Creating an enabling environment for impact investment in South Africa

Instument design and disclosure

Report 1 in our three-part series

Accelerating Impact

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About Krutham

Krutham works with clients across the spectrum of capital, from profit-led investment in emerging markets to philanthropy. We work with investors, banks, capital market infrastructure providers, corporates, insurers, law firms, development agencies, multilaterals, governments and philanthropies to develop products and systems that help mobilise finance to deliver better social outcomes. It has offices in Johannesburg and London.

This report was commissioned by the Anglo American Foundation, the First Rand Empowerment Foundation, Investec Bank and The Standard Bank Tutuwa Community Foundation. It was produced independently by Krutham and the contents represent the views of Krutham and its analysts.

Note on Process - Public Comment Stage

This version of the preliminary research report has been released for public comment by interested parties. Please use the website form where you downloaded this report to submit your comments or questions.

The deadline for submission of comments is **Tuesday 22 April 2025**.

Krutham will be hosting a series of invitation-only workshops in early May 2025 to discuss the feedback and recommendations on each report. Please register your interest for these workshops on the website.

Disclaimer

This report is based on information believed to be reliable, but Krutham makes no guarantees as to its accuracy. Krutham cannot be held responsible for the consequences of relying on any content in this report.

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Contents

Figures

Abbreviations

AUM – Assets Under Management

DNSH – Do No Significant Harm

ESG – Environmental, Social and Governance

ESMA – European Securities and Markets Authority

FCA – Financial Conduct Authority

FSCA – Financial Sector Conduct Authority

GIIN – Global Impact Investing Network

GRI – Global Reporting Initiative

GSSS – Green, Social, Sustainability and Sustainability-linked

ICMA – International Capital Markets Authority

IIRC – International Integrated Reporting Council

IFSI – Investing for Sustainability Impact

JSE – Johannesburg Stock Exchange

LFfI – Legal Framework for Impact

NT – National Treasury

PA – Prudential Authority

PRI – Principles for Responsible Investment

SDR – Sustainability Reporting Directive

SFDR – Sustainable Finance Disclosure Regulation

TCFD – Taskforce for Climate-related Financial Disclosures

UNEP FI – United Nations Environment Programme Finance Initiative

Executive Summary

Financial investments play a crucial role in addressing real-world challenges such as climate change, sustainable development and human rights. Whether intentional or not, these investments shape outcomes that directly affect global and national sustainability goals. Increasingly, investors recognise that long-term financial success depends on the health of environmental and social systems. This understanding is driving a shift towards investments that aim to enhance sustainability outcomes. As the market for more sustainable and impactful investment grows, so too does the proliferation – and marketing – of investment products designed to be sustainable and impactful. In this context, in the absence of transparency, substantial information asymmetry exists and the potential for misalignment of investor values and objectives with investment product design is significant. Investors seek to gain exposure to instruments that help them achieve certain impact objectives.

The ultimate objective of impact-focused investment is to drive real-world outcomes alongside financial returns. This requires that investment products are designed with the dual intention of delivering both financial performance and impact. Recently, policymakers and regulators have begun to intervene in capital market functioning with the intention to encourage the development of financially viable impact-focused products. The main mechanism through which they have done so is disclosure frameworks. Disclosure requirements often start out as voluntary, with mandatory adherence required over time as the capacity to enforce adherence grows or the need to affect behaviour intensifies.

In South Africa, the law does not delve into impact-focused investment with a substantial level of specificity. Instead, the term "impact investing" serves as a broad concept encompassing any approach by asset owners or their investment managers that intentionally aims to enhance positive sustainability impact and mitigate negative sustainability impact in investee.

While disclosure requirements and guidelines do exist across the financial services industry, there is no specific instrument labelling framework in place at present. However, the legal definition of impact investing aligns closely to the definition of sustainable finance presented by the National Treasury.

Establishing a robust impact fund labelling regime in South Africa would represent a critical step towards unlocking the full potential of impact investing. By standardising disclosures and ensuring transparency, such a framework will mitigate the risks of impact washing, foster investor confidence and channel capital towards initiatives that generate measurable social and environmental returns alongside financial gains. This will not only drive economic growth and innovation but also contribute to addressing South Africa's pressing developmental challenges, from inequality and unemployment to climate change and access to essential services.

This impact-focused regulatory evolution is a strategic imperative for building a more sustainable, inclusive and prosperous future for all South Africans. By taking decisive action, policymakers can position South Africa as a leader in impact investing, attracting both domestic and international capital and maximising the positive impact of investment on society.

About this report

Impact investing has the potential to deliver extensive social benefits for South African society but we need a conducive regulatory environment to realise this potential. In this research brief, we present a set of proposals to stimulate and regulate impact investing in South Africa. We believe these should be considered in three domains: instrument design and disclosure; tax regulation; and the B-BBEE framework.

Background

Impact investors desire not just financial returns but returns in the form of measurable improvements in societies and their environments. Impact investing has the potential to generate positive social and environmental outcomes in addition to a form of financial return.

With the ability to mobilise both private and public savings, this form of investment has the potential to deliver outcomes that lead to better lives for South Africa's people. Governments around the world are actively encouraging it as they've recognised the importance of stimulating investment markets to support projects that have positive social and environmental outcomes.

From a public policy perspective, impact investing is a "no brainer" given that allocating investment in a way that has positive public outcomes creates public benefits "for free". Investing already achieves public benefits simply by financing economic activity; impact investing leverages that to achieve greater public benefit. This does not displace traditional investing but rather focuses on increasing the public benefits. For fiscally constrained governments, eager to mobilise private finance to achieve public policy objectives, impact investing is a clear opportunity.

The South African regulatory environment as it stands presents challenges to impact investing. This is limiting the potential for investment to help achieve the country's development objectives. This discussion document envisages a comprehensive process to review the regulatory environment as it affects impact investment and make recommendations for changes that will lead to a thriving impact investing sector with the resulting public benefits. It examines three areas that are critical to reform to stimulate and support impact investing:

Track 1: Instrument design and disclosure

Extensive work is being done worldwide on disclosure requirements for investment instruments that take on a sustainable investing or impact label. Such labels are part of the proposition to clients. In order to allocate their money effectively, clients who desire impactful outcomes need reliable labels and other disclosures by investment funds and instruments. A fund that calls itself an impact fund must meet the necessary and sufficient conditions to count as an impact fund. Such conditions need to be regulated to ensure appropriate conduct by providers, and be in clients' interests, with labels serving as a signal of that compliance.

