business direction.

3.3.4. The institution should describe the climate resilience of its strategy to material physical and transition risks.

3.4. **Risk management**

3.4.1. The institution should describe its risk management policies, processes, and controls for identifying and assessing climate-related risks.

3.4.2. The institution should describe its processes for managing climate-related risks, including related policies and transition plans.

3.4.3. The institution should describe how processes for identifying, assessing, and managing climate-related risks are integrated into the institution's overall risk management.

3.5. **Metrics and targets:** The institution should disclose metrics and targets that enable stakeholders to evaluate the institution's exposure, measurement, and management of climate-related risks; and how it measures and monitors its climate-related opportunities. Disclosure should clearly state the ambition level and should include both quantitative and qualitative aspects.

3.5.1. Institutions should disclose metrics used to assess their climate-related risks and opportunities, considering their strategy and risk management processes.

3.5.2. Institutions should disclose Scope 1, 2, and 3 greenhouse gas emissions[1] and related risks. The approach or methodology used for calculating emissions should be disclosed.

3.5.3. Institutions should provide sufficiently detailed narratives of the targets utilised to manage their climate-related risks and opportunities as well as performance against these targets. Where appropriate, targets on institutions financing activities that are environmentally sustainable should reference the South African green finance taxonomy[2].

4. Assurance requirements

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[1] Scope 1 refers to all direct GHG emissions; Scope 2 refers to indirect GHG emissions from consumption of purchased electricity, heat, or steam. Scope 3 refers to other indirect emissions not covered in Scope 2 that occur in the value chain of the reporting company, including both upstream and downstream emissions. Relevant scope 3 emissions for finance sector entities includes the scope 1, scope 2 and material scope 3 emissions from businesses to which they have a financial exposure (e.g., through lending activities, insurance products, and investments), or the scope 3 emissions of emissions-intensive inputs to their businesses. For further information, see the Greenhouse Gas Protocol's Corporate Value Chain (Scope 3) Accounting and Reporting Standard and Technical Guidance for Calculating Scope 3 Emissions.

[2] See link: https://sustainablefinanceinitiative.org.za/working-groups/taxonomy-working-group/

4.1. The disclosures are not expected to be subject to independent external assurance at this time but should work towards a future state in which external assurance is expected. The disclosures should be subject to internal governance processes and controls as used for financial reporting.

5. Implementation

5.1. The PA encourages institutions to be proactive in their climate-related risk management and disclosures, and not wait for regulation or be compliance-driven. Climate risk management is a developing area and approaches will evolve and mature over time; however the expectation of future improvements and developments in approach is not a justification for delay in implementation. Climate-related disclosures are expected to become mandatory over time.

5.2. Institutions, particularly those with international exposures and activities, should be developing the capacity and capabilities to disclose internationally comparable quantitative metrics.

6. Invitation for comments

6.1. Banks and other interested persons are hereby invited to submit their comments, using the template provided, on this proposed guidance note to: PA-Standards@resbank.co.za for the attention of Ms. Sarah McPhail, by no later than 13 September 2023.

Fundi Tshazibana
Chief Executive Officer

Date:

Appendix A

Further details on the disclosure under each thematic area are provided in this appendix. This is an indicative guide and not an exhaustive list. Institutions should continually evolve their disclosure practices, for relevance, comprehensiveness, and clarity.

1. Governance

1.1. The institution should disclose annually its practices and processes in maintaining appropriate oversight over climate-related risks and its impact on the financial institution. The institution should provide sufficient detail on:

- How the board of directors' responsibilities for climate-related risks and opportunities are reflected in the entity's terms of reference, board mandates, and other related policies.
- The board committees and members of the board responsible for the oversight of climate-related risks and opportunities
- How the board ensures that the appropriate skills and competencies are available to oversee strategies designed to respond to climate-related risks and opportunities
- How the board assesses climate-related risks and opportunities
- The practices, processes, and frequency through which the board and its relevant committees are apprised of climate risk-related risks and opportunities.
- The nature of climate risk-related discussions at the board or board committee level with specific reference to strategy, risk management policies, annual budgets, and business plans as well as setting the institution's performance objectives, monitoring implementation and performance, and overseeing major capital expenditures, acquisitions, and divestitures; and
- The board's activities in tracking and monitoring progress against targets for addressing climate-related issues, including whether and how related performance metrics are included in remuneration policies.

