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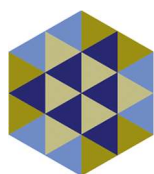
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**BRIEFING PAPER** August 2019

# GREENING THE DEVELOPMENT BANK OF SOUTHERN AFRICA: 1988 TO 2019

## AN EVOLUTIONARY APPROACH

**CHANTAL NAIDOO**



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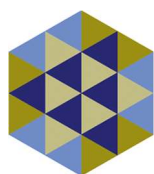
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## **ABSTRACT**

The paper is the second in a series of working papers by E3G showcasing examples of the learning process involved in designing green development banks. It follows the greening journey of the Development Bank of Southern Africa (DBSA), one of South Africa's national development banks, over a 36 years from 1984 to 2019. The journey demonstrates the internal and external forces, tensions and triggers that have contributed to the leading role that the Bank now plays in advancing the sustainability and climate agenda in South Africa and internationally. The paper applies the Learning Process Framework developed by E3G, which allows for useful insights for greening new and existing development banks.

## **ACKNOWLEDGEMENTS**

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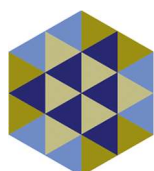


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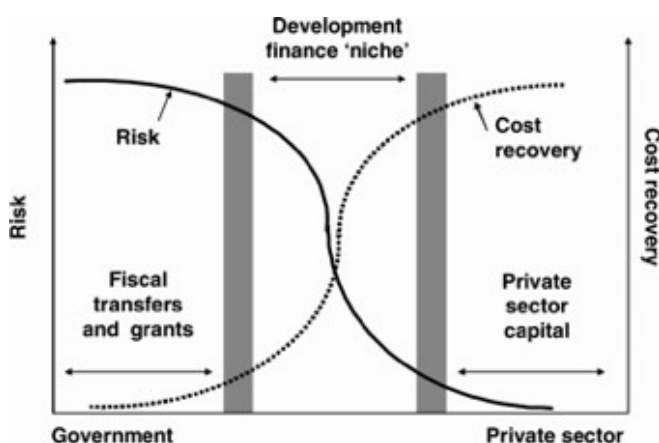


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## INTRODUCTION

Development banks are a form of government intervention in the financial system, whose traditional role addresses market failures through the provision of finance (often concessionary) aimed at achieving specific socio-economic objectives<sup>1</sup>. Development banks typically play a countercyclical role in the financial system by investing in critical socio-economic programmes and projects, where private finance is either unavailable or unwilling to do so. The traditional role of development banks is bridging financing gaps of market sectors unable to secure funding from private finance, for example, projects supporting new technologies deemed too risky or projects needing longer lead times. Figure 1 shows the “development finance niche” where a development bank would typically operate in the context of higher risk, low cost recovery and limited private sector engagement. Theoretically, a development bank participates in critical developmental projects that struggle to secure funding from private or other sources, such as building new schools, hospitals and roads.

*Figure 1: Role of development finance institutions*



*Source: Jackson, 2006 cited in Thorne & du Toit, 2009.*

The traditional role of national development banks of addressing market failures contrasts with the emergent role of such institutions in creating and shaping new markets and initiatives, such as financing renewable energy investments<sup>2</sup>. The ability to create and shape markets suggests that national development banks are useful policy instruments for financing the response to the climate breakdown, especially given the nature and scale of investments required. Growing interest in how development banks can support the transition to a low carbon, climate resilient

<sup>1</sup> Thorne and du Toit, 2009. A macro-framework for successful development banks.

<https://www.tandfonline.com/doi/pdf/10.1080/03768350903303183>

<sup>2</sup> Mazzucato and Penna, 2016. National Development Banks and Mission-Oriented Finance for Innovation in Griffith-Jones and Ocampo, 2018. The Future of National Development Banks. *Initiative for Policy Dialogue*.

development path is mounting<sup>3,4</sup>. Development banks targeting the transition to Low Carbon Climate Resilient Development (LCCRD) are referred to as “Green Banks” or “Green Investment Banks”. The assumption underpinning the growing interest is that Green Banks represent an important policy instrument and institutional mechanism for financing the transition to low emission and climate resilient development, especially in countries where a national development bank does not exist<sup>5</sup>.

A Green Bank Design Summit held in Paris during March 2019, brought together thinktanks, financial institutions and policy advisors to exchange knowledge and collaborate around the growing interest in designing financial institutions focused on the transition to low carbon, climate resilient development. Such interest, though positive in terms of offering institutional solutions also carries risk. Green Banks are not a “magic pill” applicable for every country or context. Certain basic preconditions need to be in place for such institutions to be effective within a national setting. For example, preconditions such as clear institutional mandates, robust regulation and supervision, effective governance and management, sound financial sustainability, and ongoing performance assessment of the activities of the development bank<sup>6</sup> need to exist. The institutional form of a Green Bank requires adaptive and experimental approaches that recognise the iterative, non-linear and long-term perspective associated with responding to the climate breakdown. Such approaches depend on the contextual setting, which requires social, cultural and political perspectives. It is critical to understand what problem the Green Bank is responding to within such contextual settings.

Therefore, in the spirit of continuous reflexive and adaptive approaches, the paper draws attention to the thought process involved in designing Green Banks and illustrates the context, challenges and contributions of different actors at different stages. The paper applies a framework developed by E3G, which includes case making, design, establishment, operations and evolution. These stages are framed as “Learning Process”, which are presented as a useful way for policymakers and designers of Green Banks to navigate the learning stages necessary for either creating a new institution or refocusing an existing one.

The example presented in this paper is that of the Development Bank of Southern Africa (DBSA), which, over its 36 year history, continuously evolved its approach to environment and climate breakdown. The DBSA is one of several institutions within South Africa’s development finance ecosystem, primarily funding physical, social and economic infrastructure such as housing, technology, energy, transport and water. The example is especially relevant for the Global South, where development banks have long been used as a policy instrument. Development banks in the Global

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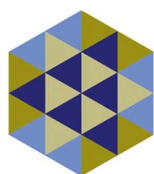
<sup>3</sup> OECD, 2017. Green Investment Banks: Innovative Public Finance Institutions Scaling Up Private, Low Carbon investment. Working Paper. Available at OECD Library.

<sup>4</sup> Smallridge et al., 2013. The role of national development banks in catalysing international climate finance. IDB-MG-148 and Smallridge et al, 2018. Establishing a Green Bank or Greening an Existing Bank? IDB.

<sup>5</sup> OECD, 2016. Green Investment Banks: Scaling up private investment in low-carbon, climate resilient infrastructure. OECD.

<sup>6</sup> Thorne and du Toit, 2009 (see note 1).

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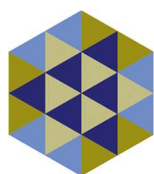


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South face competing pressures to integrate economic, social and environmental policies and require competitive and concessionary sources of capital to achieve their developmental mandate. Several development banks in the Global South already draw on international climate finance facilities to address the climate breakdown, such as the Climate Investment Funds, Green Climate Fund and the Global Environment Facility. These climate finance facilities enable the development banks to deploy domestic and international resources towards low carbon and climate resilient investments, and opens space for engaging the private sector. Section 3 of this paper provides further detail on the DBSA.

The paper is organised as follows: Section 2 describes the E3G Learning Process Framework, Section 3 describes the DBSA's learning process, Section 4 summarises the broader governance and policy implications for greening development finance institutions (DFIs) and Section 5 presents conclusions and aspects of the learning process that require further investigation.

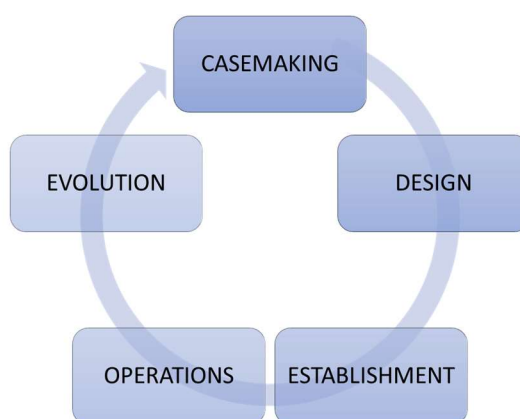


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## FRAMEWORK FOR CASE STUDY

The Learning Process is informed by E3G's broad experience in developing national finance strategies and supporting national development banks in the Global South and Global North, specifically their intimate knowledge and contributions towards designing the United Kingdom's Green Investment Bank. E3G's Learning Process for designing a green bank is illustrated in Figure 2, which aims to show the internal processes involved in creating or adapting institutions towards orienting their mandates towards low emission climate resilient development. The Learning Process infers iterative reflections between each of the phases, with decisions co-evolving as a result of feedback across different stages, engagement among stakeholders, analytical support and guided by the key industry standards and norms.

*Figure 2: Five Stages of Learning Process on Designing Green Banks*

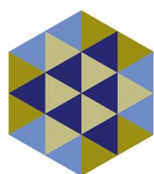


*Source. Adapted from Orozco et al., 2019*

Underpinning the Learning Process are the following questions to frame the design or redesign process for a green development bank:

- i) *Decision Making* – How are decisions on a course of action reached and who will take that decision?
- ii) *Stakeholder Engagement* – Who are the critical individuals and organisations to engage that will inform the decision-making process?
- iii) *Analytical Support* – What analysis is essential to develop options that can inform decisions and stakeholder engagement?
- iv) *Standards and Frameworks* – What definitions, limitations or statutes are relevant for the decision-making?

The benefit of the Learning Process is that while contextual factors differ country to country, there is a theme that resonates across as reflected in these five stages.

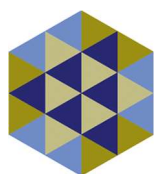


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Therefore, by breaking the process into distinguishable dimensions it simplifies what at first appears complex. Importantly, the core functions of Green Banks regardless of the contextual factors are markedly similar across different examples. Therefore, the Learning Process offers insight into the critical decisions that emerge along the design journey, which lead to different pathways bespoke to the country context.





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## THE LEARNING PROCESS: DBSA

The section describes the DBSA's greening journey through the lens of E3G Learning Process, first providing a brief background on the origins of the DBSA, which represents the institutional context for the incremental approach adopted by the Bank.