Impact investments have several unique characteristics. Unlike traditional investments, they are usually not listed on public capital markets, given that the funding often supports development activities that do not fit traditional corporate structures, though there are several listed instruments such as green bonds and sustainability linked notes that are impact instruments. Another differentiating feature is that they can be illiquid, with long time horizons before the realisation of returns. They also must serve two objectives: financial and social/environmental outcomes, with reporting and measurement requirements for both.

Globally, sustainable finance and impact disclosure frameworks are being developed, which can be embraced by regulators by defining certain instruments. This may require unique regulatory instruments that accommodate illiquid assets and have both impact and financial measurement and disclosure requirements.

Relatedly, regulation should support investors to incorporate such instruments into their investment strategy where appropriate, including institutions like foundations, pension funds and insurance companies.

Track 2: Taxation and public benefit organisations

This theme is essentially the focus of this document because the vanguard of impact investing worldwide has been public foundations. These are non-profit organisations that have large investment endowments. Traditionally those endowments have been invested in debt and equity instruments through public capital markets to generate a return that finances their programmes. But these foundations have over time come to recognise that their endowment portfolios can be managed, at least in part, in a way that achieves positive impact in line with their overall mission. They have therefore become more active managers of their portfolios and are using a portion of portfolios for "mission-aligned investing". Foundations can also supplement their traditional grant-making activities by introducing investing instruments as part of their programmes, such as small loans, which potentially allow grant monies to be recycled and increase impact (this is often called "programmatic investing").

Globally, foundations are learning that through impact investing they can magnify the difference they make in the world. Impact investing enables them to catalyse their limited financial resources to have a much greater impact than through grant-making programmes alone. Given that foundations undertake public benefit activities, this scaling of their impact ultimately means greater public good is delivered through impact investing than through traditional grant-making.

However, when a foundation becomes an active manager of a portfolio that has both impact and financial objectives, there is a risk that such activities conflict with tax-based restrictions on non-profit activities, and foundations risk losing their tax exempt status. This risk discourages foundations from engaging in impact investing even though it has clear public benefit consequences. The ambiguities and risks around the tax status of impact investing must be resolved to stimulate greater impact investing activity by foundations and other non-profits.

Track 3: B-BBEE framework

The broad-based black economic empowerment framework involves impact investing, though it is seldom referred to as such. Empowerment transactions that aim to deliver transformation of the economy are impact investments by another name, as are the enterprise and supplier development components on the B-BBEE scorecard.

Supplementing those is the socioeconomic development component which drives direct investments that improve socioeconomic outcomes, often made in the communities surrounding a business's operations. There are also sector-specific B-BBEE targets – banks, for example, get empowerment points for ensuring access to banking facilities in rural or other underserved areas.

By delivering on the empowerment components, companies supplement financial returns with the impact objective of achieving transformation.

The B-BBEE framework, however, is activities-based and does not focus on the impact created by these activities. Rather, it measures the inputs – usually that is the money spent or invested, the number of employees sent on skills training, etc. In contrast, impact investing has formalised the measurement and management of impact, ensuring it is not just the money invested but the impact delivered that is assessed. That is what guides decision-making.

While B-BBEE has many features of impact investing, specifically the broad objective of delivering social impact alongside traditional investing, it has been primarily focused on inputs and activities rather than outputs. As part of building the impact ecosystem in South Africa, there may be opportunity to enhance the impact of B-BBEE by aligning it with broader impact investing methods and approaches to deliver transformation. This track of the research project will review the opportunities and make recommendations.

Methodology / approach

Our recommendations for South African policymakers have been developed to support addressing the aforementioned challenges. The recommendations are the outcome of both **research** and **engagement** with key stakeholders – including regulators and policymakers – which ensures that any proposals for the way forward are appropriately ambitious, but pragmatic.

The methodology applied to this work consists of three phases:

1. Developing a draft policy paper on each of the three key focus areas **(this document)**.
2. Circulating and workshopping the paper with relevant stakeholders to enable a co-creation process for developing the final draft paper.
3. Gathering feedback on the draft policy paper and incorporating commentary to develop the final draft report.
4. Initiating a policy engagement process with relevant stakeholders.
5. Finalising policy recommendations.

Impact Investing

There are several definitions of the term "impact investing". The Global Impact Investing Network's definition is: "Investments made with the intention to generate positive, measurable social and environmental impact alongside a financial return."

The diagram below illustrates how impact investing is growing in appeal for both philanthropic organisations and asset managers alike.

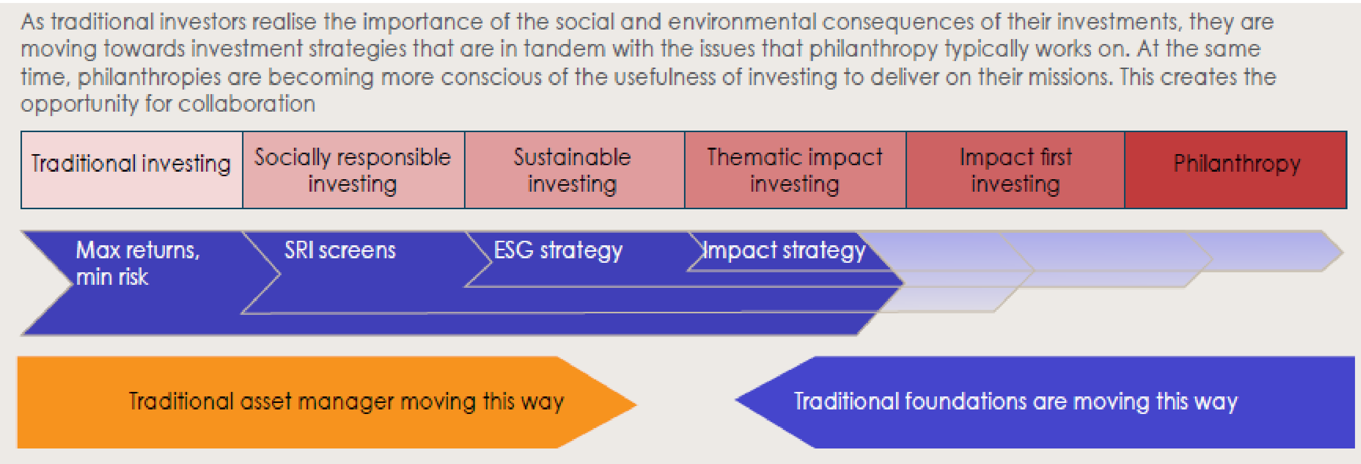

Figure 1: The spectrum of capital (Source: Krutham)

The GIIN Impact Investing Guide describes four "core characteristics" of impact investing:

1. Intentionality: An investor's intention to have a positive social or environmental impact through investments is essential to impact investing.

