The Regulatory Reporting Reality of Making Trade Sustainable

By ESG Committee and Dr Rebecca Harding

The current regulatory structures that govern sustainability reporting by Financial Institutions are creating a raft of unforeseen consequences that will ultimately militate against the long-term objective of meeting sustainability targets globally in the long run. These unforeseen consequences are the result of a market distortion that is providing perverse incentives to banks and has the potential to:

1. Disincentives lending the transition to more sustainable business models because there is no favourable regulatory capital for Environmental, Social and Governance (ESG) or "green" deals compared to non-transition or "brown" financing.
2. Rely on a backward-looking risk-based approach to sustainability that does not model transition risk on reasonable time frames for climate change.
3. Widen the trade finance gap in emerging markets and for smaller businesses in supply chains.
4. Replace "green-washing" with "green-hushing" where minimum regulatory reporting becomes the norm where achievable, modest, targets are set to avoid accusations of green-washing.
5. Where the "S" in ESG, is under-incentivised because it is an intangible and hard to measure compared to the "E" part.
6. Where the focus on "E" creates a barrier to the development of appropriate frameworks based on "S" in emerging markets and Africa in particular.

This "regulatory paradox" is the basis of the report which have been launched on Thursday, May 25th. The report is based on 40 semi-structured interviews with ITFA members and a survey representing one quarter of the organisations across the ITFA membership.

Dr. Rebecca Harding, **Independent Trade Expert and author of the report said**, "This research is a comprehensive overview of the challenges that banks and insurance businesses face in relation to regulatory reporting for ESG around the world. It points clearly to the need to collaborate across the trade and trade finance sector and beyond to develop clear and workable guidelines for ESG reporting. If we don't do this soon, the risk is that we exclude smaller businesses, take a one-size-fits all approach to regulatory reporting that excludes Africa and worsens the trade finance gap and, in short, undoes all of the good work that has been done within banks and trade associations to make trade sustainable."

Mr Sean Edwards, ITFA Chair said, "Our report and research shows that the wealth of standards has led to a certain degree of paralysis which is making the life of banks as well as regulators, all of whom have the best intentions, very difficult as they seek to bring about the change that is needed to achieve net zero and meet global targets. We also emphasise the importance of measuring the inherent value of trade finance as a force for good in improving especially the "S" and the "G" in ESG metrics and to do this in a nuanced and relevant way for all markets. It is clear that banks and finance providers need guidance and a better sense of direction and our work is intended to kick-start this critical dialogue."

Ms Johanna Wissing, ITFA ESG Committee Chair said, "The ITFA ESG Committee is extremely grateful for the efforts put into the report by its author, and for the wide contribution of ITFA members responding to the survey. We want to be an advocate for fair and impartial standards that attribute the due importance to trade finance to achieving the UN SDG, and a just and equitable transition to more positive ESG outcomes."

Key Data Findings:

- Nearly 60% of banks, credit insurance businesses and fintechs surveyed had ESG as one of the top Key Performance Indicators (KPI) or the top KPI for their organisation. 71% said they had become more focused on ESG matters in the last year and 51% said that more budget had been allocated to ESG. However, interviews suggested that no organisation has perfected this and that everyone is dealing with a "work in progress" in relation to regulatory reporting.

- Client facing objectives lay behind much of the work to develop internal and external ESG strategies. Nearly 90% of respondents said they saw provision of appropriate finance as a means of helping the planet to become more sustainable. 88% said it would create business opportunities and nearly 83% said it was a means of engaging with clients in a different way. 55% said an ESG focus was a new way of looking at their internal processes. Nearly 40% of respondents had a dedicated ESG cross-organisation function and for 30% responsibility for ESG was C-Suite.
- The majority of respondents were Europe-based and 65% said that the EU taxonomy was the most important regulatory reporting framework for their organisations, 59% said the EU's Sustainable Finance Disclosures Regulation was the most important, and 58% the global International Sustainability Standards Board.
- There is very little clarity on measurement standards. 78% said that the biggest challenge facing their organisation in relation to ESG was confusion over what to measure; 71% said that the biggest challenge facing their organisation was how to measure ESG. Interestingly, on 37% said that pressing regulatory pressures were a challenge.
- In terms of ESG strategy focus, 20% of respondents said that their ESG strategy would be focused on dialogue with clients, while a further 19% said that they would be focused on regulatory compliance. These were the two strongest areas of focus and points to the two roles of ESG strategy – a product based, client facing one, and a regulatory one. This was also reflected in the interviews which pointed to an organisation pivot towards more values-driven strategies internally and externally. The biggest revenue driver from ESG policies was 72% saying they saw an uplift in revenues from pricing products for transition of up to 25%.
- Trade finance was regarded as a special case within the regulatory frameworks for ESG that are emerging with 25% saying this was because of the need to have transactions-level measurements, and an additional 22% saying that the scale of the reporting requirements made it distinctive. Interviewees pointed to the fact that trade finance is not well understood by the regulatory community or the ESG community and that a united voice to regulators to explain how trade could be made more sustainable through targeted lending to deep tiers in supply chains was essential.
- Credit insurance is a mechanism for supporting trade finance through creation of appropriate risk assessment tools (33%), creation of common measurements (28%) and creation of common sustainability definitions (28%).

- Technology can help support trade finance provide transition support to their clients by automating ESG risk assessments (84%) and providing systematic and consistent data (84%). ESG measurement in deep tier supply chains was seen as a key area for Fintechs by 80% of respondents, as was data aggregation and automation of standards benchmarking. However, many saw the role of Fintechs as being restricted by the lack of common audit standards.

We would like to notify you that the **complete report** has been uploaded to the member section of the ITFA website. We invite our members to access the report and make use of the valuable insights it contains. For ease of reference, we have also prepared an **executive summary**.

For additional information kindly reach out to:

Dr. Rebecca Harding is available for comment via email (rh@rebeccanomics.com) or phone +44(0)7803710711

and/or

Mr. Sean Edwards is available for comment via info@itfa.org.