Addressing the regulatory paradox

Dr. Rebecca Harding

+44-(0)7803 710711

rh@rebeccanomics.com

&

The ITFA ESG Committee

SPECIAL THANKS TO OUR GOLD AND SILVER WEBSITE SPONSORS

Agenda

- Introduction and objectives – Sean Edwards, Chairman ITFA
- Explaining the Regulatory Paradox and why we have re-launched our Whitepaper – Rebecca Harding, Independent Economist
- A practical solution, the Sustainable Transition Foundation – Sean Edwards
- Q&A

Introducing the regulatory paradox

- Reporting requirements and blunt capital treatment of sustainability based on a backward-looking risk-based approach are militating against longer-term transition towards more sustainable trade
- This matters because trade and trade finance are:
  - Systemic to the global economy
  - A means of allocating approx. $17tn of resource globally to SDGs
  - A catalyst for transition to more sustainable business models
  - A tool for approaching regulators with practical advice on measuring intangibles and creating global rules and standards
- Current structures disincentivize sustainable lending & trade finance

What is causing this?

- Lack of clarity on reporting standards
- Unclear relationship between “who pays” and ”who gains” in transactions
- Lack of consistent data - especially social
- Lack of modelling to understand link between sustainability risk and financial risk
- Inappropriate understanding of risk from an emerging market and African point of view

This creates unforeseen consequences

Weak incentives to fund transition

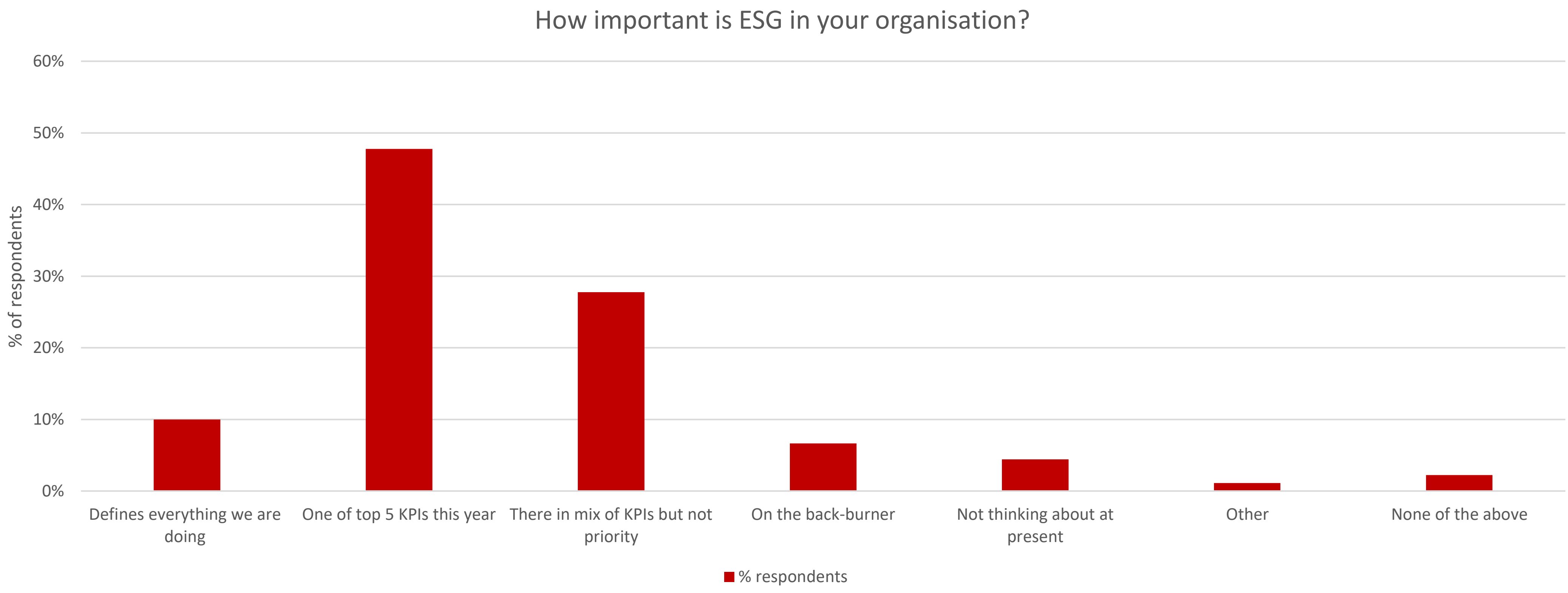
Greenwashing being replaced with green-hushing