2. Investment with return expectations: Impact investments are expected to generate a financial return on capital or, at minimum, a return of capital.

3. Range of return expectations and asset classes: Impact investments target financial returns that range from below market (sometimes called concessionary) to risk-adjusted market rate, and can

be made across asset classes, including but not limited to cash equivalents, fixed income, venture capital and private equity.

4. Impact measurement and management: A hallmark of impact investing is the commitment of the investor to measure and report the social and environmental performance and progress of underlying investments, ensuring transparency and accountability while informing the practice of impact investing and building the field.

Risks: information asymmetry and the dangers of impact washing

Financial investments play a crucial role in addressing real-world challenges such as climate change, sustainable development and human rights. Whether intentional or not, these investments shape outcomes that directly affect global and national sustainability goals. Increasingly, investors recognise that long-term financial success depends on the health of environmental and social systems. This understanding is driving a shift towards investments that aim to enhance sustainability outcomes. As the market for more sustainable and impactful investment grows, so too does the proliferation – and marketing – of investment products designed to be sustainable and impactful. In this context, in the absence of transparency, substantial information asymmetry exists and the potential for misalignment of investor values and objectives with investment product design is significant. Investors seek to gain exposure to instruments that help them achieve certain impact objectives.

It is critical that the regulatory framework provides certainty for investors seeking out such investments. The development financial monitoring and reporting has evolved over millennia and practices from accounting standards to stock market disclosure rules have created an extensive framework for investor information that supports financial decisions. But this cannot be said of the regulatory environment for impact disclosures, which in many respects resembles financial reporting before the advent of standardisation. Companies and fund managers are free to prepare disclosures using their own methods, creating wide variability in reporting practices, and selective disclosure that is more qualitative than quantitative. It took the Great Depression to spur the creation of generally accepted accounting practices. When comes to impact, the hope is that regulators will lead on disclosure frameworks and instrument design.

One manifestation of the lack of standardised investment instruments and disclosures is greenwashing. This is the practice of misleading stakeholders by portraying products, activities or organisations as more environmentally friendly than they truly are. The term was coined in the 1980s by environmentalist Jay Westerveld, who critiqued hotels for promoting towel reuse programmes under the guise of sustainability while neglecting more substantial environmental practices. Greenwashing often involves exaggerated claims, vague terminology or selective disclosure to enhance a company's reputation without substantive environmental action.

Over time, as sustainability has expanded beyond environmental concerns, impact washing has emerged as a broader term to describe exaggerating or misrepresenting the social or environmental benefits of investments, products or services to appear more sustainable or impactful than they truly are.

This practice has several damaging results. First, it violates consumer protection principles. Investors should have sight of the true nature of the products that they purchase to ensure that these are truly aligned with their investment values and objectives.

Impact washing also undermines consumer confidence. By masking superficial or insignificant efforts as impactful, impact washing dilutes the credibility of sustainability standards and erodes public trust in the financial markets' role in fostering positive environmental and social change.

Further, obscuring the true risks and returns of investments can lead to potential financial losses or misaligned portfolios, creating inefficiencies in the market that often perpetuate practices that are net negative in terms of their impact.

Finally, impact washing diverts resources away from genuinely sustainable initiatives, thereby hindering the achievement of national and global sustainability objectives.

In the absence of clear frameworks for designing and labelling investment products according to their relationship with impact, it is impossible to know for sure whether products labelled as impact-focused are effectively delivering on investors' objectives, presenting a set of circumstances conducive to impact washing.

Mitigating the risk of impact washing: the theory of change underpinning enhanced transparency

The ultimate objective of impact-focused investment is to drive real-world outcomes alongside financial returns. This requires that investment products are designed with the dual intention of delivering both financial performance and impact. Recently, policymakers and regulators have begun to intervene in capital market functioning with the intention to encourage the development of financially viable impact-focused products. The main mechanism through which they have done so is disclosure frameworks. Disclosure requirements often start out as voluntary, with mandatory adherence required over time as the capacity to enforce adherence grows or the need to affect behaviour intensifies.

The theory of change underpinning more rigorous disclosures posits that greater transparency will lead to better decision-making, accountability and performance (Topping, 2012). Most crucially, improved disclosure enables regulators to identify areas of non-compliance or excessive risk, prompting closer scrutiny or enforcement by authorities and feeding into policy design.

Second to regulatory requirements, market demand is the most powerful driver of product design. Transparency equips consumers and the broader market, including civil society, with information that can be used to demand more sustainable or impact-focused practices aligned with their values.

The process of gathering and disclosing information also enables the suppliers of investment products to identify and assess gaps in their performance, fostering a deeper understanding of their impact. This facilitates commitments to improvement and enables comparability, driving competition and raising standards across the market.

Disclosure on its own, though, is just a first step in influencing the design of investment products. Increasingly, policymakers are putting pressure on asset managers to disclose detail on the performance of investment products in relation to national sustainability objectives – principally through the use of tools like standardised product labelling aligned to national taxonomies.

With respect to financial instruments, standardising products, particularly through product labelling, plays a crucial role in fostering consumer confidence and enabling comparability across different suppliers and markets. When impact-labelled products adhere to standardised specifications, consumers can trust that they meet consistent benchmarks. This standardisation reduces uncertainty and mitigates risks associated with misleading claims, thereby enhancing consumer trust in both the product and the market more broadly. Clear, standardised labels further empower consumers by providing transparent and reliable information, allowing them to make informed purchasing decisions based on impact.

Beyond consumer benefits, standardised labelling enhances market efficiency by enabling fair competition. When product labels follow uniform guidelines, consumers can easily compare products based on key attributes. This comparability incentivises companies to improve their offerings, driving innovation and higher standards.

Regulatory bodies and certification organisations play a vital role in maintaining these standards, ensuring that labelling systems remain credible and resistant to deceptive marketing practices. One way to ensure that impact-labelled products are working towards a standard impact objective is to align labelling regimes to a single imperative, through an instrument like a sustainable finance taxonomy.

A sustainable finance taxonomy is a classification system that defines what qualifies as sustainable economic activities or investments. It provides a framework to guide financial institutions, investors, companies and regulators in aligning capital flows with sustainability goals, such as mitigating climate change, preserving biodiversity or achieving social objectives like equity and inclusion.

In theory, mandating disclosure on taxonomical alignment should give investors confidence that their investment products meet their intentions.

The push toward global taxonomical alignment

The push for taxonomical alignment across markets is gaining momentum as regulators, investors and policymakers recognise the need for standardised definitions of sustainable activities to enable effective cross-border investment and reporting as a means of enabling a more integrated and efficient global sustainable finance ecosystem.