The primary inputs for applying the Learning Process to the DBSA are textual analysis of DBSA publications and funding submissions and eight interviews with individuals having direct insights on the bank's engagement on the environmental and climate agenda since its inception in 1983.

### Origins of the DBSA

At the Carlton Conference in 1979, the then Prime Minister PW Botha put forward the idea of a development bank for southern Africa for developing the former homelands of Transkei, Bophuthatswana, Venda and Ciskei<sup>7</sup>. A four-year process of engagement with regional governments and design followed resulting in the Establishment Agreement being signed on 30 June 1983, which formally launched the DBSA. The primary function of the Bank at that time was *"to promote economic development in its broadest sense, increase productivity and thus raise the standard of life of the people in the less developed areas of the southern African economic region included within the Bank's membership"*. The DBSA was a unique institution within South Africa's development finance system at that time, as it maintained a strong focus on building knowledge on developmental issues facing the country – a legacy attributed to the founding CEO, Dr Simon Brandt:

*"Dr Simon Brandt (1983-89) was an intellectual at heart and brought along strong intellectuals – they were fighting apartheid, so had to be cleverer than the apartheid government. They based their work on fundamentally reassessing policies, which made the organisation rooted in policy objectives, rather than it being an add-on or only being an implementing bank of government's policies. The Bank's roots are in subversive policies and anti-apartheid activism, which was most evident when the Bank funded Soweto!"*<sup>8</sup>

Historically, the DBSA had a legacy of strong governance, knowledge-based investment policies and practices and effectively engaging with government's development objectives through co-development and implementation<sup>9</sup>. The DBSA falls within the definition of a "classic development bank" as it is a state-owned, wholesale bank, which funds public and private sector companies and is not a deposit-taking institution.

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<sup>7</sup> DBSA, 2010. The Evolution of the Development Bank of Southern Africa. Published by DBSA.

<sup>8</sup> Christina Golino, Senior management (1984 to 2011).

<sup>9</sup> Thorne and du Toit, 2009 (see note 1).

After the 1994 democratic elections the DBSA's mandate changed, under the DBSA Act of 1997. It shifted towards providing financial, technical and other assistance for infrastructure finance and catalysing private sector investment. The DBSA maintains a progressive approach towards sustainability development, which is embedded in the organisational mission, vision and investment strategies throughout its 36-year history<sup>10</sup>.

## Approach to Environment and Climate Change

The DBSA adopted an incremental approach to environmental and climate issues over its 36-year history, which represents a continuous iterative learning process as the DBSA organically responds to national, internal and international approaches to environment and climate change. Table 3 illustrates different stages<sup>11</sup> in the DBSA's greening journey from the bank's inception in 1983 to its present context as of the date of this report, July 2019.

The DBSA greening journey shifts over time from a compliance-driven approach, which starting in **1988 and lasts till 2008**. Over this period, the DBSA introduces environmental standards due to external influences into the investment appraisal standards of the bank and enforces project compliance. Over time, the capacity and knowledge of the DBSA has grown significantly through testing of new approaches and adopting specific green finance mandates, leading to its present-day context where it actively engages in mobilising domestic and international funds for environmental and climate responses.

*Table 3: DBSA Evolutionary Approaches to Environment and Climate Change*

Time	Focus of the phase
<b>1988 - 2008</b>	Compliance motivated (initiating risk appraisals, standard setting)
<b>2009 – 2012</b>	Closer government engagement on environmental issues
<b>2013 – 2016</b>	Learning-by-doing on Global Environment Facility, Green Climate Fund and South Africa's Green Fund
<b>2017 - 2018</b>	Making case for dedicated climate finance functions at the Bank
<b>2018 &amp; beyond</b>	Reflecting on investment mandate: to finance coal or not?

*Source: Inspired by interviewee inputs and adapted by author*

**From 2009 till 2012**, the DBSA entered a new phase in its relationship with government, broadening the scope of engagement and focusing on strategising and advising on critical development issues which included climate change, the green economy and renewable energy. During this time, the DBSA advised and managed various programmes on behalf of the South African government and the World Bank as reflected on the timeline, including the Desertification Fund, the Green Fund, the Renewable Energy Market Transformation Unit and the programme office for the Renewable Energy Independent Power Producers Programme. These programmes

<sup>10</sup> Consensus view across the interviewees whose collective experience spans senior management and technical specialists.

<sup>11</sup> The categorisation builds on the inputs of two interviewees, adjusted by author based on interpretations from the textual analysis and other interviewees' inputs.

largely remained outside the mainstream activities of the DBSA, though drawing on its specialist expertise and strategic management as needed.

**From 2013 to 2016**, a period of experimentation and learning-by-doing emerged through the Green Fund's initiatives, which contributed to the Bank's understanding of the design, implementation and monitoring challenges associated with environmental and climate-related projects and programmes. The insights from the Green Fund's experimental approach coupled with the Bank's existing track record of embedding environmental and social risk into its projects appraisal process were critical<sup>12</sup> in securing accreditation by the Global Environment Facility and the Green Climate Fund.

**From 2017 to 2018**, the DBSA's momentum grew as it deepened its engagement with international climate funds on environmental and climate issues, including securing project funding from the Green Climate Fund<sup>13</sup> for the SCF Capital Solutions project in 2017, the DBSA Climate Finance Facility in 2018 to support climate investments in South Africa, Lesotho, Namibia and Swaziland and the Embedded Generation Investment Programme in 2019. The DBSA has 5 approved projects and one approved concept with the Global Environment Facility, addressing climate change, biodiversity and chemicals and waste. In 2018, the DBSA created a dedicated Climate Finance Unit which represents an evolutionary shift in the Bank's 36-year history of engaging on environmental and climate issues. Looking forward, the DBSA is actively exploring strategies for financing future energy investments and for promoting a just transition<sup>14</sup>.

A forthcoming report by the OECD studies the DBSA's contribution to financing South Africa's transition to a low carbon climate resilient economy<sup>15</sup>. It finds that national development banks like the DBSA are critical partners to implementing countries' Nationally Determined Contributions through the financing of green investments, as illustrated in Figure 3.

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<sup>12</sup> Interviewee reflections.

<sup>13</sup> The project lapsed in October 2017 however it is important to note because it was among the first projects supported by the Green Fund. <https://www.greenclimate.fund/projects/fp029>. For full project history with the Green Climate Fund see: <https://www.greenclimate.fund/entities/development-bank-of-southern-africa>

<sup>14</sup> The DBSA issued a Request for Proposal in August 2019 to develop an integrated energy investment framework that considers transition risk (existing and future coal investments) and just transitions. <https://www.dbsa.org/EN/TenderInfo/RFP%208/RFP168.2019%20-%20Integrated%20Energy%20Sector%20Investment%20Framework.pdf>

<sup>15</sup> OECD, 2019. **Financing Climate Futures: The role of National Development Banks in Brazil and South Africa**

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Figure 3 – Green Finance Commitments of the DBSA



Source: OEC, 2019 based on DBSA inputs<sup>16</sup>

DBSA's approach to environment and climate change shows different entry points over time, starting with its environmental safeguards, progressing to managing agencies and programmes for third parties and beginning to mainstream green finance through dedicated facilities, as illustrated in Figure 4 below. Strong partnerships and engagements driven by strong internal champions at technical and managerial level underpins the DBSA's incremental approach to environmental and climate change issues over its 36-year history.

Figure 4 – Entry Points for Greening DBSA



Source: Author depiction

<sup>16</sup> OECD, 2019. *Financing Climate Futures: The role of National Development Banks in Brazil and South Africa*

The sections that follow further elaborate the learning inherent in these entry points, focusing mainly on the i) environmental safeguards, ii) implementing agencies and iii) dedicated facilities. The entry point described as “Next Frontier?” is discussed in Section 4 and refers to the current context of DBSA’s engagement, which requires a watching brief as debates unfold at national and institutional level.

## Entry Point 1 - Environmental Safeguards

The DBSA’s learning process in building its environmental safeguards benefits from the consistent support and technical expertise of highly skilled specialists, who appraise the environmental and social risks of every investment proposal considered by the Bank since 1988 and 1984 respectively. The environmental standards developed by the DBSA represents the first entry point along its evolutionary journey, which began in 1988 when the bank first started developing such standards.

### CASE-MAKING<sup>17</sup>

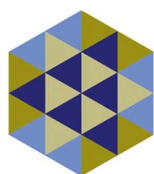
The DBSA’s founding mandate of 1983 promoted the economic development of the former homelands, representing the then apartheid government’s approach to social issues. By 1988, the DBSA was engaging international DFIs on potential co-financing of developmental projects in the southern African region. The international DFIs, following the recommendations of the 1987 Brundlandt Report<sup>18</sup>, had begun considering environmental and social risk assessment in their investment appraisal procedures. Prompted by the due diligence process on co-financing an infrastructure project in Swaziland, the DBSA management at the time realised that ongoing co-operation with international lenders on infrastructure depended on the bank having compatible environmental and social standards. An internally focused strategic decision was then taken to develop environmental safeguards for the bank, which laid the foundation for DBSA’s engagement on environmental and climate change issues.

The analytical process for developing the environmental safeguards involved setting up a specialist unit of four people in 1988, tasked with developing a framework for appraising projects from an environmental perspective. The specialist functions included environmental, social, finance, technical, institutional and economic appraisal requirements. Policy papers were developed based on the international precedents of the environmental and social safeguards of the World Bank and Asian Development Bank, which influenced the initial design of DBSA’s environmental standards. The DBSA standards were adapted for the South African environmental

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<sup>17</sup> Orozco, D. 2019. Green Bank Design Principles: A Synthesis of E3G’s Learnings from Building Green Banks

<sup>18</sup> Commonly referred to as The Brundlandt Report and published in 1987, the Report of the World Commission on Environment and Development: Our Common Future represents the foundational work on sustainable development by the United Nations. <https://sustainabledevelopment.un.org/content/documents/5987our-common-future.pdf>



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management, social and institutional contexts. At the time, the primary policy context was the Environmental Conservation Act, which required impact studies and permits to be issued, these dimensions were included in the appraisal framework. The environmental laws of South Africa were in place since 1988, however, they were not yet being used at financing institutions to appraise projects.