Widening trade finance gap for SMEs and Africa

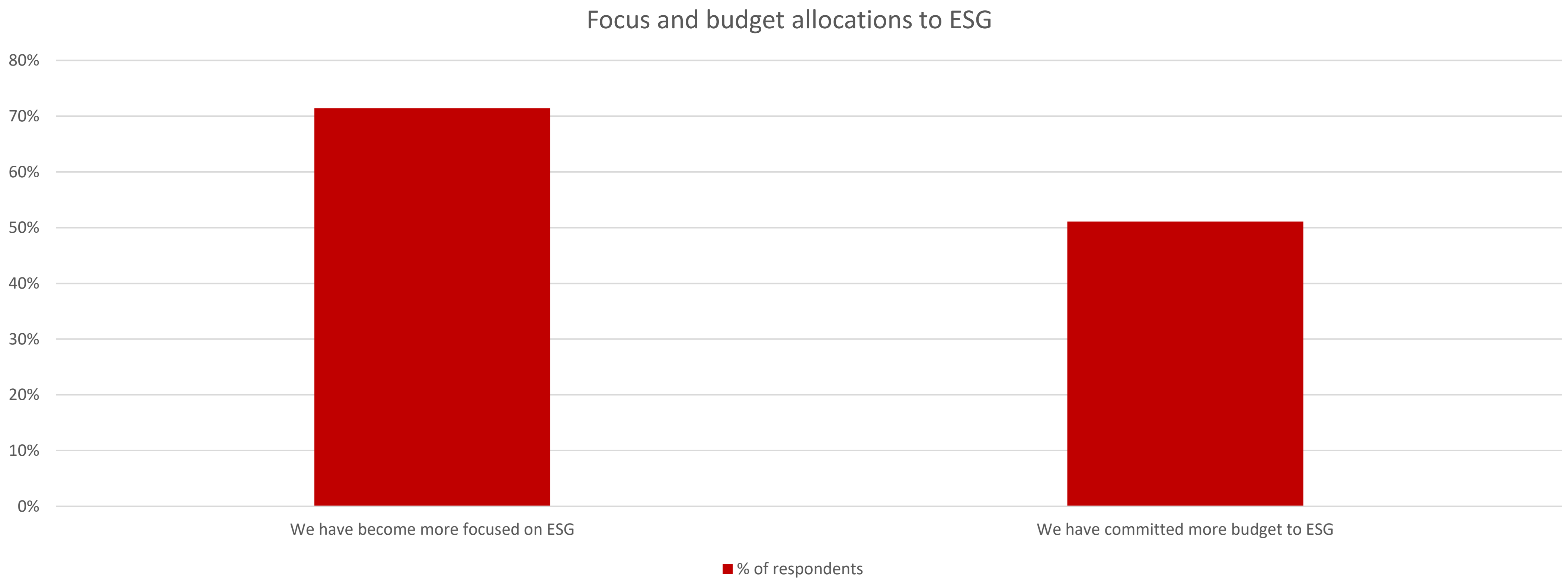
Excluding projects and geographies where “S” may outweigh “E”