Efforts such as the International Platform on Sustainable Finance (IPSF) are fostering dialogue and collaboration among jurisdictions to harmonise taxonomies, while initiatives like the EU-China Common Ground Taxonomy aim to identify areas of convergence between major systems.

Over time, regulatory requirements can evolve from disclosing alignment to taxonomies, to meeting specific levels of alignment.

As regulation evolves further, it is reasonable to expect that requirements for taxonomical alignment may be replaced by mandatory requirements for achieving specific impact metrics. To ensure credibility, these would over time need to be subject to independent assurance.

Figure 2: the evolution of impact-related disclosure (Source: Krutham)

The South African policy and regulatory environment

In South Africa, the law does not delve into impact-focused investment with a substantial level of specificity. Instead, the term "impact investing" serves as a broad concept encompassing any approach by asset owners or their investment managers that intentionally aims to enhance positive sustainability impact and mitigate negative sustainability impact in investee.

While disclosure requirements and guidelines do exist across the financial services industry, there is no specific instrument labelling framework in place at present. However, the legal definition of impact investing aligns closely to the definition of sustainable finance presented by the National Treasury.

National Treasury

In 2017, the National Treasury (NT) established a Working Group consisting of financial sector regulatory bodies and industry associations to create a framework for sustainable finance. After engaging with stakeholders, NT released a Draft Technical Paper titled *Financing a Sustainable Economy* (Sustainable Finance Paper) in May 2020.

The paper aims to address the "real urgency to rapidly increase local financial sector capability to respond to the prevailing social and environmental challenges, which will increasingly have a major impact on our economic resilience and national well-being". In the paper, NT presents recommendations for a process to establish minimum practice and standards with regard to climate change and emerging environmental and social risks. It recommends the adoption of the following definition of "sustainable finance": "Sustainable finance encompasses financial models, products, markets and ethical practices to deliver resilience and long-term value in each of the economic, environmental and social aspects and thereby contributing to the delivery of the sustainable development goals and climate resilience."

In June 2021, following the recommendation in the Sustainable Finance Paper to "develop or adopt a taxonomy for green, social and sustainable finance initiatives aligned with international standards to enhance credibility, attract investment and facilitate effective monitoring and performance disclosure," a working group led by NT released a Draft Green Finance Taxonomy (the taxonomy).

Both instrumental IFSI and ultimate ends IFSI are consistent with NT's objectives, the taxonomy purpose and structure, and NT's definition of sustainable finance. This presents a good foundation for legal and regulatory action to more explicitly encourage and facilitate IFSI in South Africa.

South Africa's Green Finance Taxonomy

South Africa's Green Finance Taxonomy was officially launched on April 1, 2022, by NT as part of the country's Sustainable Finance Initiative.

This taxonomy serves as a classification system that defines criteria for economic activities that are considered to be environmentally sustainable, aiming to guide investors, issuers and lenders in identifying and funding projects that contribute to South Africa's climate and environmental objectives.

The development of South Africa's taxonomy was significantly influenced by the EU Sustainable Finance Taxonomy. A comparative study revealed approximately 70% alignment between the two, indicating substantial equivalence in their environmental ambitions.

This alignment facilitates cross-border financial flows and ensures that South Africa's taxonomy is compatible with international standards, thereby attracting global investors interested in sustainable investments.

The South African Green Finance Taxonomy covers various sectors and activities, including energy, water, waste management and agriculture. It provides detailed criteria for each sector to determine what qualifies as a "green" activity, ensuring that investments are directed towards projects with genuine environmental benefits. The taxonomy is designed to be used by financial institutions, corporations and policymakers to assess the sustainability credentials of different investments and to promote transparency and consistency in the green finance market.

As of January 2025, the implementation of South Africa's Green Finance Taxonomy is ongoing. Financial institutions and corporations are progressively integrating the taxonomy into their investment decision-making processes and reporting frameworks. NT continues to engage with stakeholders to refine and expand the taxonomy, ensuring it remains relevant and effective in promoting sustainable economic activities. This collaborative approach aims to solidify the taxonomy's role in facilitating South Africa's transition to a low-carbon, sustainable economy.

The Financial Sector Conduct Authority (FSCA)

Ensuring that capital allocation supports real-world outcomes is firmly within the regulator's objective "to foster a fair, efficient, and resilient financial system that supports inclusive and sustainable economic growth in South Africa".

In its 2023 Statement on Sustainable Finance and Programme of Work, the FSCA commits to building its capacity to "ensure that customers receive fair outcomes in the design, marketing and sale of financial products and services that are related to sustainability opportunities".

Further, the FSCA notes the importance of "consistency in disclosures regarding sustainable financial instruments, products and services, so that similar information is disclosed in similar manners, assisting with comparability"; and that financial instruments, products and services should be designed to contribute towards sustainability objectives.

The FSCA has acknowledged that clear and reliable financial product disclosure requirements are crucial to maintaining trust and integrity in sustainability labelled instruments and products and that as sustainable investments expand, the risk of green-, social- or impact-washing also increases.

The FSCA is examining appropriate disclosure requirements for various financial products and engaging with industry to assess readiness for sustainability standards. Plans include revising the Code of Conduct for Authorised Financial Services Providers (BN 194 of 2017) to incorporate socially responsible investing guidelines.

Under the pending COFI Bill, thematic workstreams are being developed to create cross-cutting requirements supported by industry-specific chapters over time. A disclosure-focused workstream may explore global best practices in sustainable finance, aiming to enhance transparency, direct credit and savings effectively, and mitigate the risk of greenwashing. Instrument labelling is expected to be a core component of this work.

Pension funds

As long-term investors, and in many cases universal investors, pension funds are well suited to participate in impact-focused instruments.

In South Africa, pension funds are required by law to focus on instrumental IFSI as an intermediate goal to achieve financial returns, rather than pursuing ultimate IFSI goals as ends in themselves. Regulation 28 of the Pension Funds Act mandates pension funds to consider factors, including ESG, that could materially affect the long-term performance of their assets. While this obliges boards to integrate ESG into investment processes, it does not compel funds to achieve specific or pre-determined IFSI outcomes. A fund can legally pursue ultimate ends IFSI only if explicitly mandated and recorded for the fund or a specific portfolio.

It is permissible for pension funds to pursue instrumental IFSI and set parallel objectives that include ultimate ends IFSI and financial returns. However, the board must ensure that the fund remains financially sound and prioritise the interests of its members, as per the fund's rules and the Pension Funds Act. In such cases, the pursuit of financial returns and sustainability impact goals must align, with neither being compromised.