1.2. The institution should disclose annually the role of senior management in assessing and managing climate-related risks and opportunities. The disclosures should provide sufficient detail on:

- The assignment of climate risk-related responsibilities to management-level positions or committees; and, if so, whether such management positions or committees report to the board of directors or a committee of the board.
- The organisational structure relative to the management layers– a description of the associated organisational structure(s) reflecting the management layers to which climate risk-related issues are assigned.
- Whether dedicated controls and procedures are applied to the management of climate-related risks and opportunities and, if so, how they are integrated with other internal functions.

2. Strategy

2.1. The institution should describe climate-related risks and opportunities identified by the institution as transpiring over the short, medium, and long term and provide sufficient detail on:

- How the institution defines short, medium, and long term, and how these definitions are linked to the institution's strategic planning horizons and capital allocation plans.
- How the identified material climate-related issues have informed the institution's business model, its strategic objectives and targets, and financial planning.
- Specific climate-related issues for each time horizon (short, medium, and long term) that could have a material financial impact on the institutions.
- The process(es) used to determine which risks and opportunities could have a material financial impact on the institution.
- The nature and outcome of the processes in place to determine the institution's material climate-related issues, including an assessment of:
    - The institution's most significant positive and negative impacts on the economy, society, and the environment, over the short, medium, and long term; and
    - Significant climate-related risks and opportunities that the institution reasonably expects could positively or negatively impact its business model, strategy, and cash flows over the short, medium, and long term – and the impact of these risks and opportunities on enterprise value.

2.2. The institution should describe the impact of climate-related risks and opportunities on the institution's business, strategy, and financial planning and provide sufficient detail on:

- The potential impacts of climate-related risk drivers when developing and implementing their business strategies, including addressing the resiliency of their business models to any material climate-related financial risks over various time horizons and considering how these risks may impact their ability to achieve their business objectives.
- Climate-related risks identified that have affected the institution's business, strategy, and financial planning, where the impact or potential impact of climate-related risk on business and strategy is considered in the following areas:
    - Products and services
    - Supply chain and/or value chain
    - Adaptation and mitigation activities
    - Operations (including types of operations and location of facilities)
- How the institution has integrated climate-related risk data into its financial planning process, the time period(s) used, and how these risks and opportunities are prioritised relative to the overall business strategy.
- Commentary on the value created, preserved, or eroded for the institution, its stakeholders, and society and the environment more broadly, as a result of implementing its strategy.
- The impact on financial planning in the following areas:
    - Operating costs and revenues
    - Capital expenditures and capital allocation.
    - Acquisitions or divestments
    - Access to capital, if climate-related scenarios were used to inform the institution's strategy and financial planning, such scenarios should be described.

2.3. The institution should describe the resilience of the institution's strategy and provide sufficient detail on:

- The resiliency of the strategies to climate-related risks and opportunities, taking into consideration a transition to a lower-carbon economy consistent with a 1.5 degree Celsius or lower scenario and, where relevant to the institution, scenarios consistent with increased physical and transition climate-related risks.
- The scenario analysis undertaken, including the sources of the scenarios, a description of how the institution has analysed at minimum (a 1.5 degree Celsius) climate-related scenario; time frames being considered (define short, medium, and long term), mitigating actions that the institution will take in response to scenarios findings; and quantifying the institution's vulnerabilities to climate-related risks (potentially within different risk areas such as credit risk, market risk, and other financial risks).
- Where institutions believe that strategies may be affected by climate-related risks and opportunities.
- Any trade-offs between climate-related risks and opportunities that were considered by management in their decision-making.
- How institutional strategies may change to address such potential risks and opportunities; and – the climate-related scenarios and associated time horizon(s) considered.
- The nature, extent, and outcomes of any analysis, including scenario analysis, undertaken to test the resilience of the institution's strategy, considering the likelihood and magnitude of material climate-related impacts, risks, and opportunities in its operations, its products and services, its value chain, and its investment research and development activities.

3. Risk Management

3.1. Institutions should describe their risk management policies, processes and controls for identifying and assessing climate-related risks. The description should, among other things, cover the following aspects:

- Explain the process for understanding and assessing the potential impacts of climate-related risk drivers on the institution's businesses and on the environments in which it operates.
- Explain how the institution determines the relative significance of climate-related risks in relation to other risk exposures.
- Describe how existing and emerging regulatory requirements related to climate change, as well as other relevant factors, are considered.
- Provide details of processes for assessing the potential size and scope of identified climate-related risks, including the input parameters it uses such as data sources, assumptions made, and the scope of operations covered.
- Define risk terminology used or references to existing risk classification frameworks used in respect of climate-related risks.
- Explain how the institution incorporates identified risks into its overall business strategies and risk management frameworks.
- Describe how policies, procedures, and controls are implemented across the institution's operations to ensure effective management of climate-related financial risks, and whether it has changed the processes used compared to previous reporting periods.