Regulatory arbitrage geographically

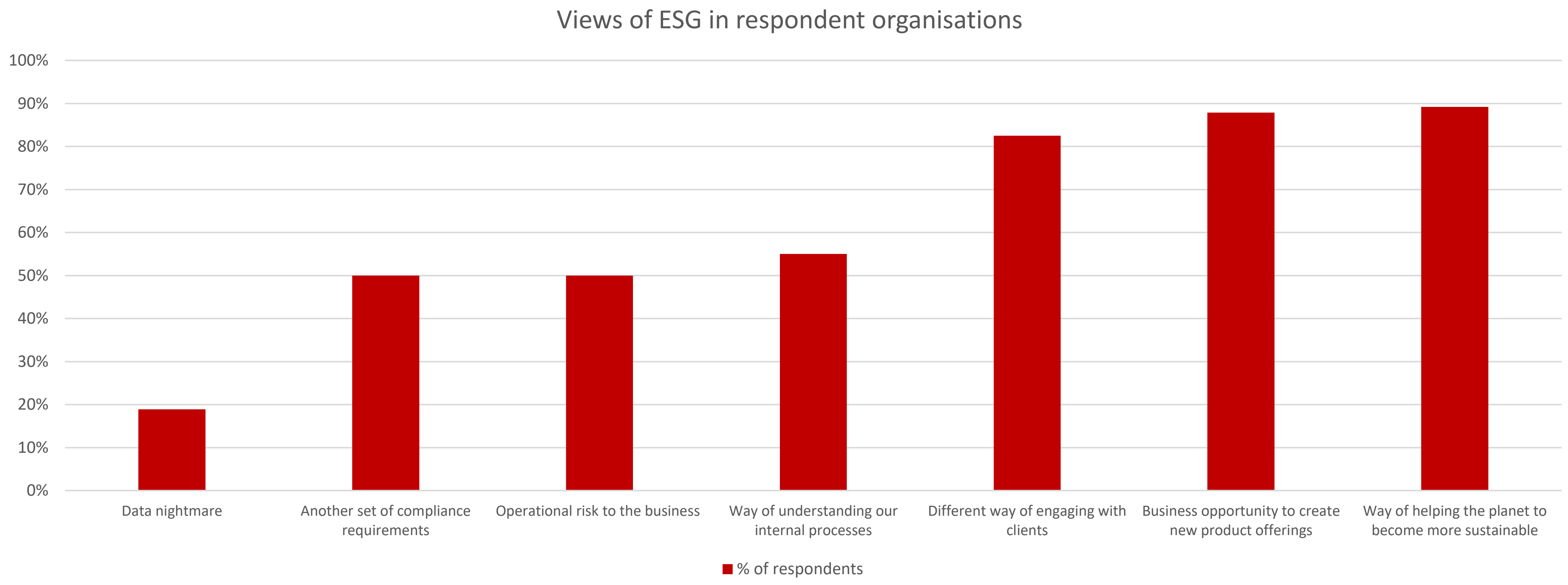
ITFA members are doing something



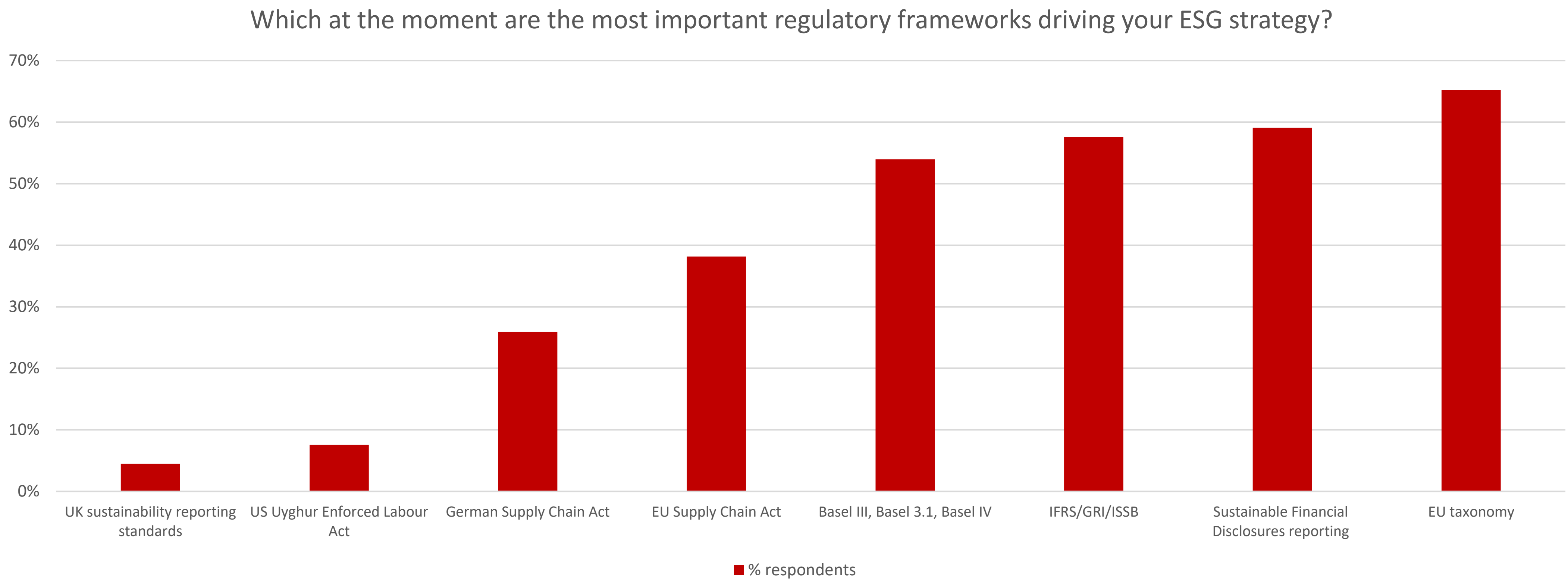
Spending more money and time on ESG



And want to do well while doing good