On 14 June 2019, the FSCA published Guidance Note 1 of 2019 (GN 1 of 2019) to boards of retirement funds on how the Authority would expect a fund to include essential aspects of sustainable investments in an IPS. GN 1 of 2019 also set out the Authority's expectations regarding the disclosure and reporting requirements relating to sustainability. Although it is a guidance, the retirement funds industry is encouraged and advised to apply the principles set out in GN 1 of 2019, dealing with sustainability in the interest of transparency, accountability and the fair treatment of its members. Since then, several of the country's largest pension funds have adopted developmental or impact-focused mandates for all or a portion of their assets. The asset owners would benefit significantly from the implementation of impact-focused fund labelling to guide allocation decisions.

The Prudential Authority (PA)

While it has not explicitly introduced formal labelling for impact instruments, the PA has focused on integrating climate and sustainability considerations into its supervisory framework for banks and insurers. The PA refers to South Africa's green finance taxonomy to encourage consistency in defining and categorising sustainable economic activities.

In May 2024, the PA issued Guidance Notices on climate-related disclosures for banks and insurers, following a public consultation process. This initiative is part of its broader effort to integrate climate-related risks into regulatory and supervisory frameworks. The Guidance Notices outline minimum expectations for institutions regarding climate-related disclosures, governance and risk management practices.

Aimed at promoting transparency, the Guidance Notices encourage local institutions to align with international climate disclosure standards while supporting industry efforts to enhance climate-related governance and risk management.

Although the notices are not legally binding, the Prudential Authority will monitor their implementation. These notices align with IFRS S2 and initially focus on climate-related risks, with the potential to expand to other environmental and sustainability disclosures in the future, as relevant to the Authority's mandate.

Despite this guidance, Krutham's review of South Africa's largest banks reveals that no two banks define sustainable investment in the same way, despite all claiming to have based their respective definitions on the same core international and local frameworks. The result is that banking products labelled as sustainable vary significantly in design and in the outcomes they generate. A standardised framework for product labelling would support the design of products that are comparable and that deliver financial return alongside impact.

The Johannesburg Stock Exchange (JSE)

The JSE plays an important role in mandating disclosure standards through its listings rules. It has implemented several sustainability related frameworks to promote transparency and responsible investment among its listed companies. A key component is the Sustainability Disclosure Guidance, introduced in June 2022. This guidance assists companies in preparing standardised sustainability or ESG reports and integrating these disclosures into their financial statements. It aligns with global best practices, drawing from frameworks such as the Global Reporting Initiative (GRI), the Task Force on Climate-related Financial Disclosures (TCFD), and the International Integrated Reporting Council (IIRC). By providing a structured approach to ESG reporting, the JSE aims to enhance the quality and comparability of sustainability information disclosed by listed entities.

In addition to disclosure guidance, the JSE has established a Sustainability Segment to facilitate the listing of green, social and sustainability bonds. This segment offers issuers a platform to raise capital specifically for projects with positive environmental or social impact. To qualify for listing in this segment, issuers must provide evidence, often through an independent external review, that the proceeds will be allocated to eligible sustainable projects. This initiative not only broadens investment opportunities but also encourages the development of financial products that support sustainable development goals.

These existing frameworks lay a solid foundation to develop impact-focused fund labelling for South Africa's public market. The JSE's emphasis on standardised ESG disclosures and dedicated sustainability segments demonstrates a commitment to integrating sustainability into financial markets. By building upon these structures, the JSE can further develop labelling schemes that identify and promote funds with explicit impact objectives, thereby enhancing investor confidence and attracting capital towards sustainable investments.

Creating an enabling regulatory environment for enhanced transparency for impact investing

Best practice principles

In a 2021 report (Freshfields Bruckhaus Deringer, 2021) commissioned by the United Nations-supported Principles for Responsible Investment (PRI), Generation Foundation and the United Nations Environment Programme Finance Initiative (UNEP FI), Freshfields Bruckhaus Deringer presents a set of proposed legal reforms designed to catalyse and accelerate impact-focused investment. The Legal Framework for Impact report (LFfI) was compiled based on research conducted across several markets, including South Africa. In the LFfI, the authors differentiate between two types of "investing for sustainability impact" (IFSI): "instrumental IFSI" and "ultimate ends IFSI."

Instrumental IFSI occurs when achieving a specific sustainability impact is necessary to fulfil the investor's financial return objectives. For instance, an investor might determine that their financial goals (and the interests of beneficiaries) cannot be met unless a particular sustainability outcome is realised, with the desired sustainability impact playing a supportive role in achieving those goals.

Ultimate ends IFSI, in contrast, involves pursuing sustainability impacts as independent goals, alongside financial return objectives, but not as a means to achieve them. While there may be some overlap between these two types, the critical difference is that ultimate ends IFSI seeks sustainability impacts as ends in themselves, whereas instrumental IFSI views them as a means to achieving financial returns. "Impact investing" is the pursuit of ultimate ends .

The LFfI found that, to a large extent, instrumental IFSI is supported by legal frameworks, although significant variations exist across jurisdictions. Ultimate ends IFSI, however, receives less robust regulatory support. The vast majority of regulatory frameworks are typically designed to support institutional investors in prioritising financial returns, making the case for a focus on impact clearer when sustainability risks directly affect their duty to pursue financial objectives. In such cases, if sustainability impact strategies can effectively support these goals, investors are likely obligated to consider and potentially adopt them. This may present a challenge for investors looking to pursue impact objectives independently, alongside financial goals.

The LFfI outlines several policy and regulatory recommendations to facilitate IFSI in general, and ultimate ends IFSI in particular. With respect to disclosure, best practice principles for creating an enabling policy and regulatory environment for impact-focused investing would include:

1. Adopting comprehensive corporate sustainability disclosure frameworks which meet the needs of investors seeking to understand material sustainability risks, opportunities and impacts.
2. Ensuring that sustainability disclosure and labelling regulations address not only integration of ESG risks, but also how investment entities and products assess sustainability outcomes, set sustainability impact goals and take steps to contribute to positive sustainability impacts.
3. Creating and implementing sustainable taxonomies to help investors understand and promote economic activities that are environmentally and socially sustainable.

Globally, regulators are at various stages of implementation when it comes to these principles. To date, regulation has been focused on improving transparency through increasingly stringent disclosure requirements. In many markets, disclosure expectations apply at both the entity level and the product level.

Disclosure of instrumental versus ultimate ends IFSI

Instrumental ends focus on sustainability factors as drivers of financial performance. Disclosures in this context emphasise financial materiality, detailing how sustainability risks and opportunities, such as climate risk or regulatory changes, influence investment returns. Metrics like ESG ratings, risk-adjusted returns and carbon footprints are commonly disclosed to inform stakeholders about how sustainability is integrated into financial decision-making. The primary purpose is to ensure financial resilience while addressing sustainability risks.