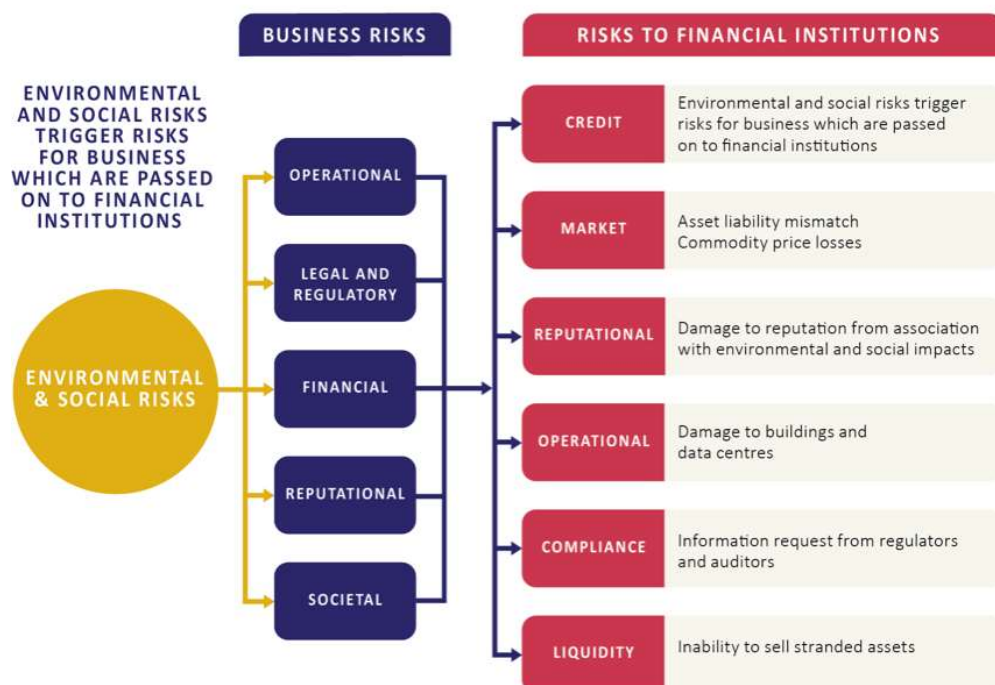
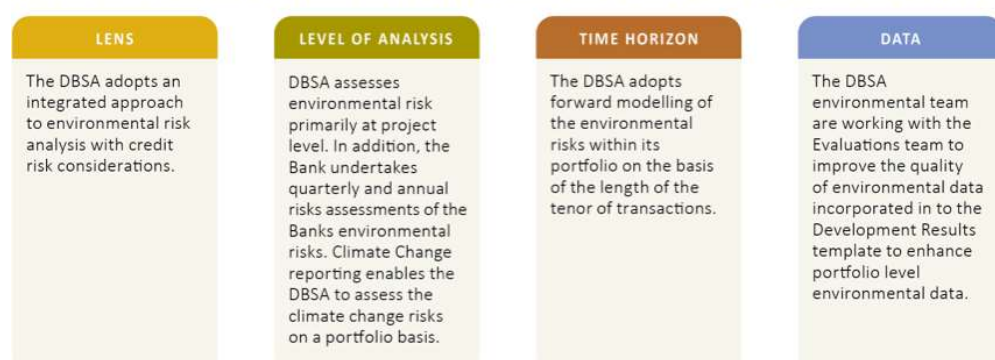
The case for the DBSA's improving and refining the environmental safeguards is now unquestionable, as demonstrated in Figure 5. The case making for the environmental safeguards over the bank's history was not always smooth and was marked by tensions between compliance and progressive approaches.



Figure 5: DBSA Case for embedding environmental risk into appraisal and decisions



#### FINANCIAL INSTITUTIONS STRUGGLE TO SYSTEMATICALLY ASSESS THEIR ENVIRONMENTAL RISK



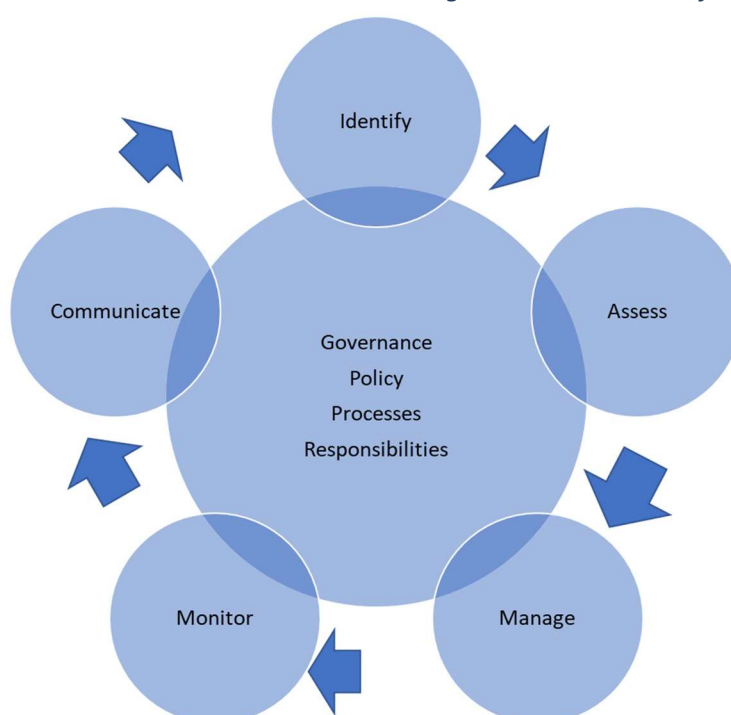
Source: DBSA via interviewee.

The DBSA continues to evolve its case for embedding environmental and social risk management into its investment appraisal, which is now far removed from being a response to international development partner pressures in 1988. The DBSA recently adopted “bending the arc of history” as its primary vision and message, driven by an executive level commitment to *“do the right thing, not the popular or most financially incentivized or politically enforced – but focus on what is right thing for life on earth”*<sup>19</sup>. The safeguards therefore enable the DBSA to remain comparable with international best practice - by facilitating the increasingly urgent task of evaluating the impact and compatibility of new projects and programmes with sustainable development and the climate breakdown and by extending the ambition of institutional responses.

## DESIGN<sup>20</sup>

The environmental and social risk management framework employed by the DBSA, which the organisation updates every 2 to 3 years aligns with emerging good practices, relevant national and regional legislation and feedback from within the bank’s portfolio.

Figure 6: Environmental and Social Risk Management Framework of the DBSA

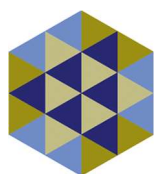


Source: Adapted from DBSA internal presentations.

<sup>19</sup> Based on interviewee feedback.

<sup>20</sup> Orozco, D. 2019. Green Bank Design Principles: A Synthesis of E3G’s Learnings from Building Green Banks





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As illustrated in Figure 6, the DBSA applies an environmental and social risk management framework to identify, assess, manage, monitor and communicate the environmental and social risks on its projects. The risk categories for environmental and social factors include credit, market, reputational, operational, compliance and liquidity.

The most recent evolution of the DBSA Environmental and Social Safeguard Standards<sup>21</sup> released in 2018 addresses the following areas:

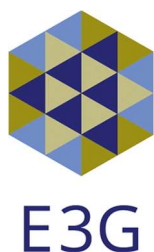
Standard	Areas
1	Assessment and management of environmental social risks and impacts
2	Stakeholder engagement and information disclosure
3	Gender mainstreaming
4	Indigenous peoples
5	Development induced displacement and resettlement
6	Labour
7	Community health and safety
8	Cultural heritage
9	Biodiversity conservation and sustainable management of living natural resources and resilience
10	Resource efficiency and pollution prevention and management
11	Dam Safety

The DBSA regards integrating environmental and social governance as a “*responsible investment practice which generates positive outcomes for public and private sector practices*”<sup>22</sup> (DBSA, 2018:16). The Bank mainstreams its Environmental and Social Safeguard Standards into all investment decision processes, applying inputs from additional policy documents and guidelines. This process deepens the mainstreaming of sustainable development and climate change considerations into the DBSA’s investment appraisal processes, supplemented by the following internal policies:

- DBSA Environmental Sustainability Strategy
- DBSA Climate Change Policy Framework
- DBSA Environmental Appraisal Framework
- DBSA Social and Institutional Guidelines

<sup>21</sup> The safeguards can be accessed via DBSA website: <https://www.dbsa.org/EN/About-Us/Publications/Documents/DBSA%20Environmental%20and%20Social%20Safeguard%20Standards%202018.pdf>

<sup>22</sup> DBSA, 2018. Making Change Happen DBSA (2018). **Make Change Happen. Environmental and Social Safeguard Standards, March 2018. Development Bank of Southern Africa.**



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The DBSA recognises that designing the ESR management framework to integrate environmental and social risk throughout its investment appraisal processes is challenging and therefore, it partners with organisations to develop appropriate methodologies and decision-making tools to advance the Bank’s safeguards and standards. The result of these partnerships is that DBSA’s Environmental and Social Safeguard Standards aligns with industry practices from similar institutions, such as those of the International Finance Corporation, World Bank, African Development Bank and Asian Development Bank. The Constitution of South Africa, the Equator Principles and the National Environmental Management Act offers further guidance for developing and refining the Environmental and Social Safeguard Standards of the DBSA.

The accreditation of DBSA as an implementing entity for the Global Environment Facility and the Green Climate Fund further contributed to refining the design of the Bank’s environmental and social safeguards. Having access to the global funding facilities requires continuous alignment and annual reporting on the standards being maintained by the DBSA, which ensures the institutional approach of the organisation is maintained as initially accredited and undergoes continual improvement to retain its accreditation status.

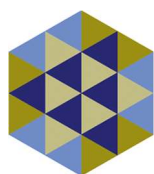
### ESTABLISHMENT<sup>23</sup>

The ESR management framework is designed for application across the project appraisal process, which assesses the risk appraisal across the investment making decision process within the DBSA, as illustrated in Figure 7. The investment decision cycle covers the project from its inception based on an “in-principle” decision to finance or develop the project further and follows through to credit approval, negotiation, monitoring and evaluation of the development results of the project.