Regulation is a driver

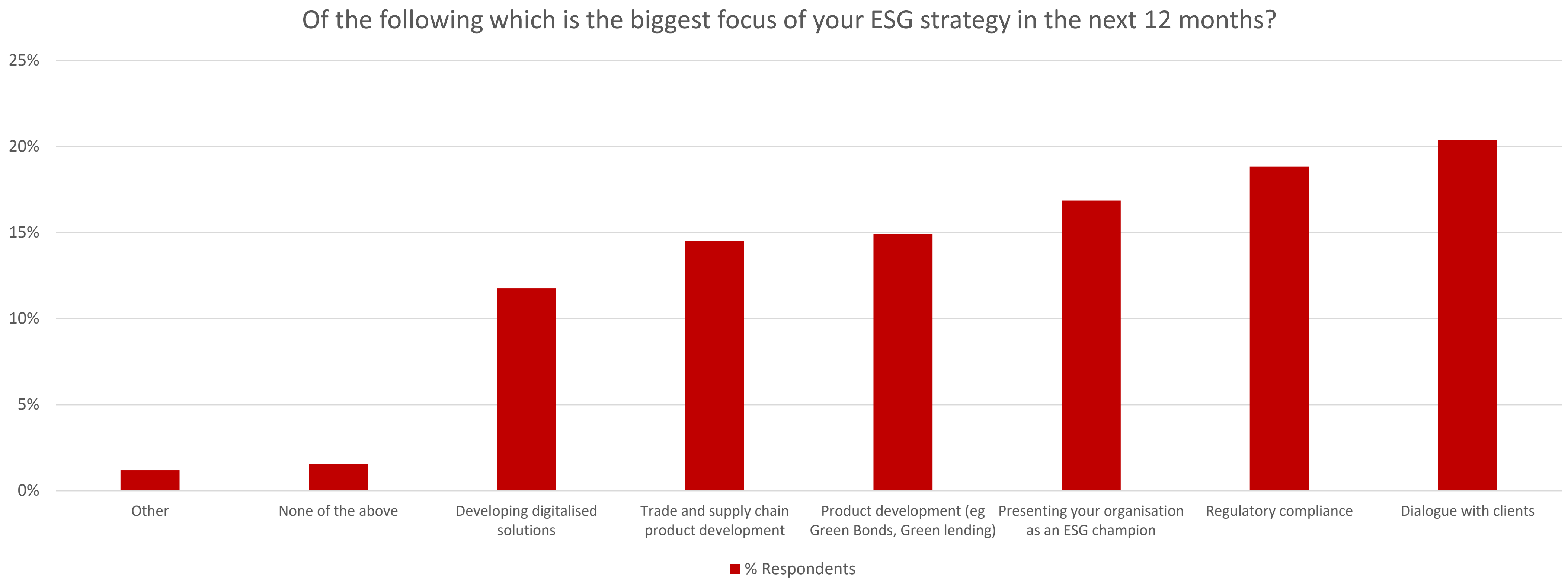


But it’s complicated

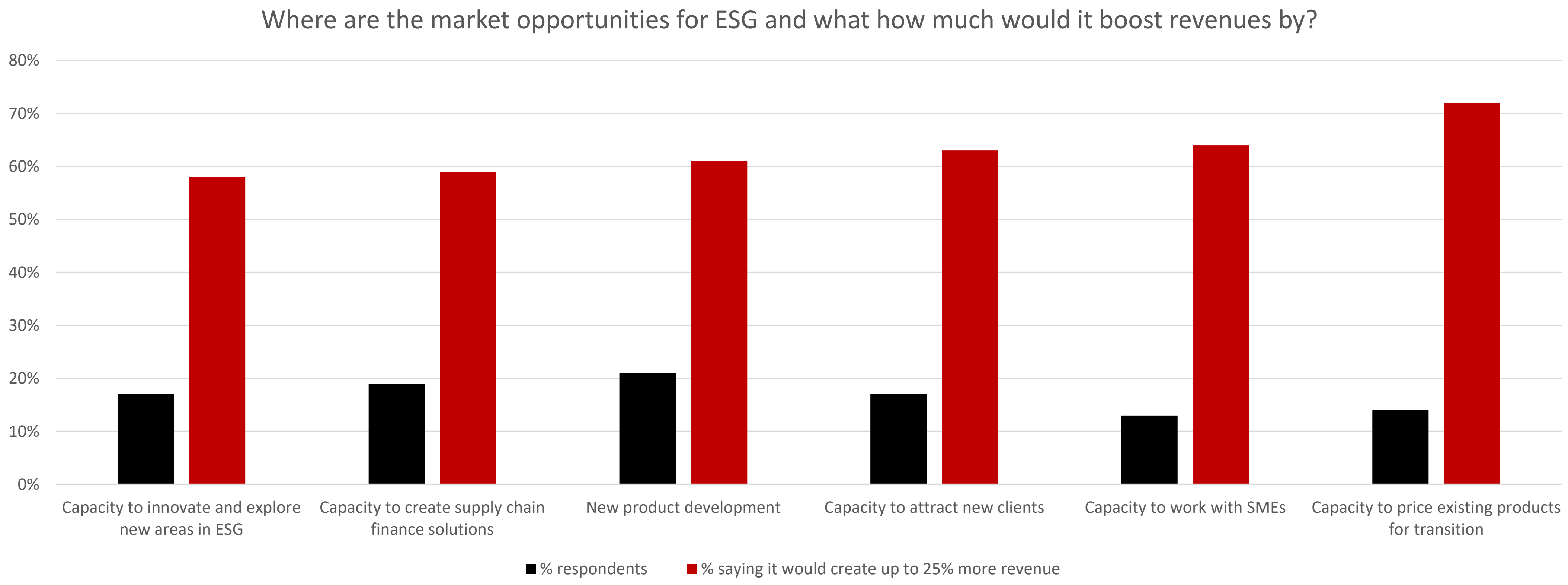
- Regulatory frameworks don’t promote transition– tackle effects but not causes of sustainability risk
- Status quo hides uncertainty
- More direction from regulators needed to avoid nightmare of KYC
- Smaller banks and African banks, and credit insurance, disadvantaged or excluded by current regulatory system