In contrast, **ultimate ends** aim at achieving real-world sustainability outcomes, such as advancing the United Nations Sustainable Development Goals (SDGs) or reducing greenhouse gas emissions. Disclosures here emphasise impact materiality, showcasing the effects of investments on environmental and social goals, regardless of financial returns. These include measurable outcomes like carbon emission reductions, biodiversity preservation or contributions to affordable housing. Frameworks such as the Impact Management Project (IMP) or SDG indicators are often used to structure these disclosures, targeting stakeholders focused on sustainability impacts, such as policymakers and socially responsible investors.

A key difference lies in the concept of materiality. Instrumental ends prioritise **financial materiality**, assessing how sustainability affects the portfolio's financial value. In contrast, ultimate ends adopt a **double materiality** approach, considering both the financial implications and the broader societal or environmental impacts of investments. This distinction shapes the metrics and language of disclosures, with instrumental ends focusing on financial risk and return while ultimate ends report on measurable contributions to sustainability goals.

For example, an instrumental disclosure might highlight a portfolio's lower carbon footprint to mitigate financial risks from carbon pricing. An ultimate disclosure, however, would focus on real-world outcomes, such as the portfolio's contribution to reducing emissions equivalent to removing thousands of cars from the road. By clarifying these distinctions, the Freshfields framework provides a structured way to align investment practices with both financial objectives and sustainability impacts.

Leveraging existing sustainability focused frameworks for impact

The EU and the UK are arguably the most advanced markets when it comes to regulation to encourage impact-focused investment. In both markets, regulation has leveraged international commitments and targets coupled with robust disclosure requirements to catalyse and accelerate impact-focused investing.

The initial focus of existing fund labelling frameworks has been primarily on environmental issues, particularly issues related to climate change, such as CO_2 emissions. This emphasis reflects the urgent global response to the climate crisis, epitomised by international agreements like the Paris Accord, as well as growing regulatory and investor pressure to mitigate climate-related risks. Environmental issues, especially greenhouse gas emissions, are relatively easier to measure and standardise compared to social or governance impacts, making them a practical starting point for sustainable finance frameworks. The availability of tools such as carbon footprint calculations, science-based targets and established reporting standards like the Task Force on Climate-Related Financial Disclosures (TCFD) has further cemented the environmental focus.

These existing frameworks provide a strong foundation for developing broader, impact-focused fund labelling regimes. By building on the methodologies, taxonomies and reporting standards established for environmental issues, regulators can expand their scope to include social and governance dimensions. The existing emphasis on transparency, accountability and measurable outcomes in environmental reporting can be leveraged to establish similar standards for social and governance impacts, creating a more comprehensive approach to sustainability.

Expanding fund labelling regimes to encompass broader impact categories would not only align with global sustainability goals like the SDGs but also address growing investor demand for funds that generate tangible social and governance outcomes. While environmental issues remain critical, a more inclusive framework would enable fund managers to align their strategies with a wider range of sustainability priorities, fostering a more holistic approach to impact investing. By starting with the proven structure of environmental disclosures, regulators can gradually develop robust, multi-dimensional frameworks that fully integrate the "S" (social) and "G" (governance) aspects into sustainable finance.

For instance, the European Securities and Markets Authority (ESMA) has been working on guidelines to enhance transparency in ESG fund labelling, aiming to prevent greenwashing and ensure that funds marketed as sustainable meet specific criteria. This includes considerations for both environmental and social factors, indicating a move towards more comprehensive sustainability frameworks (ESMA, 2024).

Additionally, the Platform on Sustainable Finance has been advising on extending the EU Taxonomy framework to include a social taxonomy, considering both social objectives and governance aspects. This effort aims to create a more inclusive and comprehensive framework for sustainable finance, addressing the need for standardised criteria in evaluating social and governance impacts alongside environmental ones (European Commission, 2021).

Impact investing through private versus public markets

Impact investing in public and private markets differs significantly in the nature of the investment pipeline and process, as well as the ability to attribute impact to investment, while sharing overarching goals of generating measurable social and environmental outcomes alongside financial returns. These differences are rooted in the structural and operational characteristics of the two markets and the degree of control investors have over the businesses in which they invest.

In public markets, the investment pipeline largely consists of publicly traded companies that offer transparency, liquidity and scalability. Investors typically rely on ESG screening, shareholder engagement or thematic funds to align portfolios with impact objectives. While public markets may offer thematic instruments such as green bonds or sustainability-linked notes, in general, the indirect nature of public market investing means that attributing impact to an individual investor is often challenging. Typically, the impact arises from cumulative market forces or specific interventions, such as shareholder activism, rather than the direct allocation of capital to impactful projects. This creates a reliance on proxy measures, such as improvements in a company's ESG metrics or adherence to impact-aligned frameworks like the UN Principles for Responsible Investment (PRI).

In private markets, the investment pipeline is more tailored and bespoke, consisting of start-ups, private companies or projects specifically designed to achieve measurable impact. Investors often have a more direct role in shaping outcomes through active ownership, governance influence and the deployment of capital to support targeted initiatives. The due diligence process in private markets tends to be more intensive, requiring detailed assessments of an investee's operations, goals and alignment with impact objectives. Private market investors can often attribute impact more directly to their funding since they play a crucial role in enabling activities that might not have occurred without their support, such as funding a renewable energy start-up or expanding access to affordable housing in underserved communities.

The ability to attribute impact is generally stronger in private markets due to the direct nature of investments and the close relationships with investees. In public markets, while progress towards sustainability goals can be influenced by capital allocation trends and shareholder actions, attributing impact to any one investor or fund is more complex. This difference underscores a key alignment: both markets require robust methodologies for defining, measuring and reporting impact. Impact fund labelling frameworks can serve this purpose across both markets. Clear fund labelling frameworks can help bridge the gap between public and private market approaches, driving consistency in how impact is assessed and reported across both domains.

Example frameworks

EU: Sustainable Finance Disclosure Regulations (SFDR) and the European Securities and Markets Authority's (ESMA) guidelines on ESG-related fund names

The SFDR framework was developed to protect investors across the market from greenwashing by enhancing transparency to ensure sustainability claims are credible. Further, SFDR serves to create a uniform approach to sustainability disclosures across the EU. SFDR is also closely linked to the EU Taxonomy Regulation to ensure consistency in defining "sustainable activities" (to which policymakers and regulators are encouraging capital to flow). SFDR sets the foundation for transparency in sustainable finance, while ESMA's guidelines provide additional safeguards to ensure that fund names accurately reflect the sustainability features disclosed under SFDR. Together, they aim to build trust and accountability in sustainable investing.