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<sup>23</sup> Orozco, D. 2019. Green Bank Design Principles: A Synthesis of E3G’s Learnings from Building Green Banks

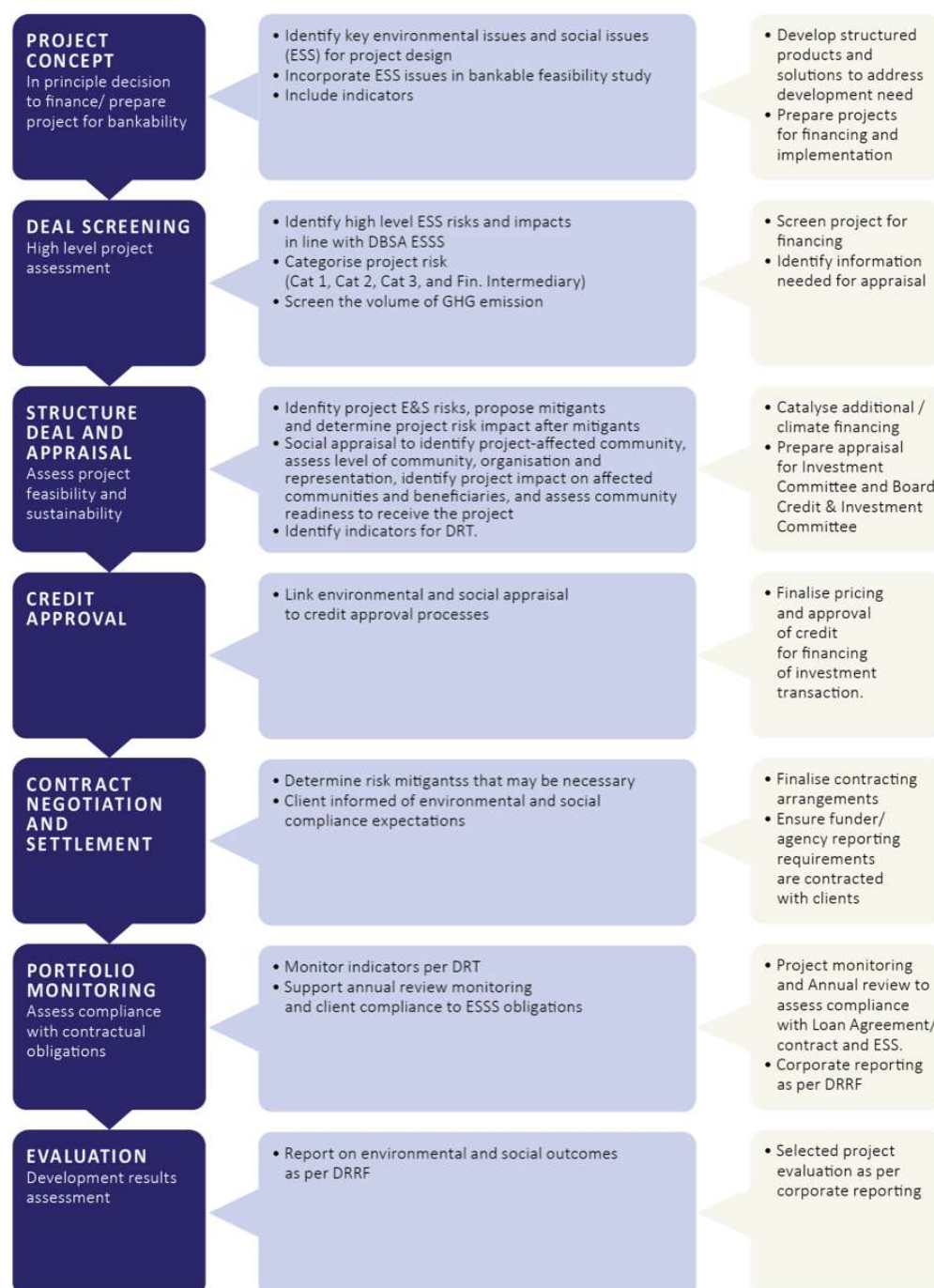
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Figure 7: Investment Appraisal Process of DBSA

ENVIRONMENTAL AND SOCIAL RISK ASSESSMENT IS EMBEDDED IN DBSA INVESTMENT DECISION MAKING



Source: DBSA via interviewee.

Tensions between compliance and ambitious approaches to environmental risk appraisal existed within the organisation. For example, although the early stages of introducing the environmental appraisal standards benefited from management

support, its findings relative to other appraisal factors were viewed as a “lesser child”<sup>24</sup>. During this period (between 1998 and 2008), the DBSA adopted a compliance approach towards environmental safeguards, which implied that doing justice to all elements of the risk appraisal depended on how managers and experts engaged. To avoid the risk of adopting only minimum environmental standards on projects, the executive management at the time introduced the institutional operating standards of the World Bank and British banking sector. The DBSA has significantly progressed from these early tensions, which is evident in ongoing training programmes, reward and recognition of the critical contribution of specialist skills to projects and ensuring the specialists directly address the Credit and Investment Committees of the DBSA Board. The DBSA further promotes policy compliance among the Key Performance Indicators of its staff members, which requires embedding good practices in the project appraisals including peer review mechanisms where applicable.

## OPERATION<sup>25</sup>

The environmental safeguards are applied across the investment decision process, as highlighted in earlier sections and offer an opportunity for the investment teams to become fully engaged in environmental and climate issues. A notable example is a drought in the Western Cape, which exposed key decision makers in the DBSA to the impacts of climate change at a municipal level over the period 2015 to 2018. The investment teams comprising specialists, investment officers and senior management are working together in responding to the critical water shortages in the City of Cape Town, investigating aquifer recharge and desalination of seawater projects. The longer duration of the project development and appraisal processes means that understanding of the climate-related project impacts and potential solutions built institutional and individual capacity, beyond the expertise of the specialists.

The DBSA's governance structures overseeing the investment appraisal process includes the following structures. Firstly, at the DBSA Board level, specialist committees receive, evaluate or engage on appraisal reports, namely the Social and Ethics Committee, its Credit and Investment Committee and the Infrastructure Delivery and Knowledge Committee. The Social and Ethics Committee tends to the quarterly review of DBSA's sustainability efforts. Secondly, at the management level, the DBSA Investment Committee and Infrastructure Delivery and Knowledge Committee support the internal pre-board appraisal processes. Monitoring and reporting on the performance of the environmental risks of projects are critical, which the Portfolio Management Unit of the Bank tracks based on the appraisal results and final approval conditions. Throughout the investment appraisal process,

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<sup>24</sup> Based on interviewee feedback.

<sup>25</sup> Orozco, D. 2019. Green Bank Design Principles: A Synthesis of E3G's Learnings from Building Green Banks

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the environmental and social analysts are critical team members, who develop precise development results for the project.

The Environmental indicators of the DBSA's Development Results Framework guide the monitoring and evaluation of DBSA investment results and outcomes and integrate the inputs from the project screening and appraisal.

## EVOLUTION<sup>26</sup>

The DBSA is drawing on various analytical approaches to improve its environmental and climate standards. These approaches include the Climate Action in Financial Institutions Initiative which assists banks to respond to climate risk and the Climate Policy Initiative's Transitions Risks<sup>27</sup> report. The CPI report studies the transition risks<sup>28</sup> facing a coal-dependent South African economy and the consequences of continued support for carbon intensive industries. The Chief Executive, Mr. Patrick Dlamini, actively supported the CPI research including convening executive counterparts in other development institutions to engage on the results.

The DBSA is deepening and broadening of its knowledge of climate-specific risks, including engaging in a pilot study by the Natural Capital Finance Alliance which incorporates natural capital approaches in the credit assessment process, going beyond measuring greenhouse gas emissions to also include ecosystem resilience to climate impacts<sup>29</sup>. A guide is being piloted by the DBSA and FirstRand Group in South Africa, which first allows the institution to understand and assess their exposure to natural capital risks. In addition, the DBSA is progressing its understanding of the physical risks associated with maladapted infrastructure through its involvement in reviewing the Green Book<sup>30</sup> developed by the Council for Scientific and Industrial Research, which is a climate risk profiling and adaptation tool aimed at supporting local government in mainstreaming climate change design principles for climate smart human settlements.

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<sup>26</sup> Orozco, D. 2019. Green Bank Design Principles: A Synthesis of E3G's Learnings from Building Green Banks

<sup>27</sup> The report examines the risk to the South African economy, its government, municipalities, companies and financial institutions emerging from the global transition to a low carbon economy  
<https://climatepolicyinitiative.org/publication/understanding-the-impact-of-a-low-carbon-transition-on-south-africa/>

<sup>28</sup> Transition risk is defined in the CPI report as the risk that the value of assets and income is less than expected, due to economic development shifts emerging from climate policy and the switching of energy sources to low carbon.

<sup>29</sup> The Natural Capital Finance Alliance self-describes as an initiative among financial institutions to develop knowledge and tools to reduce and manage the risks of environmental impacts and dependencies.

<https://naturalcapital.finance/about-ncfa/> and the launch of the guide <https://naturalcapital.finance/blog/ground-breaking-guide-launched-in-south-africa-to-empower-banks-to-assess-natural-capital-risk/>

<sup>30</sup> The Green Book can be accessed here: <https://www.greenbook.co.za/>

The DBSA now faces an important juncture which goes beyond the organic evolution of its environmental safeguards, which is the broader policy context of South Africa's position on coal and continuing investment by the institution. The Bank faces public pressure to explicitly express a position on its future financing of coal projects, including experiencing public demonstrations outside its premises. The rapid changes in global and local carbon policy place pressure on the DBSA to reflect on exit strategies from its current coal investments and establish incentives for greener investment, which means the iterative learning process starting with case-making begins again as the Bank enters a new phase of its engagement on environmental and climate issues.

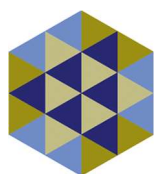
## Entry Point 2 – Implementing Agencies

The DBSA mandate as a development bank allows it to offer its services as an implementing agent to government, development partners and other development partners. The platform afforded by managing third party agencies allows the DBSA to pilot and build internal expertise and awareness around the needs of various development and environmental projects and programmes. The DBSA's role as an implementing agent for such programmes represents the second entry point for DBSA's evolutionary journey, a phase which began around 2010.