And fraught with difficulties

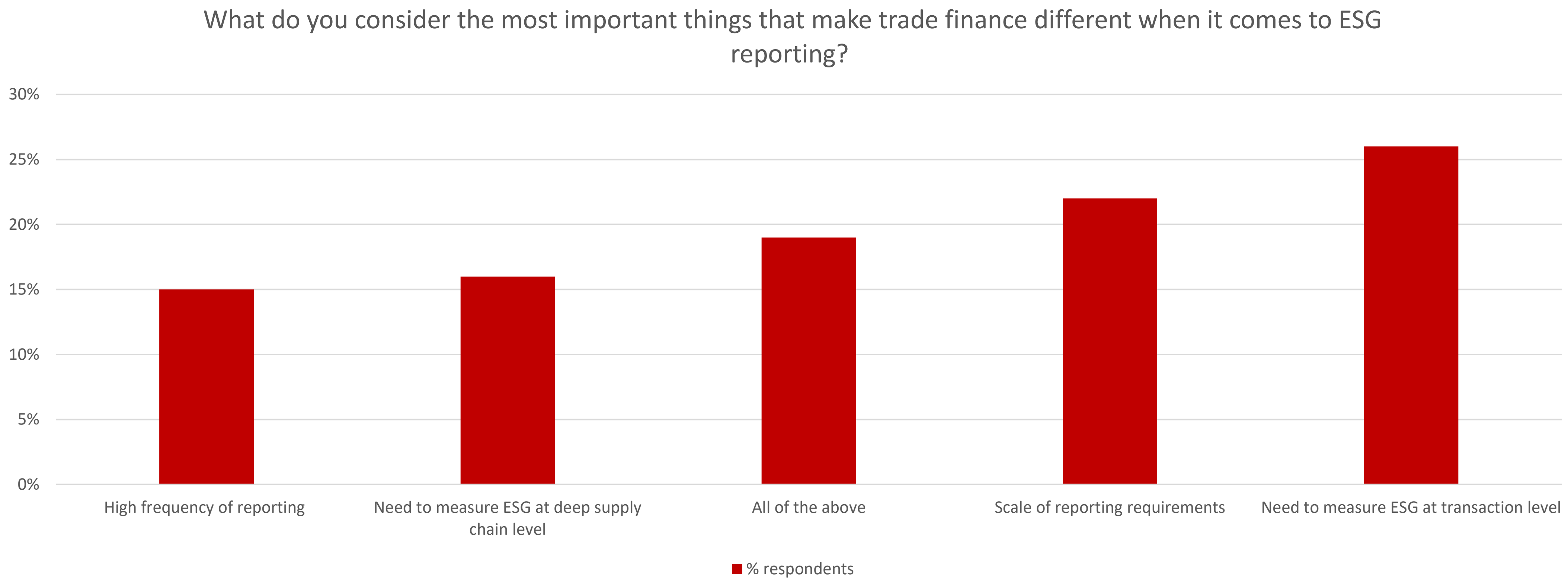
Intrinsic conflict: client or regulator facing?