SFDR applies to financial market participants and advisers operating in the EU, covering funds, portfolios and financial products marketed as sustainable. Disclosures are required at both the entity and product levels. At the entity level, firms must disclose their sustainability risks and impacts, including Principal Adverse Impacts on sustainability factors. At the product level, investment products can be classified as falling into one of three categories:

- **Article 6**: Funds that do not explicitly integrate sustainability into their investment process. For these products, the focus is on financial performance without ESG considerations. These funds must disclose how sustainability risks are integrated into the investment process or explain why they are not relevant. No specific quantitative thresholds apply to these funds.
- **Article 8**: Funds promoting environmental or social characteristics as integral to the fund's investment strategy. To use ESG-related terms in the fund name, at least 80% of the fund's investments must align with the environmental or social characteristics promoted and 50% of those investments must qualify as "sustainable investments" under the EU Taxonomy or SFDR definitions. *(These funds are examples of instrumental IFSI)*.
- **Article 9**: Funds targeting sustainable investment as their core objective. Investments must contribute substantially to an environmental or social objective (eg, climate change mitigation or adaptation) and must "do no significant harm" (DNSH) to other sustainability objectives. Minimum safeguards (eg, adherence to OECD Guidelines for Multinational Enterprises and the UN Guiding Principles on Business and Human Rights) must be met. All (100%) of the fund's investments should align with the sustainable investment objective, with limited exceptions for hedging or liquidity purposes. *This could be considered an "impact investment fund" – an example of ultimate ends IFSI.*

Since the launch of the ESMA guidelines, many funds have been required to rename or reclassify themselves to ensure compliance. As of 2024, approximately 1,300 funds across Europe have been renamed or rebranded to align with the ESMA guidelines on ESG fund naming. These funds had to adjust their names or classifications to accurately reflect their ESG objectives and avoid misleading investors about their sustainability characteristics.

At end-2023, the total assets under management (AUM) for funds classified under Articles 8 and 9 of the SFDR reached approximately €6.2tn globally. Projections suggest that AUM for these funds could exceed

€9tn by 2027, driven by increasing investor demand and regulatory focus on sustainability (PwC Luxembourg, 2024).

While progressive, SFDR is by no means perfect. Critics of SFDR argue that the regulation is overly complex and ambiguous, with vague criteria for Article 8 and 9 classifications often leading to inconsistencies. The nature of the disclosure requirements may also place financial pressure on companies looking to comply, a challenge that is experienced most acutely by smaller firms. Compliance requires access to a broad and deep range of sustainability data, which is often unavailable or incomparable across investments. The regulation has also undergone several updates since its launch, leaving market participants uncertain about the strategic trajectory of the framework.

On 17 December 2024, following the European Commission's public consultation, the Platform on Sustainable Finance, an advisory body to the European Commission, published a briefing note for the Commission outlining how a new categorisation system for sustainable finance products could be set up and calibrated. The proposed changes to product categorisation aim to improve the current framework for Article 6, 8 and 9 funds. The new scheme introduces clearer categories:

- **Sustainable:** Contributions through Taxonomy-aligned Investments or Sustainable Investments with no significant harmful activities, or assets based on a more concise definition consistent with the EU Taxonomy.
- **Transition:** Investments or portfolios supporting the transition to net zero and a sustainable economy, avoiding carbon lock-ins, in line with the European Commission's recommendations on facilitating finance for the transition to a sustainable economy.
- **ESG collection:** Excluding significantly harmful investments/activities, investing in assets with better environmental and/or social criteria or applying various sustainability features.
- All other products would be identified as unclassified products.

The proposal will affect Article 9 funds by refining their eligibility criteria. Specifically, the proposal aims to make it clearer that these funds must contribute to specific, measurable environmental or social objectives, with impact-driven goals being prioritised. This shift would require Article 9 funds to demonstrate a direct, measurable impact, potentially aligning them with EU Taxonomy goals and increasing transparency regarding their outcomes. The changes would likely make the classification more stringent and better aligned with broader sustainability targets.

UK: Financial Conduct Authority (FCA) Sustainability Disclosure Regulations (SDR)

Under the SDR, the FCA's fund labelling framework allows for classification of UK funds into one of three categories:

- **Sustainable Focus**: Investments in assets meeting high sustainability standards. The aim is to invest in assets that are already sustainable, and the fund typically excludes any companies or assets that do not align with these standards. Examples include funds that focus on renewable energy, clean technology or companies with a strong record of sustainability practices (characterised by clear objectives, measurable outcomes and transparent communication with respect to sustainability, to prevent misleading claims).

- **Sustainable Improvers**: Investments in companies or assets expected to improve their sustainability credentials over time. The focus is on companies that may not yet meet high sustainability standards but are making significant efforts to improve. Investors in these funds expect that, over time, these companies will enhance their sustainability practices and performance. Examples include funds investing in companies with sustainability transition plans or those involved in the process of moving towards more sustainable business models (eg, a traditionally high-emission company that is actively working to reduce its carbon footprint).

- **Sustainable Impact**: Investments aimed at achieving measurable, positive social or environmental outcomes. The goal is to invest in projects, companies or assets that directly contribute to solving social or environmental challenges, such as tackling climate change, poverty, inequality or other global issues. These funds track and report on the measurable impacts of their investments. Examples include funds focused on social housing, renewable energy infrastructure, education, or sustainable agriculture projects with a clear, measurable impact on specific social or environmental goals.

The FCA requires that consumer-facing disclosures include accessible summaries of a fund's sustainability focus and restricts the use of terms like "sustainable" or "ESG" in fund names without compliance with the framework. The framework requires that firms provide periodic updates on fund performance against stated sustainability objectives as a means of mitigating greenwashing risk.

The framework is designed to support the UK's net zero ambition by encouraging investments that contribute to the UK's broader climate and sustainability targets and is intended to complement international standards while catering to UK-specific needs.

Some critics argue that the framework's criteria may exclude innovative strategies and that it presents potential duplication with other reporting frameworks like TCFD (Task Force on Climate-Related Financial Disclosures). The focus on fund-level disclosures has also been argued to present a risk of overlooking broader systemic risks. The cost of compliance has also been raised as a significant challenge to implementation, as has limited consumer understanding of the labels (FCA, 2023).

The labelling framework came into force in July 2024, with naming and marketing rules enforced for larger entities as of December 2024.

The International Capital Market Association (ICMA) Principles for Green, Social and Sustainability (GSSS) Bonds

The ICMA principles provide a framework to guide the issuance of GSSS bonds, ensuring they align with internationally recognised standards for environmental and social impact. First launched in 2014, the principles are designed to promote transparency, integrity and accountability in the GSSS bond market, fostering investor confidence and supporting the financing of sustainable development.