For example, in 2004, through seed funding provided by the South African government, the DBSA created a Development Fund to ring-fence its development focused projects as a result of a restructure. The Development Fund was a valuable channel for making funds available for studies on a variety of development and environmental issues (e.g. Nuwejaars Wetlands Projects in 2004, adjacent to the Agulhas National Park) and to help farmers develop new tourism projects on their farms. The seed funding invested in these projects would not have otherwise been made available, and in later years its impact led to the first project approved by the Green Fund, another agency managed by the DBSA.

Several examples of agencies managed by the DBSA exist, such as the Jobs Fund, the Renewable Energy Market Transformation Unit, Desertification Fund and the Green Fund. The DBSA also supports the Department of Minerals and Energy and the National Treasury in managing the Independent Power Producers Office, which is the programme under which South Africa procured its renewable energy resources. This section is, however, limited to the example of the Green Fund, which the DBSA co-designed and managed on behalf of the Department of Environmental Affairs and the National Treasury. The Green Fund played an instrumental role as an experimental financing mechanism, building internal capacity and understanding of the differentiated needs and responses for green and climate-related investment appraisal and monitoring.





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## CASE-MAKING<sup>31</sup>

The seeds for the Green Fund were laid by the South African Department of Environmental Affairs<sup>32</sup> over the period May to August 2010. Over this time, the Department of Environmental Affairs engaged in a discovery process to better understand how the term ‘green economy’ applies in South Africa through a series of focus groups and indications of project interest<sup>33</sup>. The period coincided with South Africa’s hosting of the green legacy projects linked to the hosting of the FIFA World Cup in 2010, and the hosting of the UNFCCC annual negotiations in Durban in December 2011. Just prior to these developments, the then President Zuma had announced greenhouse gas emission targets for South Africa to be met by 2020 and 2025, while calling South Africa ‘a greenhouse gas offender’<sup>34</sup>. The growing awareness and engagement of senior government officials around the impact of the climate breakdown and need to transition to a low carbon economy laid the groundwork for a public finance allocation of R1,195m (USD85 million) by the National Treasury<sup>35</sup> in March 2011. The budget allocation was assigned to the Department of Environmental Affairs, who assumed responsibility for developing a financing mechanism to utilise the allocation. The key decision makers involved in this process were Director-Generals and their technical support teams at the respective government departments.

Close policy engagement between the DBSA, the National Treasury and the Department of Environmental Affairs led to the DBSA being tasked with developing the initial design parameters of the Green Fund (see below under ‘Design’ which describes the analytical work involved in the design of the Green Fund). Once the design parameters were agreed among the parties, the DBSA was offered the role of implementing agency. Obtaining executive support within the DBSA to host the Green Fund as a ringfenced programme and facility was not contentious. The DBSA had an established track record of hosting similar initiatives, e.g. the R9 billion (USD650 million) Jobs Fund, and the Green Fund offered an opportunity for potential co-financing of green projects. The key decision makers involved in making the case for the DBSA to host the Green Fund were Group and Divisional Executives, representing the rationale to the Chief Executive and management committee of the DBSA.

<sup>31</sup> Orozco, D. 2019. Green Bank Design Principles: A Synthesis of E3G’s Learnings from Building Green Banks

<sup>32</sup> This department has subsequently been renamed to the Department of Environment, Forests and Fisheries post the May 2019 elections in South Africa. However, for the purpose of this document and the historical context of the material presented here, the Department’s former name will be used.

<sup>33</sup> Naidoo, CP., 2019. Transitioning South Africa’s finance system towards sustainability. Chapter 6 in Sustainability Transitions in South Africa edited by Mahomed, N., 2019. Taylor and Francis.

<sup>34</sup> <https://www.iol.co.za/news/south-africa/sa-a-greenhouse-gas-offender-zuma-436138>

<sup>35</sup> The report examines the risk to the South African economy, its government, municipalities, companies and financial institutions emerging from the global transition to a low carbon economy  
<https://climatepolicyinitiative.org/publication/understanding-the-impact-of-a-low-carbon-transition-on-south-africa/>

Motivating the Green Fund mandate to the DBSA Board was also uncontentious, as the fund management was a functionality offered by the DBSA. A key drawcard for the DBSA Board was the chance to serve as a senior funder on selected projects supported by the Green Fund and the DBSA becoming a thought leader in greening policy debates ensuing at national and international level. The Green Fund, therefore, offered the DBSA the learning space by managing a programme using its fiduciary, project appraisal and management capabilities. The Green Fund represented an experimental approach to understanding the challenges associated with green projects and offer policy feedback to inform future greening policies by the South African government.

### DESIGN<sup>36</sup>

The DBSA assumed the primary role of developing the design parameters of the Green Fund, which was informed by extensive research. While the research was not commissioned specifically for the design of a Green Fund, the design process benefited from two research projects. These research projects formed part of the DBSA's ongoing support to the Department of Environmental Affairs on emerging policy debates related to the green economy and the climate breakdown, including South Africa's strategy on climate finance.

**The first research project during 2010 was funded through in-kind support by the DBSA to the Department of Environmental Affairs, and was informed by a series of stakeholder focus groups to define and programme potential green economy initiatives for the country as well as commissioning opinion pieces from sector experts. The DBSA also supported the Department of Environmental Affairs in analysing over 300 projects, which represented the public perception of what constituted a green economy. The analysis resulted in the emergence of eleven sector priorities for the green economy, including water, built environment, renewable energy and biodiversity and conservation. The focus groups comprised academics, subject matter experts, financiers and government officials, during which three questions were posed:**

- i) Whether the market segments reflected the green priorities the country should be addressing?
- ii) What is needed at a policy level to implement green priorities?
- iii) What resources are required to ensure green projects are financed?

From a finance perspective, the focus groups highlighted the lack of coordination, and limited awareness of the international concessional and grant-related climate and environmental finance mechanisms that South Africa had access to at the time. In addition, the need for a climate finance coordination mechanism was identified

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<sup>36</sup> Orozco, D. 2019. Green Bank Design Principles: A Synthesis of E3G's Learnings from Building Green Banks



to raise awareness of such international mechanisms. In addition, the need for a distinctive role to be played by the development banks in South Africa was raised to support the private sector in bridging funding gaps and risks that they could not assume. The outcome of the focus groups is available from the DBSA website<sup>37</sup>.

**The second research project in 2011** conducted by the DBSA was by invitation of the Department of Environmental Affairs to support research for the National Climate Change Response Policy, and which was funded by the GIZ. Three teams of South African researchers worked together under supervision of the DBSA to address three key questions:

- i) What should South Africa's climate finance strategy be in light of the international climate finance debates?
- ii) What support does the financial sector require to engage in green investment?
- iii) What are the best practices for environmental funds to inform a national fund or funding mechanism?

The findings linked to each of these questions are available on THE DEPARTMENT OF ENVIRONMENTAL AFFAIRS website<sup>38</sup>. The key outcomes of the research were informative in the long term for developing the design parameters of the Green Fund. For example, the analytical work showed that international climate finance can best be leveraged if blended with national resources. This meant that, in the South African context, the strategy for financing the climate breakdown should focus on mobilising domestic resources and crowding in appropriate international and other funders as needed. The financial sector research raised three requirements, being the need for policy certainty, clear identification by government of its climate investment priorities and access to project development support. These three requirements represented the main components for any future national mechanism. Finally, regarding the best practices from the design of environmental funds, the research identified that the critical features for any fund should be i) ease of access to such funds; ii) defined support measures, and iii) ensuring the funding gap being supported was clearly determined.

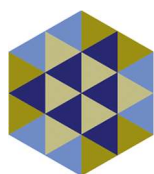
Following from the two sets of research conducted, the DBSA offered specific recommendations for the financing component of the National Climate Change Response Policy. The recommendations related to:

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<sup>37</sup> Programmes in support of transitioning South Africa to a green economy. <https://www.dbsa.org/EN/About-Us/Publications/Documents/DPD%20No24.%20Programmes%20in%20support%20of%20transitioning%20South%20Africa%20to%20a%20green%20economy.pdf>

<sup>38</sup> The reports are titled "Governance of Climate Change in South Africa", "Synthesis of climate finance literature report", "High level consultation with finance sector on climate change and funding mechanisms", "Financing climate change" and "Institutional funding mechanisms: case study review". Available at [https://www.environment.gov.za/documents/research#climate\\_change](https://www.environment.gov.za/documents/research#climate_change)

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- Focusing the climate response policies on development and transitioning to a climate resilient and low carbon economy
  - Identifying short-, medium- and long-term priority areas for mitigation and adaptation
  - Creating an interim coordination mechanism to test the resource needs for priority areas and building an evidence base for a more permanent financing mechanism
  - Establishing a technical working group to conduct a “sanity check”, ensuring that the national financial sector is compatible with the transition to a low carbon, climate resilient economy and identifying any blind spots in understanding what is required of the financial sector

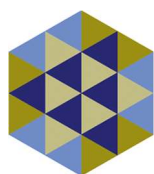
The findings and research methodology applied in the second research project on the National Climate Change Response Policy was instrumental in defining the design parameters of the Green Fund. Firstly, the findings emphasised the need for the Green Fund to have a clear and defined goal. For example, the primary goal of South Africa’s climate policy was to transition the economy towards low carbon and climate resilient development. Such a goal required a portfolio of interventions over a specific time scale, which meant asking: *what is the desired impact of the intervention?* Secondly, the Green Fund should focus on defining the risk profiles of the different interventions to be funded and understanding the extent to which these risks could be absorbed by different financial sector players, and where its specific support to do so was needed. Thirdly, the research showed that a clear role definition for private and public finance emerges where blending resources catalyses investment, and that resource needs are not evenly spread across a project cycle. Fourthly, mainstreaming low carbon and climate resilient development into national budgets and considering the planning specificities at sub-national government level was critical to support any national financing intervention such as the Green Fund. Finally, managing the transition required engaging the private sector in a dialogue to understand the areas where they are not able to absorb risk or redirect finance flows towards green investment.