Market and revenue opportunities exist



But trade finance is a special case



And there are gaps

- 54% said emerging frameworks did not cater for Africa particularly because the “S” aspects of ESG are not included
- 89% said credit insurance could help with risk assessment, definition and measurement
- Smaller and niche trade finance providers are being pushed out of the market
- Without clear and inclusive standards, technology and digital solutions will get confused with regulatory standards and take time to grow

THE SUSTAINABLE TRANSITION FOUNDATION

The next steps

Calling out the paradox

Climate change and inequality are the core issues of our era

The regulations that have been put in place do not incentivise long-term transition – this is a regulatory paradox

And there are no common reportable, auditable and comparable standards associated with those regulations

Common audit standards applied equally across the corporate and banking space are vital to understand where we are, how we compare, and how we transition

Scope 3 carbon emissions are an example of where impacts are felt: supplier bases are huge and that’s before any financed emissions from clients are

This is a global existential problem: it is too big for **us** to fail!

This is a problem for supply chains

All must report on sustainability risk exposures in same way as report on credit risk

Models to assess sustainability-related financial risk are under-developed because data is poor

- So financial institutions and corporates are taking their own routes to solve the problem – meaning that ESG will be measured differently in each supply chain

There are no accepted audit standards so that firms can benchmark and monitor performance

- So there is a risk that the KYC-AML nightmare is being recreated. We all need to worry about this – for example 80% of emissions sit within corporate supply chains

Regulators can't and don't apply different capital ratios to sustainable lending or sustainable trade finance

- So sustainable financing cannot be priced to enable transition to more sustainable business models, the likelihood of green-hushing is increased, and it will be difficult to reduce emissions in supply chains.

The STF is trying to solve the problem of the Regulatory Paradox:

- “Sustainability reporting regulations take a backward-looking ‘one size fits all’ perspective which is insufficiently predictive of future needs and restricts finance for projects which may in the longer-term be more sustainable by providing weak incentives to corporates and their finance providers.”

ITFA research suggests that this is a particular challenge for trade and supply chains because of the frequency of transactions and the complexity of supply chains. Instead of supporting trade finance which is inherently ESG by its nature of supporting global economic development there is a real risk that ESG reporting regulations unintentionally lead to worsened capital treatment for trade finance.

What you suggested ITFA should do

- **Audit Council** to set common audit standards – trade finance has track record for creating global and unified rules and standards of which excluded groups are members
- **Shared data repository** to learn and develop scenarios for transition risk and climate or social-related financial risks
- **Commitment to sharing learning and an inclusive approach to regulation and sustainability**

What is the Sustainable Transition Foundation (STF)

- An independent entity that will:
  - Define trade finance sustainability audit standards
  - Create the world's first data repository for climate-related risk modelling
  - Combine the shared learning and expertise of global trade finance banks to create common approaches to these audit standards and benchmarks
- Proposed structure is a UK-based Community Interest Company (CIC):
  - Founded by ITFA
  - Supported by up to £500,000 with a minimum of £150,000 in commitments in the form of founder funding from major trade finance banks and ITFA members by end October 2023 and £250,000 during the course of 2024 to allow organisation to get off the ground
  - Funding is tiered and will enable access to data, founding Board membership, definitional role in setting audit standards and benchmarks, and publicity and profile
  - Founding Board's role will be to define and agree the audit standards for sustainability reporting
  - After year one has proved the concept, shares will be issued proportionate to investment to scale the CIC

How will the STF solve this problem

Independent cross-industry organisation	Defines and establishes common audit standards	Data repository and modelling to allow differential capital treatment
• Advisory board to include all industry bodies and global regions • Funded by the banks for the banks • Solution that is best-practice technology/AI, data collaboration and best practice sharing	• AI-based identification of existing reporting standard commonalities • Automated updates of reporting standards in online portal • Cross-industry collaboration to create audit standards and benchmarks	• Collaboration on data for sustainability reporting • Modelling of climate and sustainability financial risk • Development of capital requirements frameworks for risk mitigation and transition pricing

Why do we need another Sustainability organization?

