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In this issue

SOUTH AFRICA

The Future of Sustainability-Linked Bonds in South Africa

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The Future of Sustainability-Linked Bonds in South Africa

The South African market for sustainability-linked bonds (SLBs) holds significant potential for the future. South Africa, grappling with complex environmental, social and governance challenges, finds itself at the precipice of a transformative financial instrument: sustainability-linked bonds.

With its nascent SLB market exhibiting promising momentum, questions arise about its future trajectory and the legal landscape it navigates. This article delves into the potential of SLBs in South Africa, analysing the current landscape, challenges and future prospects that must be addressed for this finance tool to flourish.

SLBs are a burgeoning class of debt instruments, which can be issued by all types of issuers in the debt capital markets. These instruments function as fixed-income investments traded within the Johannesburg Stock Exchange's (JSE) interest rate market.

Within the umbrella of SLBs, various subtypes exist, each with distinct nuances. A critical distinction lies in the earmarking of proceeds. While some bonds provide greater flexibility in deploying the raised funds, others necessitate pre-defined allocations towards specific green or other sustainability-oriented projects and assets. This targeted approach, exemplified by the JSE's Sustainability Segment that distinctly lists Sustainability Use of Proceeds Debt Securities, which mandates issuers to disclose the specific sustainability assets they intend to invest in with the raised funds, providing additional transparency and alignment with investors' environmental and social priorities.

An Early-Stage Adopter

South Africa saw the rise of its first SLB in 2021. That issuance has served as a catalyst, which has accelerated widespread participation from both corporate and financial sector players, underscoring a robust and growing interest in sustainability-linked finance.

The country's status as an early adopter, coupled with its upcoming sovereign entry, underscores its commitment to advancing sustainable finance. National Treasury's announcement of a potential sovereign SLB issuance in 2024 adds major weight to the market. This will set a strong precedent and attract broader investor attention.

Within the ever-evolving landscape of sovereign SLB issuances, South Africa's potential entry would hold notable historical significance. Not only would it establish the country as the third sovereign issuer, following Chile and Uruguay, but it would also mark a decisive step towards bypassing the initial stage of use-of-proceeds instruments, a strategy previously adopted by Chile.

The Future of Sustainability-Linked Bonds in South Africa

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SLBs (which are also referred to as sustainability-linked debt securities), stand out in the green finance landscape due to their flexible approach to capital allocation. Unlike traditional ring-fenced green bonds, SLBs grant issuers discretion in deploying raised funds, provided they achieve pre-determined sustainability goals and targets. These forward-looking objectives, also known as performance-linked securities, form the core of the instrument. The achievement of these objectives is measured through the application of pre-established key performance indicators and evaluated against predetermined sustainability performance targets (SPTs). SLBs, similar to conventional bonds, stipulate two key financial terms, such as the maturity date (which defines the specific date upon which the issuer must repay the principal amount borrowed from bondholders) and the interest to be paid (which may be fixed or variable).

Preventing greenwashing

While the future of SLBs appears promising, proactive mitigation of certain key challenges is crucial to optimise their potential and ensure their long-term success. The following key challenges warrant attention:

- **Data availability and verification**: Robust data availability and independent, demonstrably credible third-party verification of sustainability performance are not only essential for securing investor confidence, but also play a critical role in mitigating potential legal risks associated with greenwashing claims.
- **Ensuring genuine sustainability progress**: Navigating the potential pitfalls of greenwashing requires vigilant efforts to demonstrate authentic commitment to environmental goals. Implementing transparent reporting protocols and diligently aligning operations with internationally recognised sustainability frameworks are fundamental to safeguarding investor confidence and fostering genuine environmental progress.
- **Limited domestic investor participation and regulatory tailoring**: While international interest in SLBs steadily ascends, the domestic investor pool in South Africa remains comparatively limited. This poses a hurdle to the market's full potential in the region. Fostering wider domestic participation necessitates concerted efforts towards enhanced investor education and aligning the regulatory framework for SLBs with the specific needs and concerns of domestic investors.

The Future of Sustainability-Linked Bonds in South Africa

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Jacqueline King ranked by **Chambers Global 2017 - 2023** in **Band 2**: Capital Markets: Debt.

Deon Wilken ranked by **Chambers Global 2021 - 2023** in **Band 3**: Banking & Finance.

Sammy Ndolo ranked by **Chambers Global 2023** in **Band 4**: Banking & Finance.