**A third segment of research work** related to the DBSA’s growing engagement in international climate finance policy-related work, specifically the newly launched Green Climate Fund. By late 2011, the DBSA convened a workshop together with the World Resources Institute and the French Development Agency (Afd) bringing together financial experts from development banks in India, Philippines, US, Norway among others. The focus of these discussions was the design parameters for Green Climate Fund to facilitate direct engagement by national development banks<sup>39</sup>. Inspired by these discussions, the design parameters of the Green Fund of South Africa mirror the aspirations of how national development banks could be engaged as a national conduit for channeling funding from the Green Climate Fund.

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<sup>39</sup> [https://www.dbsa.org/EN/About-Us/Publications/Documents/DFI%20submission%20%20to%20GREEN CLIMATE FUND%20September%202011.pdf](https://www.dbsa.org/EN/About-Us/Publications/Documents/DFI%20submission%20%20to%20GREEN%20CLIMATE%20FUND%20September%202011.pdf)

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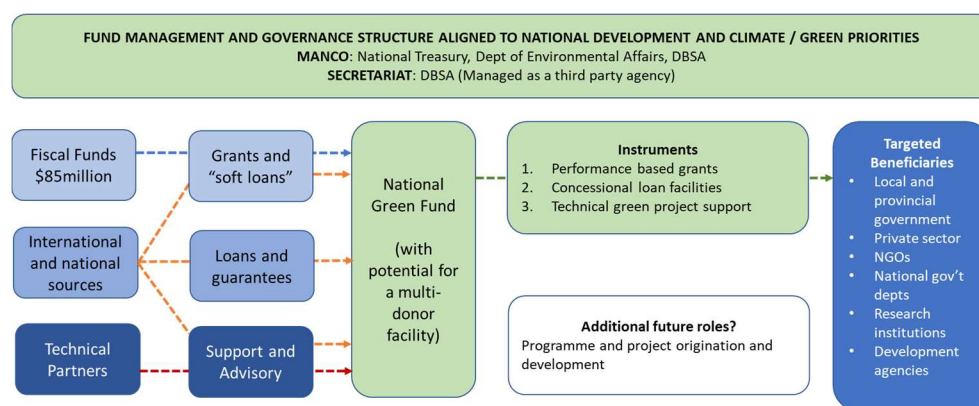


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The DBSA also participated in international events, including the Rio+20 Sustainable Development Agenda in 2012, where the bank supported the government in promoting the need for a sustainable development finance strategy. The South African government propositions for such a strategy ultimately led to the formation of the Intergovernmental Committee of Experts on Sustainable Development Financing, which presented its findings to the UN General Assembly in August 2014<sup>40</sup>. The DBSA also engaged in meetings and work being conducted by the Inter-American Development Bank for the Latin American Countries on the role of development banks, including the review of research on climate finance by that bank. At COP17 in 2011, DBSA showcased its work with the Department of Environmental Affairs, including the need for governments to create a national financing strategy for climate action. The message conveyed by the DBSA was that such a strategy should encompass short- to medium-term financial innovations and access to finance. Further, the DBSA emphasised that understanding the actions needed in the short-term to effect long term system-level changes was critical. By being exposed to the broader global climate and development finance agenda and sharing the DBSA experience and perspective, the DBSA was able to frame its approach to financing environmental and climate-related interventions. It did so by translating the global climate finance agenda into the South African context at a national and institutional level.

The design parameters of the Green Fund, as illustrated in Figure 8 below, represents a synthesis of the analytical work relating to the national context for green economy programmes and climate policy, and the international context in terms of the Green Climate Fund.

*Figure 8 – Design Parameters for a National Green Fund*



Source: Naidoo, 2013.

<sup>40</sup> Report of the Intergovernmental Committee of Experts on Sustainable Development Financing.  
<https://www.un.org/esa/ffd/wp-content/uploads/2014/12/ICESDF.pdf>

The DBSA also conducted additional research to explore financing mechanisms that supported transition processes, which led to drawing insights from the design of the Canadian Health Transition Fund<sup>41</sup>. The key design principle was that the Green Fund would catalyse investment in green economy programmes and offer policy and project-related lessons for the South African government to consider in its strategy for financing future green investments. The understanding was that the impact of the Green Fund investment may not be visible within the short term, however over time the lessons may emerge. The risk appetite for the Green Fund was intended to be high risk with strong demonstration value, therefore early stage investments were preferred. This meant that the Green Fund investments was likely to generate both successes and failures, using a traditional investment lens.

The governance structure of the Green Fund comprised a management committee (Manco) made up of DBSA, National Treasury and the Department of Environmental Affairs. The Manco also served as the Investment Committee of the Green Fund. The Manco consulted with an intergovernmental advisory committee on priorities and key decisions and was responsible for all investment decisions. The Green Fund was designed to catalyse public and private investment in green projects by providing appropriate financial instruments and technical support as needed. The Green Fund was designed with a prescribed capital allocation in mind, being 75% allocated towards green investment, 20% assigned towards capacity building and 5% towards policy research and development. The capital allocation recognised that projects yield essential lessons that can inform the funding challenges and solutions for green investment (hence, the policy research allocation). Capacity building recognises that new skills are needed that may not yet exist or be known within institutions. Further, geographic balance was critical for the Green Fund across South Africa's nine provinces – the intention was for the Green Fund to be proactive in sourcing projects from areas where low volumes of project applications were being received.

The instruments offered by the Green Fund included non-recoverable grants, recoverable grants and concessional loans, as well as grants for capacity building and research and development. The range of instruments was critical for signaling and attracting serious project developers and preventing any negative perceptions that the Green Fund represented 'free money'. Therefore, setting a standard that each project would be assessed on merit and matched to the appropriate financial instrument relative to its requirements, with a clear message that awarding grants was not the default instrument. The target beneficiaries of the Green Fund include small to medium sized enterprises and research institutions, who accessed the Fund by responding to specific calls for proposals<sup>42</sup>. Additional design features included the focus on learning-by-doing and offering a wide range of financial instruments to attract the best proposals and ensure the future replenishment of the Green Fund.

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<sup>41</sup> This fund was set up to understand the impacts of a shift in health policy and afford government early lessons through to show what policy adjustments may be necessary.

<sup>42</sup> Transition risk is defined in the CPI report as the risk that the value of assets and income are less than expected, due to economic development shifts emerging from climate policy and the switching of energy sources to low carbon.

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The Green Fund was designed at that time to present clear thematic funding windows, including renewable energy and natural resource management.

The design parameters were primarily accepted by the Department of Environmental Affairs and National Treasury, with some debate ensuing around the Green Fund being able to public and private capital for governance purposes. The agreed position was that the Green Fund, in principle, would be open for the capital injection by other sources seeking to complement the seed capital contributed by National Treasury. The design process between the National Treasury, the Department of Environmental Affairs and the DBSA unfolded over a period of 8 months from late 2011 to early 2012 and culminating in the parties signing a Memorandum of Understanding by March 2012 awarding the DBSA the role of the implementing agency.

### ESTABLISHMENT<sup>43</sup>

The DBSA, in its role as implementing agency, was responsible for setting up the institutional infrastructure of the Green Fund. As a ringfenced agency of the DBSA, the Green Fund relied upon the bank's institutional infrastructure such as the financial management and reporting systems. Project appraisal and evaluation criteria specific to the Green Fund, reflecting national development priorities and the green economy objectives of South Africa were developed by the DBSA. The bespoke criteria were adapted based from the DBSA's environmental, social and governance safeguards.

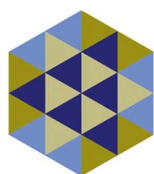
Staffing was limited to 12 individuals, to be employed as consultants to the Green Fund. The core skills of investment management, environmental analysis, financial analysis, portfolio management and policy analysis were prioritised, with technical oversight by senior managers and divisional executives of the DBSA. The Green Fund was situated as an agency within the Investment Banking Division of the DBSA, with the Group Executive of that unit having executive oversight and accountability for the operations of the Green Fund.

DBSA was undergoing a significant restructuring around the same time that the Green Fund was being established and operationalised. The restructuring led to the loss of several key staff members of the DBSA involved in the design and case-making phases, which meant the loss of significant institutional memory. The loss was partially mitigated by a GIZ secondee and a local consultant who had worked with the key staff members since 2011 in developing the design parameters and bridged the institutional knowledge gaps for the operational team.

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<sup>43</sup> Orozco, D. 2019. Green Bank Design Principles: A Synthesis of E3G's Learnings from Building Green Banks

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## OPERATION<sup>44</sup>

The establishment period overlapped with operationalising pressures from the Department of Environmental Affairs and National Treasury as the public finance allocation was unutilised. The Green Fund<sup>45</sup> held its first Manco in the first quarter of 2012 - by 2018 a total of 46 projects were approved. The total portfolio valued at R680 million (USD48,5million) comprised 22 investment projects, 8 capacity building projects and 16 research and development projects<sup>46</sup>. The Green Fund's activities have been independently evaluated, and the Department of Environmental Affairs and National Treasury recognise the positive contribution of the Green Fund portfolio in developing South Africa's green economy agenda and demonstrating a diversity of project options<sup>47</sup>.

Among the notable operational lessons that emerged from the Green Fund was the difference between expectations at approval stage versus expectations upon implementation. The early-stage investment focus of the Green Fund meant that had limited implementation capacities on one hand, while the Green Fund on the other had low ability to monitor the projects during the early phases of implementation.

## EVOLUTION<sup>48</sup>

Designed as a catalytic and experimental fund, the Green Fund offered important lessons for understanding the challenges and dynamics needed for financing South Africa's transition to green economy. However, the Green Fund was also subject to the tensions of generating traditional returns on investment, which conflates with the notion of experimentation. For example, so-called failures in an experimental financing mechanism offers valuable insights of what works and what does not. These insights relate to level of project development required, the tensions in meeting both developmental and green goals and understanding the monitoring impacts (lag and lead factors) related to green economy projects. From the Department of Environment's perspective, taking the Green Fund further required a reflexive approach. Specifically, to re-engage on attracting external funders, risk buy-down on national projects and programmes and determining the expected

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<sup>44</sup> Orozco, D. 2019. Green Bank Design Principles: A Synthesis of E3G's Learnings from Building Green Banks

<sup>45</sup> See [www.sagreenfund.org.za](http://www.sagreenfund.org.za)

<sup>46</sup> See Note 24. Box 6.1 "Learnings from South Africa's Green Fund (contributions by Jenitha Badul and Michelle Layte).