The ICMA principles consist of four key components: the Use of Proceeds, ensuring funds are directed towards projects with clear environmental or social benefits; the Process for Project Evaluation and Selection, outlining how issuers select eligible projects based on environmental or social criteria; the Management of Proceeds, ensuring funds are tracked and allocated appropriately; and Reporting, which requires issuers to provide regular updates on the use of proceeds and the impact of funded projects.

The principles are voluntary but widely adopted across the market, helping to establish credibility and consistency in the GSSS bond space, while also facilitating alignment with frameworks such as the UN SDGs and Paris Agreement.

Since the launch of the ICMA Principles, the market for GSSS bonds has seen substantial growth, driven by rising demand for sustainable finance. The principles provided a standardised framework that enhanced transparency, credibility and investor confidence, leading to a surge in the issuance of green bonds, which finance environmental projects. By 2023, the total issuance of GSSS bonds exceeded $1tn, with green bonds alone surpassing $500bn annually. The market has expanded to include social bonds and sustainability bonds, reflecting an increased focus on both environmental and social outcomes, especially during events like the Covid-19 pandemic, which highlighted the need for social impact investments.

Looking ahead to 2030, the market for GSSS bonds is expected to continue its robust growth, driven by increasing regulatory support, growing investor interest in ESG investments, and a broader global push to meet climate goals and the UN SDGs. Some forecasts suggest that the global GSSS bond market could grow to $5tn by 2030 as more governments, corporations and financial institutions issue these bonds to fund sustainable projects. The growth will likely be further fuelled by stricter ESG regulations, innovations in impact measurement and an expanding investor base committed to aligning capital with long-term sustainability objectives.

This framework is an encouraging example of the value that can be derived from clear product labelling.

Other frameworks

Several other markets have developed or are in the process of creating frameworks to label and standardise financial products' sustainability characteristics. While the details vary by region, the objectives are generally to improve transparency, combat greenwashing and guide investors.

United States

The proposed **SEC ESG Disclosure Rules** are intended to enhance transparency and consistency in ESG-related disclosures for funds and advisers. The rules require funds claiming an ESG focus to disclose specific criteria and metrics used in investment decisions and to categorise their strategies as "integration", "ESG-focused" or "ESG impact".

Canada

The **Canadian Securities Administrators (CSA) Guidelines** have been developed to address greenwashing and improve the clarity of ESG-related claims by investment funds. Under the guidelines, funds must clearly define ESG objectives and how they integrate ESG factors into their decision-making processes. The framework is still in developmental stages, with less emphasis on strict labelling frameworks.

Asia-Pacific Region

In **Hong Kong,** the **SFC Green and ESG Funds Requirements** have established clear requirements for ESG funds marketed to retail investors. Funds are required to demonstrate ESG objectives and the methodology for measuring them, and to report on progress towards ESG goals.

Australia

ASIC's Greenwashing Guidance is intended to reduce the incidence of greenwashing by requiring increased transparency regarding ESG claims. Funds are required to provide evidence to support any ESG-related claims.

Policy recommendations for South Africa

The South African policy and regulatory landscape presents a strong base for the design of impact-focused instrument labelling frameworks. A natural starting point would be to consolidate and align existing platforms such as NT's Sustainable Finance Initiative (including the Green Finance Taxonomy); the FSCA's Sustainable Finance and Programme of Work; the PA's Guidance Note series, Regulation 28 of the Pension Funds Act; and the JSE's Sustainability Disclosure Guidelines and Sustainability Segment. As a first step, ensuring alignment across these platforms and frameworks in terms of how impact investment is defined would go a long way towards creating an enabling environment for impact-focused investment. Once a clear, standardised definition is in place, it will be possible to develop an impact-related fund-labelling framework.

Defining impact investing

Adopting a clear, universal definition of impact investing is the first step in developing policy and regulatory frameworks that are designed to catalyse and accelerate impact investing in South Africa.

Impact investing is defined by the Global Impact Investing Network (GIIN) as "investments made with the intention to generate positive, measurable social and environmental impact alongside a financial return". This definition aligns closely to that of ultimate ends IFSI, as presented by the LFfI.

In the case of South Africa, the definition of "impact" should be further refined to align to the Green Finance Taxonomy. While the taxonomy does not provide a detailed or standalone framework for social impact, its focus on the just transition is reflected through its emphasis on inclusive growth and socially responsible development, particularly in sectors that are crucial for South Africa's energy transition.

The taxonomy recognises that while the focus is on green activities like renewable energy, energy efficiency and sustainable agriculture, the transition must be fair and equitable, addressing social, economic, and labour concerns. It aligns with the principles outlined in South Africa's Just Transition Framework, which includes ensuring that the benefits of the green economy are widely shared, creating decent jobs, protecting livelihoods and supporting communities affected by the transition away from carbon-intensive industries.

Introducing an impact-focused fund labelling regime

The next step in policy evolution is to implement an impact-focused fund labelling regime that categorises investment products in relation to impact as per the definition of impact investing agreed. Funds should be categorised according to their intention and their composition.

We propose the following considerations for the categorisation of impact funds:

- **Investment intention:** investments aimed at achieving measurable, positive social or environmental outcomes.
- **Fund composition:** 100% of investments should be focused on delivering impact aligned to both investor and national objectives (in other words, in line with the taxonomy). This will include projects, companies or assets that directly contribute to addressing social or environmental challenges, specifically the just transition.
- **Disclosure:** mandatory reporting on the measurable impacts of investments.

Practically, it would be reasonable for disclosure according to this framework to be voluntary initially, and then over time mandate alignment, starting with larger funds. Also, over time, it would be prudent to require target-setting and continuous improvement, alongside assurance of reported impact data.

Given that the framework would aim to combat impact washing, which is predominantly a conduct issue, the regulator best suited to the enforcement of these specific disclosure requirements is likely to be the FSCA.

Conclusion

Establishing a robust impact fund labelling regime in South Africa would represent a critical step towards unlocking the full potential of impact investing. By standardising disclosures and ensuring transparency, such a framework will mitigate the risks of impact washing, foster investor confidence and channel capital towards initiatives that generate measurable social and environmental returns alongside financial gains. This will not only drive economic growth and innovation but also contribute to addressing South Africa's pressing developmental challenges, from inequality and unemployment to climate change and access to essential services.

This impact-focused regulatory evolution is a strategic imperative for building a more sustainable, inclusive and prosperous future for all South Africans. By taking decisive action, policymakers can position South Africa as a leader in impact investing, attracting both domestic and international capital and maximising the positive impact of investment on society.

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