Creation of audit standards	Creation of data standards	Transactions level focus on trade and supply chain
• No competitor currently focuses on common audit standards **and** data but these are mutually reinforcing • Most competitors are focused on climate only but trade finance complexity means that social and governance aspects are as important	• There is no shared data repository that identifies and models sustainability financial risk at a transactions level • Shared data enables longer-term scenario modelling and the inclusion of a broader definition of sustainability than just climate	• No competitor currently focuses exclusively on trade and supply chain reporting standards • Yet trade, and accordingly trade finance, are the life-blood of the global economy. • Trade finance has specific requirements because of the importance of supply chains, the complexity of data and the frequency of reporting

Why does STF have to be a CIC?

- The public/community interest is defined as:
  - The imperative to meet the challenges of climate change and inequality around the world
  - The imperative that banks are part of the solution and not part of the problem
- There is $17tn of trade finance globally of which only $1 in every $5 contributes positively to sustainable development goals
- These are public interest concerns, but a charity is too restrictive given:
  - The need for investment
  - The need to pay Directors and executives from the start
  - The need to provide banks with support that will enhance their commercial operations
- Can accommodate an executive board composed of Tier 1 investors and an advisory board which may include other institutions e.g. ICC, BAFT and lower-tier investors

It will need to grow beyond Year 1 to achieve its long-term objectives and needs the legal structure to enable this

The organisation must be professional with a proper administrative structure so it must be a business

Sustainability is in the public interest – it has a high component of research and data collection so it must reinvest profit

How will STF resource itself after Year 1?

Advisory

- Advice on ESG reporting compliance
- Advice on achieving ESG audit standards

Data

- License to access aggregated and anonymised data
- Scenario and climate-related risk models

Training and events

- ESG training in different jurisdictions tailored to specific markets
- Regular global sustainability practice events

Research

- ESG thought leadership and data reporting
- Data research and modelling support

What is the opportunity?

- We are asking for a minimum of £150,000 to fund year 1 of the STF.
- This will be raised through direct requests for tiered funding scaling to £30,000 + VAT for a Founding Board place
- In return, funders will receive benefits in relation to their contribution
- After first year, funding model will be reappraised

Tier 1: £30,000

- Seat on Founding Board
- Core role in defining and setting ESG audit standards
- Recommendations to Advisory Board
- Access to data, white papers and insights
- Publicity and acknowledgement of support

Tier 2: £15,000

- Membership of Advisory Board with lobbying function
- Access to data, white papers and insights
- Publicity and acknowledgement of support

Tier 3: £7,500

- Access to data , white papers and insights
- Publicity and acknowledgement of support

How will this money will be used?

Consultancy, advisory and thought-leadership

- Defining data and audit standards; publication of white papers
- Establishing CIC governance structure for scaling beyond Year 1
- Management and Admin support to Year 1 data and audit standard proof of concept
- Support to thought-leadership and fundraising

Data and audit standards

- Data collection and management
- Action research to establish audit standards (eg what is reported currently and the commonalities across trade finance)
- AI-based real-time tool tracking ESG regulatory & reporting changes globally
- Partnership with Coalition Greenwich, a division of S&P, underway

What are the timelines?

- 11th October 2023: Abu Dhabi launch and agreement in principle to Board Level investment from up to 6 trade finance banks; press launch
- December 2023: full first year seed funding achieved
- By September 2024:
  - AI-based regulatory reporting tool developed and commercialized
  - Agreement around common audit standards and benchmarking
  - Data repository founded and commercialization begun
  - Thought leadership and advisory programmes launched with commercialization model
  - Training programmes developed and launched with a commercialization model
- Q2 2024 – launch of major investment round

For more information, please contact

Mr. Sean Edwards, Chair ITFA
sean_edwards@gb.smbcgroup.com

Ms. Johanna Wissing, Chair ITFA ESG Committee

johanna.wissing@credit-suisse.com

Dr. Rebecca Harding, Independent trade and sustainability expert

rh@rebeccanomics.com