<sup>47</sup> Department of Environmental Affairs, 2017. Green Fund Impact Study Technical Report (unpublished).

<sup>48</sup> Orozco, D. 2019. Green Bank Design Principles: A Synthesis of E3G's Learnings from Building Green Banks



returns on investment as well as reconsidering the governance structure of the Green Fund<sup>49</sup>.

The Green Fund directly contributed towards deepening the DBSA's experience and standards for environmental safeguards and monitoring standards. In the long-term, the Green Fund experience was valuable in addressing gaps identified by the Global Environment Facility and the Green Climate Fund evaluation panels, which led to the bank securing the bank's accreditation to the Global Environment Facility and the Green Climate Fund. Specifically, the approach of the Green Fund satisfied the Accreditation Panel of the Global Environment Facility that the DBSA was engaging around specific themes of environmental action. The Accreditation Panel were also impressed with the Green Fund's development of early stage indicators for assessing a project's potential green impact. These include environmental, economic and social indicators and measured in terms of project level and system-level impacts.

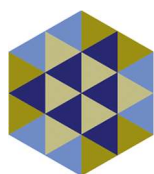
The Green Fund built significant internal expertise and capacity among DBSA and the operational team, which led to proposals for re-designing the investment proposition of the Fund to take into account the critical lessons. The Green Fund is attributed with building the groundwork for the next stage in DBSA's incremental greening journey, that of mainstreaming green finance. The funding cycle for the Green Fund closed in 2017, and the DBSA now manages the remaining investment portfolio on behalf of the Department of Environmental Affairs and National Treasury.

### Entry Point 3 - Mainstreaming Green Finance

The third entry point along the DBSA's evolution on greening finance relates to its experimentation with mainstreaming green finance at various stages during its 36-year history. For example, the DBSA had begun securing green credit lines from international development agencies for initiatives such as solar water heating for local government and energy efficient housing. In 2010, DBSA launched an environmental finance unit to develop a programmatic approach towards strategising and mainstreaming environmental and climate breakdown-related interventions. By 2011, the first experience with pursuing accreditation to international finance mechanisms was initiated. Finally, in 2018, the DBSA established a Climate Finance Unit, which consolidates the bank's current climate financing efforts and its management of the Green Fund. The Climate Finance Unit oversees the DBSA's work with the Global Environment Facility, Green Climate Fund, South Africa's Green Fund and the Climate Finance Facility. This section briefly describes the DBSA's evolution in mainstreaming green finance.

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<sup>49</sup> See note 31.



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## CASE-MAKING<sup>50</sup>

The DBSA had established funding relationships with KfW and AfD, specifically, which related to the provision of dedicated green credit lines to promote renewable energy and energy efficiency initiatives at provincial and household levels. The green credit lines of the Bank were largely underutilised, though attracting facility fees payable to its partners. The case-making for further green credit lines, though offering concessional benefits, was poor in the absence of a dedicated programme and project development function. In addition, the policy context for green projects in South Africa at the time was muted, which meant a low public interest for investment projects.

By 2009, the DBSA and its international DFI counterparts developed a learning and exchange platform to address critical leadership issues facing development banks. This would later manifest in the International Development Finance Club (IDFC), with DBSA as a core founding member. Among the critical issues facing development banks was responding to the climate breakdown. The DBSA executive decided to launch an environmental finance unit to develop the Bank's institutional response to the climate breakdown. The unit operated between 2010 and 2012, undertaking technical work on several foundational issues, being i) policy research relating to the green economy and financing mechanisms for a green economy, ii) policy research relating to climate finance content of the National Climate Change Response Policy, iii) co-developing design features of the Green Fund and leading the review process for the first two sittings of its investment committee, and iv) initiating the DBSA's accreditation application to the Global Environment Facility. The unit was disbanded in late 2012 due to the DBSA's restructuring, however the fund management mandate of the Green Fund remained.

Between the years of 2012 and 2018, the DBSA gained valuable insights into the financing challenges associated with greening initiatives through its management of the Green Fund. During this time, the DBSA also secured accreditation to the Global Environment Facility and to the Green Climate Fund, which benefited from the learnings of the Green Fund and demonstrated that the bank had clear understanding of the project development, monitoring, evaluation and financial structuring challenges for green projects. The Green Fund opened the pathway for mainstreaming environmental and climate specific issues into the bank's investment portfolio, ultimately contributed to the newly formed Climate Finance Unit in 2018, for which the DBSA has received funding from the Green Climate Fund.

Making the case for the accreditation process was largely driven by requests from the Department of Environmental Affairs, who selected DBSA as the main channel through which such international finance mechanisms should be channeled. The accreditation process revealed tensions relating to the impact it would have on the

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<sup>50</sup> Orozco, D. 2019. Green Bank Design Principles: A Synthesis of E3G's Learnings from Building Green Banks



investment mandate of the DBSA. The Green Fund operating team led internal workshops with units within the bank and stating what the benefit of accreditation and access to international climate finance would be. The process of building internal support was challenging and required lengthy engagement and debate among colleagues. For example, would the DBSA be prevented from financing “brown investments”? Critical executive leadership was provided by the DBSA’s Chief Executive, Mr. Patrick Dlamini, who secured senior management support for the Global Environment Facility and Green Climate Fund accreditation. He is reported to have said “*ultimately, the DBSA will be a green bank*”<sup>51</sup>. Therefore, making the case for continued greening efforts immeasurably smoother, as it was backed by executive support and championing of these issues. The timing and nature of what a fully-fledged green bank may look like within the context of the DBSA will reveal itself over time.

The critical issues for the Green Climate Fund accreditation were the DBSA’s track record on how to implement climate-related projects. A useful example of the benefits of DBSA’s evolutionary approach towards greening the institution is that one of the first projects approved by the Green Climate Fund was a pilot projected funded by the Green Fund (although subsequently withdrawn ). This showed the importance of the early stage investment and how initiatives can be scaled up for larger scaled investment.

## DESIGN and ESTABLISHMENT<sup>52</sup>

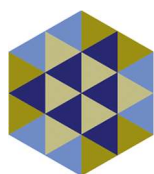
A major shift among occurred among colleagues in the DBSA when the Global Environment Facility approved an application to provide equity support for the small-scale players in South Africa’s Renewable Energy Independent Power Producers Procurement Programme. The DBSA combined the equity support from the Global Environment Facility with an interest rate subsidy from another programme, which will enable the smaller independent power producer proposals to reach financial close. As colleagues began to witness the possibility of blending the Global Environment Facility resources with the DBSA’s investment funds, a greater awareness and appreciation of the value of the accreditation unfolded. Directing the use of funds towards supporting small to medium-sized independent power producers addresses a significant funding gap for such producers and offers innovative financial solutions.

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<sup>51</sup> Per interviewees.

<sup>52</sup> Orozco, D. 2019. Green Bank Design Principles: A Synthesis of E3G’s Learnings from Building Green Banks

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## OPERATION<sup>53</sup>

The accreditation process of the DBSA brought specific internal lessons. The Global Environment Facility accorded DBSA accreditation as a National Project Agency in 2014, which has influenced the DBSA's engagement on infrastructure. For example, the Government of South Africa applies the frame of "ecological infrastructure" to recognise the natural resources provided by the earth, rather than the globally used term "Payment for Ecosystem Services". Through programming priorities for the Global Environment Facility replenishment process, the DBSA convened different stakeholders around infrastructure-related projects, which deepened internal capacity and understanding of the sustainable infrastructure needs, particularly for water-related infrastructure. The internal benefits deriving from these engagements meant an increased awareness among colleagues on the climate-related requirements for project development and appraisal.

## EVOLUTION<sup>54</sup>

By 2017, the DBSA and the Green Fund operational teams had built a substantive experience base of managing the Green Fund, with funded investment projects by the Global Environment Facility and Green Climate Fund. The DBSA was actively engaged in international fora around green finance, including the bank's participation in the International Development Finance Club. The Green Fund was initially earmarked to evolve over time beyond its experimental stage to a larger scale intervention. The DBSA actively engaged in considering options for the Green Fund, including the need identified in the evaluation report to introduce support for private sector investment and consider options for buying down project risk.

By 2018, the DBSA launched its Climate Finance Facility<sup>55</sup>, which originated as a result of the discussions with the Dept of Environmental Affairs on how to restructure the Green Fund and the bank's engagement on international climate finance platforms. The Climate Finance Facility is a structured finance platform with a committed funding base of R2 billion (USD143 million) supporting mitigation and adaptation projects in South Africa and across the region. The DBSA received co-funding from the Green Climate Fund for the facility. The intention of the Climate Finance Facility is to catalyse private sector funding, blending it with funding from development and private sector institutions. The initial target countries are South Africa, eSwatini, Lesotho and Namibia. The financial instruments include credit enhancement products in the form of first loss or subordinated debt support. The Climate Finance Facility intends to provide long term competitively priced debt.

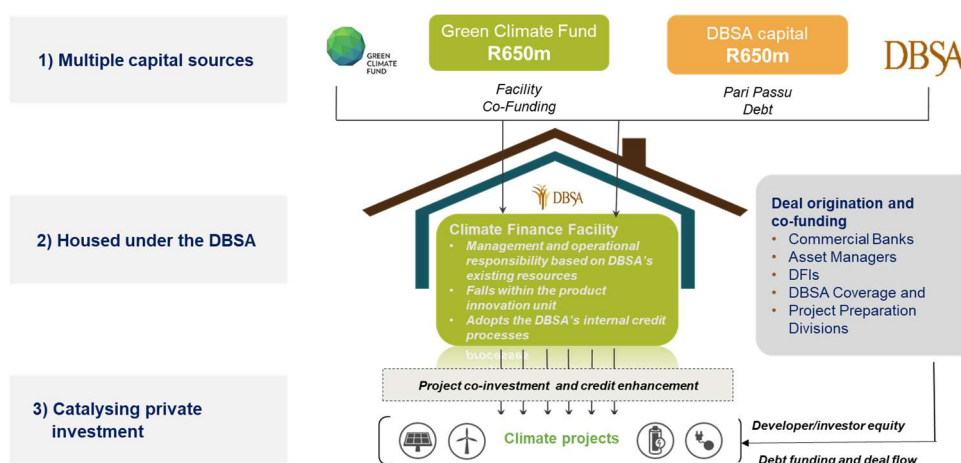
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<sup>53</sup> Orozco, D. 2019. Green Bank Design Principles: A Synthesis of E3G's Learnings from Building Green Banks

<sup>54</sup> Orozco, D. 2019. Green Bank Design Principles: A Synthesis of E3G's Learnings from Building Green Banks

<sup>55</sup> DBSA, 2019. Presentation on the Climate Finance Facility (information provided by DBSA).