While the future of SLBs in South Africa appears promising, with potential for market expansion and innovation across diverse sectors, concerns about potential greenwashing must be addressed to unlock the instrument's full potential. To mitigate these concerns and ensure genuine sustainability outcomes, several key considerations are paramount:

- **Tailored frameworks and standards:** Developing robust frameworks and standards aligned with South Africa's unique context and sustainability priorities is essential. This includes focusing on metrics relevant to local sustainability challenges. Aligning with internationally recognised frameworks, such as the ICMA Sustainability-Linked Bond Principles, can provide a solid foundation while allowing for local customisation.
- **Transparency and reporting**: Implementing robust reporting requirements and ensuring transparent disclosure of performance against pre-defined SPTs will build investor confidence and deter greenwashing attempts.
- **Regulatory oversight**: Proactive government policies and regulatory frameworks should actively promote responsible issuance and prevent misleading claims. This could involve establishing independent verification mechanisms and enforcing penalties for non-compliance.
- **Investor education**: Fostering investor awareness and education around SLBs, including the identification and mitigation of greenwashing risks, is crucial for driving responsible investment decisions.

By prioritising these measures, the South African capital markets can navigate the greenwashing challenges and harness the full potential of SLBs to drive genuine sustainable development. This approach will not only attract dedicated impact investors but also enhance investor confidence and contribute to the long-term growth and success of the SLB market.

Pitso Kortjaas and Priscilla Brandt

OUR TEAM

For more information about our Finance & Banking practice and services in South Africa and Kenya, please contact:

Mashudu Mphafudi
Practice Head & Director:
Finance & Banking
T +27 (0)11 562 1093
E mashudu.mphafudi@cdhlegal.com

Johan de Lange
Deputy Practice Head:
Finance & Banking
Director: Projects & Infrastructure
T +27 (0)21 481 6468
E johan.delange@cdhlegal.com

Sammy Ndolo
Managing Partner | Kenya
T +254 731 086 649
+254 204 409 918
+254 710 560 114
E sammy.ndolo@cdhlegal.com

Sabelo Goma
Director:
Finance & Banking
T +27 (0)11 562 1602
E sabelo.goma@cdhlegal.com

Dr Adnaan Kariem
Director:
Finance & Banking
T +27 (0)21 405 6102
E adnaan.kariem@cdhlegal.com

Mbali Khumalo
Director:
Finance & Banking
T +27 (0)11 562 1765
E mbali.khumalo@cdhlegal.com

Jacqueline King
Director:
Finance & Banking
T +27 (0)11 562 1554
E jacqueline.king@cdhlegal.com

Pitso Kortjaas
Joint Sector Head:
Consumer Goods, Services & Retail
Director: Finance & Banking
T +27 (0)11 562 1589
E pitso.kortjaas@cdhlegal.com

Phetole Modika
Director:
Finance & Banking
T +27 (0)11 562 1625
E phetole.modika@cdhlegal.com

Deon Wilken
Director:
Finance & Banking
T +27 (0)11 562 1096
E deon.wilken@cdhlegal.com

Kuda Chimedza
Senior Associate:
Finance & Banking
T +27 (0)11 562 1737
E kuda.chimedza@cdhlegal.com

Koketso Maake
Senior Associate:
Finance & Banking
T +27 (0)11 562 1618
E koketso.maake@cdhlegal.com

Brian Muchiri
Senior Associate | Kenya
T +254 731 086 649
+254 204 409 918
+254 710 560 114
E brian.muchiri@cdhlegal.com

Stephanie Goncalves
Professional Support Lawyer:
Finance & Banking
T +27 (0)11 562 1448
E stephanie.goncalves@cdhlegal.com

Michael Bailey
Associate:
Finance & Banking
T +27 (0)11 562 1378
E michael.bailey@cdhlegal.com

Damaris Muia
Associate | Kenya
T +254 731 086 649
+254 204 409 918
+254 710 560 114
E damaris.muia@cdhlegal.com

Thato Sentle
Associate:
Finance & Banking
T +27 (0)11 562 1844
E thato.sentle@cdhlegal.com

BBBEE STATUS: LEVEL ONE CONTRIBUTOR
Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

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JOHANNESBURG
1 Protea Place, Sandton, Johannesburg, 2196. Private Bag X40, Benmore, 2010, South Africa.
Dx 154 Randburg and Dx 42 Johannesburg.
T +27 (0)11 562 1000 F +27 (0)11 562 1111 E jhb@cdhlegal.com

CAPE TOWN
11 Buitengracht Street, Cape Town, 8001. PO Box 695, Cape Town, 8000, South Africa. Dx 5 Cape Town.
T +27 (0)21 481 6300 F +27 (0)21 481 6388 E ctn@cdhlegal.com

NAIROBI
Merchant Square, 3rd floor, Block D, Riverside Drive, Nairobi, Kenya. P.O. Box 22602-00505, Nairobi, Kenya.
T +254 731 086 649 | +254 204 409 918 | +254 710 560 114
E cdhkenya@cdhlegal.com

STELLENBOSCH
14 Louw Street, Stellenbosch Central, Stellenbosch, 7600.
T +27 (0)21 481 6400 E cdhstellenbosch@cdhlegal.com