3.2. Institutions should describe their processes for managing climate-related risks. The description should among other things cover the following aspects:

- Institutions should describe their processes for managing climate-related risks, including how they make decisions to mitigate, transfer, accept, or control those risks.
- Processes for prioritising climate-related risks, including how materiality determinations are made within the institution, should be described.
- In describing their processes for managing climate-related risks, institutions should cover the current and anticipated impact from, inter alia, the following perspectives:
  - policy and legal risks
  - technology risk
  - market risk
  - reputational risk
  - physical risk
  - impact on products and services
  - impact on costs and operational efficiencies, etc.
- Explain how the institution incorporates climate-related financial risks into its internal control frameworks to ensure sound, comprehensive, and effective identification, measurement, and mitigation of material climate-related financial risks.
- Describe how the institution identifies and quantifies climate-related financial risks and how those risks assessed as material over a relevant time horizon are incorporated into the institution's internal capital and liquidity adequacy assessment processes, including its stress testing programmes, where appropriate.
- Provide details of how the institution ensures that its risk data aggregation capabilities and internal risk reporting practices account for climate-related financial risks and ensures that reporting systems are capable of monitoring material climate-related financial risks and producing timely information to ensure effective board and senior management decision-making.

3.3. Institutions should describe how processes for identifying, assessing, and managing climate-related risks are integrated into their overall risk management.

4. Metrics and targets

4.1. Institutions should disclose metrics used to assess their climate-related risks and opportunities, considering their strategy and risk management processes. The following aspects should be considered:

- The board of directors should ensure adequate disclosure of all key metrics used for the measurement and management of climate-related risks and opportunities.
- Metrics should be closely related to the institution's strategy, governance, and risk management processes. More granular information such as the interconnection with business units and the impact on financial performance should be considered. Quantitative information relating to assets/business activities vulnerable to physical risk and transition risks should be disclosed.
- Metrics should prove valuable for assessing how the institution manages climate-related risks and opportunities. Where appropriate, metrics should be consistent with the cross-industry metrics; climate-related metric categories;

and as generally requested by international reporting frameworks and relevant stakeholders.

- Institutions should provide information on whether any metrics are included in the institution's remuneration policies.
- Metrics should be unambiguous and understandable including sufficient context and supporting information. Assumptions, proxies, methodologies and approaches used to calculate metrics should be suitably described. Data sources and limitations should be elaborated on.
- The board of directors should ensure that there is an adequate level of data verification and that an appropriate level of assurance is provided for and communicated.
- Metrics should cover current, historical, and forward-looking time horizons; and should reflect an appropriate level of consistency over time.
- There should be separate disclosures for the parent company and its subsidiaries, and associates, affiliates, joint ventures, and unconsolidated subsidiaries.

4.2. Institutions should disclose Scope 1, 2, and 3 greenhouse gas (GHG) emissions and related risks. The following aspects should be considered:

- Where applicable, Scope 1 and Scope 2 GHG emissions should be appropriately disclosed.
- The Greenhouse Gas Protocol should be used as a basis for disclosure reporting purposes and the approach adopted, such as operation control or equity share, should be described.
- Institutions should disclose Scope 3 GHG emissions. Scope 3 emissions refer to all indirect emissions that the institution does not own or control.
- The methodology used should be clearly described and include any modifications made. Generally accepted methodologies and ratios should be utilised for comparability purposes. Internal prices and its related information should be elaborated on.
- Historical data and trend analysis should be provided where relevant. Institutions should include information on how value chains may be impacted over the years.

4.3. Institutions should provide sufficiently detailed narratives of the targets utilised to manage their climate-related risks and opportunities as well as performance against these targets. The following aspects should be considered:

- The board of directors should set and disclose its primary climate-related targets for the short, medium, and long term. This may include targets associated with greenhouse gas emissions, loss tolerances, efficiency, and financial aspects. More granular targets can be disclosed by providing information relating to various levels such as sector, geographical location or portfolio levels. The objective of each target should be clear and details relating to whether targets are absolute, or intensity-based should be stated.
- Institutions should provide time horizons for the fulfilment of goals as well as annual updates on the progress and measurement of the targets dating back to the baseline period. Updates or changes to targets should be specified with appropriate rationale for the changes, including how the targets compare to international agreements.
- Targets should be aligned to strategy and risk management, and interlinkages between targets and metrics should be described.

- Targets should be measurable and, where relevant, assumptions, data sources and methodologies should be defined.
- The changing landscape, impediments, and limitations relating to targets should be provided for in the institution’s disclosures.