Figure 9 – Design Parameters for the Climate Finance Facility



Source: DBSA.

Since the Climate Finance Facility is a newly launched intervention by the DBSA, its current impact is difficult to ascertain for the time being. A key backbone in the DBSA's greening journey is its commitment to embedding environmental appraisals in the investment process, which are constantly updated. Recently, the DBSA released new Environmental Social Safeguards to be applied to projects emerging from its climate-related pipeline<sup>56</sup> to align with the investment objectives of the Climate Finance Facility. These safeguards recognise the unique project appraisal and risk assessment needs for climate-specific projects.

## Cross-Cutting Entry Point - Partnerships and Engagements

The DBSA actively engages with different partners within South Africa, across the African region and globally, which is a critical entry point as it evolves along the spectrum of becoming a more "green" development bank. For example, the bank participates in a forum of South Africa development banks, comprising the Industrial Development Corporation and the Land Bank and chairs a working group on climate finance, which debates and exchanges lessons on financing climate and green initiatives in South Africa and the region. The DBSA applies the logic that the demand for financing climate interventions is immense, many of which are outside of the investment mandate of the bank. Therefore, the development finance ecosystem in South Africa needs to co-operate and support each other in advancing climate action – essentially ensuring that all development banks are green banks over time.

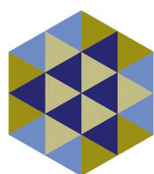
The DBSA was exposed to global environmental and climate change issues through its relationships with government, particularly through its work with the Department of Environmental Affairs. The international agreements being ratified

<sup>56</sup> [https://www.dbsa.org/EN/About-Us/Publications/Documents/Revised%20ESS%20Framework\\_CFF%2021052018.pdf](https://www.dbsa.org/EN/About-Us/Publications/Documents/Revised%20ESS%20Framework_CFF%2021052018.pdf)

by South Africa created pressure points and helped advance the environmental and climate finance agenda within the DBSA. The precise pressure came from government engaging with the DBSA, as a key national development bank to seek answers for questions such as i) how South Africa could comply with these agreements, and ii) how to operationalise the country's approach in accessing international funds being made available from the various financial mechanisms, e.g. a special fund to address desertification, the Global Environment Fund, the Adaptation Fund and the Green Climate Fund. The DBSA was not involved or associated with the World Bank's Clean Technology Fund, which was directly managed between the National Treasury, Eskom and the Department of Environmental Affairs.

A step change in the DBSA's international engagement was its role as a founding member of the International Development Finance Club, where the Chief Executives of national development banks around the world engage on critical leadership issues, including the climate breakdown. The International Development Finance Club is supported by technical Sherpas, which means that the discussion agenda is led by topical issues on development, including a strong focus on climate change and the DBSA was instrumental in shaping the research agenda of the technical Sherpas. The DBSA Chief Executive is currently the Deputy Chair of the Club, which means that the bank has a strong advocate and champion who supports climate interventions and the related institutional adjustments that may be needed. The DBSA is also a member of the Climate Lab, which is a learning partner linked to the Climate Finance Facility.

National and international partnerships and learning exchange platforms remain a critical backbone for DBSA's progressive engagement and evolution in terms of its response to the climate breakdown.



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## NEXT FRONTIER?

The discussion shows that the DBSA returns continuously over its 36 years to the case-making stage, having to consider the impact of the new insights on its current and future investments and the consequential changes that may be needed in its project appraisal and investment decision making processes. The case-making process throughout the DBSA's 36-years was not a linear or uncontested one. Tensions among colleagues across all levels of the bank required careful navigation and persistence. However, the evolutionary approach is marked by critical interventions and dogged commitment by champions at the technical, managerial and executive level through the bank's history.

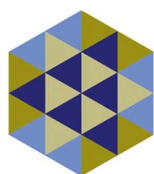
A number of new initiatives within the DBSA are underway which reflect thoughtful engagement on climate-related issues, much of which appears to be happening below the radar. For example, the DBSA supported a seminal study on the transitions risks<sup>57</sup> inherent in the South African economy, prepared by the Climate Policy Initiative. The report reflects a key message from the DBSA Chief Executive, that *"for as long as South Africa depends on coal and other commodities for a large part of its exports, the impact of climate-change driven transition on the country's economy may be more dependent on the actions of international partners than our domestic policy"*. The Climate Policy Initiative study estimates South Africa's transition risk at R1.8 trillion (USD125 billion) in present value terms and measured over 2013-2035, with the risk falling mainly on the South African government's balance sheet. The endorsement by the DBSA of this report demonstrates its active engagement and recognition of the macroeconomic risks the country is facing, and its role as a development bank in raising awareness of such risks.

New insights are emerging from DBSA's engagement on the National Capital Finance Alliance, its endorsement of the CPI Transition Risk report and its ongoing international exchanges with fellow development banks. The DBSA also faces external pressures by anti-coal activists in the country to express explicit views about its investment position. By mid-2019, South Africa's energy generation and energy-related financial challenges are overwhelming, which means that the DBSA, as a policy instrument of government, faces the prospect of creating a new entry point in its evolution. The DBSA also appears to be initiating<sup>58</sup> research on an "Integrated Energy Sector Investment Framework", which includes elements relating to just transitions, the transitions risk associated with its current portfolio of investments and an investment agenda for the rest of Africa.

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<sup>57</sup> A copy of the study can be found at: <https://climatepolicyinitiative.org/publication/understanding-the-impact-of-a-low-carbon-transition-on-south-africa/>

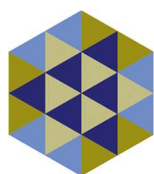
<sup>58</sup> A request for proposal inviting bidders was released in August 2019 on "Consultancy Services to develop an integrated energy sector investment framework to support DBSA investment decision making" <https://www.dbsa.org/EN/TenderInfo/RFP%208/RFP168.2019%20-%20Integrated%20Energy%20Sector%20Investment%20Framework.pdf>



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As the temporal urgency of responding to the climate breakdown accelerates, it means the conversations within the bank needs to shift towards the systemic and disruptive nature of transitions. **What demands does the transition to low carbon and climate resilient development place on the bank?** How can it use its infrastructure mandate to advance low carbon and resilient infrastructure? How does the bank engage with new and existing investments that generate high carbon emissions and display low resilience to the effects of the climate breakdown? Responses to questions such as these may imply new investment programmes that transition poorly adapted infrastructures towards more sustainable options as a first step towards creating sustainable infrastructure. The DBSA also has a critical role to play in helping the financial system in South Africa and the rest of the region understand its role in facilitating a just transition – how can project appraisals and investment decision processes incorporate this key precondition for transitioning to low carbon and climate resilient development?



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## CONCLUSIONS

Development banks have a critical role in the financial system of any country – to create and shape new investment pathways which allow other investors to follow. Although Green Banks are a helpful policy instrument for financing the climate breakdown, it is useful to remember that no magic pill for financing climate action exists. It is therefore essential that policymakers, politicians, development and financial system engage around the case-making phase – ***what is the problem being solved for, is there a shared understanding of the problem and what are the options for responding to the problem?*** For Green Banks to be effective institutional solutions to the climate breakdown, the context and capabilities to manage such an institution matters and its ability to continuously evolve in response to changing dynamics.

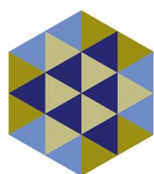
The DBSA is an example of a 36-year old institution designed with a markedly different mandate in 1983, and through the political ebbs and flows serves as a policy instrument of the state and is moving towards becoming a green bank. The institutional journey of the DBSA illustrates the tensions and trade-offs, opportunities and importance of sound analytical work and institutional responsiveness, which leads to new pathways emerging. The evolutionary process of the DBSA provides useful insights for similar institutions to reflect on. The Learning Process is iterative – the DBSA contributes towards developing, not only responding to government policy, which is its institutional legacy since its inception in 1983. As the bank's awareness shifts, its institutional response also shifts, in some case lagging behind global developments. This means that the case-making phase starts afresh as new insights to the problems arise, and mechanisms evolve into more sophisticated approaches or become redundant. The evolutionary path is scattered with tensions and debates internally – some of which are inconclusive. However, the DBSA's approach typifies learning-by-doing and using experimental mechanisms, partly driven by external and internal pressures.

In 1983, the founding Chief Executive of the DBSA, Dr Simon Brandt said "*we are living in an apartheid era, but we have to live beyond apartheid*"<sup>59</sup>. The statement resonates with the present context of the DBSA's role in financing South Africa's transition towards low carbon and climate resilient development. While the national narrative around the response to climate action is primarily around coal and renewables, a deeper wicked problem lies beneath the surface – the sober realisation that the climate breakdown will not go away, will only worsen with broad societal and economic implications. Patchwork and short-term "solutions" are unhelpful, leaving everyone behind and negating any chance of a just transition.

The DBSA plays an important role in South Africa's climate response. In light of South Africa mounting transition risks and need for rapid decarbonisation to remain below the temperature thresholds of the 2015 Paris Climate Agreement, only time

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<sup>59</sup> As cited by interviewee.



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will tell how DBSA responds - will it show the way to live beyond the current coal-dependent economic system and forge a way towards a new, more sustainable system?

### About E3G

E3G is an independent climate change think tank operating to accelerate the global transition to a low carbon economy. E3G builds cross-sectoral coalitions to achieve carefully defined outcomes, chosen for their capacity to leverage change. E3G works closely with like-minded partners in government, politics, business, civil society, science, the media, public interest foundations and elsewhere. In 2018 E3G was ranked the fifth most globally influential environmental think tank for the third year running.

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