



Too big for us to fail:

The Regulatory Paradox - towards
a common, consistent and
comparable audit standard for
sustainability reporting in trade
and supply chain finance – action
research update

ESG Committee and Dr. Rebecca Harding

itfa.org

Contents

The Regulatory Paradox: why it matters to trade finance and what we can do to resolve it – research update

Summary of key findings	3
Introduction and background	4
Section 1: What ITFA research has told us already	6
Unforeseen consequences: why this matters now	7
• Where the regulatory paradox starts to bite	8
Section 2: What do we need to do to enable a Just Transition	9
• First - creation of common audit and data standards	9
• Second - creation of a shared data repository	9
• Action research – establishing a Sustainable Trade Foundation	10
Section 3: The battle for consistency in ESG reporting practice	12
Why this is now too big for us to fail	17
• Why do we have to take sustainability reporting seriously?	17
• Concluding comment: action needed to set up the STF with a focus on standards	18
Endnotes	19

Summary of key findings

1. The original ITFA research published in May 2023 identified the need to establish a separate and independent entity that focused on creating common, consistent and comparable audit standards for sustainability reporting. The action research conducted to establish the appropriate format for that organisation suggests that ultimately it should be structured as a UK based Community Interest Company with a working name of the Sustainable Trade Foundation (STF).
2. This research update is a first step towards understanding that common practice and as such provides a potential framework for that separate and independent entity. It is based on a review of the ESG strategies of 15 of the largest global banks operating in international banking and trade finance at present matched using AI techniques to the emerging benchmark framework standard set out by the Sustainability Accounting Standards Board (SASB) in June 2023.
3. The research suggests significant divergence in common reporting practice between this pilot of 15 major trade and supply chain banks.
 - a. Only 3 banks have detailed approaches to data security and risk mitigation
 - b. Only 2 banks disclose lending to unbanked and underserved groups; 1 bank has significant detail on financial inclusion initiatives
 - c. Only 2 banks provide some detail on incorporating ESG into Credit Risk Analytics
 - d. Only 1 bank discloses financed emissions within its operations
 - e. One bank gives significantly more information than all the others on compliance issues and complaints
 - f. 2 banks disclose G-SIB and stress-testing details
 - g. Only 1 bank notes a link between remuneration and client outcomes
4. 13 of the banks were explicit about using their own methodologies for ESG reporting. This suggests that the standards themselves are insufficiently prescriptive on the “How” and the “What” in terms of data collection and analysis. This is not a viable position as the regulators increasingly become more stringent in their expectations of reporting.
5. 10 of the banks report explicitly against either the GRI, the SASB or the TCFD standards but do not state how. None of these banks states clearly that they report across all of these standards. While this position may correct itself as these standards become streamlined and inter-operable, at present this represents a substantial divergence in standards, not least because each has a different methodological framework.
6. A textual analysis suggests that the primary concerns of the regulatory reports is governance. Words like “risk”, “data” and “disclosure” dominate the language in the reports and words like “emissions” are less important relative to the mentions of management-related areas.
7. Even as the regulatory reporting standards are starting to become clearer, the divergence of reporting practice suggests that the **how** to comply and **what** to measure is not.

Introduction and background

This report is an update on research into the challenges of regulatory sustainability reporting that ITFA has commissioned throughout 2023. Based on a review of the ESG strategies of 15 of the largest global banks operating in the international banking and trade finance space it shows that there are significant disparities in the way that banks report sustainability at present when compared to the emerging benchmark framework standard set out by the Sustainability Accounting Standards Board (SASB) in June 2023¹. This base line matching matters for two reasons:

1. Starting a matching process with the SASB standards intuitively makes sense. This is because the SASB standard is now part of the International Financial Standards Board (IFSB)'s coordinated and inter-operable approach² with and the Global Reporting Initiative (GRI) to setting sustainability standards through the International Sustainability Standards Board (ISSB). The ISSB will also assimilate the work of the Task Force on Climate-Related disclosures (TCFD) from 2024¹. As the GRI is now developing an inter-operability between European Financial Reporting Advisory Group (EFRAG) and the European Sustainability Reporting Standards (ESRS)ⁱⁱ this means that the SASB represents the first step along the path towards global and interoperable standards.
2. The diversity of reporting standards compared to the SASB evidenced in this report shows both that the process of identifying standards for appropriate sustainability reporting has been costly and time-consuming and highlights how timely the move to a more streamlined system is.

Apart from the general relief that will be felt as the alphabet soup of sustainability standards clears, there is still divergence in terms of what is reported against those standards. In other words, although the standards themselves are becoming clearer, the **how** to comply and **what** to measure is not. Reporting is inconsistent even against the SASB, and therefore of little use either to regulators or to the banks themselves in terms of performance benchmarking and enabling transition.

ITFA's first report on sustainability reporting was published in May 2023 and identified the need to establish a separate and independent entity that focused on creating common, consistent and comparable audit standards for sustainability reporting. Such an organisation would have a remit to create those standards on the basis of:

1. A qualitative iterative process which seeks to draw on best practice amongst ITFA banks from this to regulatory structures applicable to trade and supply chain finance banks, and
2. A quantitative process of data collaboration at a transactions level to create a data repository that allows sustainability-related financial risks to be modelled.

The original research was based on action research. This is a very specific research methodology that aims to identify and explore solutions to problems simultaneously by working iteratively between research evidence

1 SASB Standards (June 2023): Asset Management and Custody Activities, Sustainability Accounting Standard, Financials Sector, Sustainable Industry Classification System (SICS), Under Stewardship of the International Sustainability Standards Board, Industry Standard Version 2023-06. https://d3fraxduht3gu.cloudfront.net/latest_standards/commercial-banks-standard_en-gb.pdf

2 <https://sasb.org/blog/issb-issues-global-inaugural-ifrs-sustainability-disclosure-standards-updates-sasb-standards/>

and practiceⁱⁱⁱ. This makes the approach highly suited to resolving the identified “regulatory paradox” of sustainability reporting because it works with ITFA members and beyond to assess both the consequences for the banking and insurance sectors and create effective solutions.

The purpose here, accordingly, is to update on the research that has been conducted since the original report was published to provide more detail on how current practice stacks up against regulatory reporting requirements and, as a result of this, the scope and remit of any independent organisational structure.

The report is structured as followed. Section 1 summarises the research so far. It defines the Regulatory Paradox and looks at the consequences of it for the use of corporate transactions and trade and supply chain finance as a means of enabling the transition to more sustainable business models. The clear message is that current regulatory structures for sustainability reporting currently are backward-looking and risk based and clearly state that they regulate only for the financial risks associated with climate change but do not look at the causes of climate change. This means that they are unable to regulate for transition unless and until the financial modelling is in place to allow for an equitable treatment of sustainable transactions.

The second section looks at the remit of the institutional structure to govern the development of audit standards and data that the action research identified in the first phase of the research. It argues for a Community Interest Company structure that is for profit over the longer term to allow for a return from investment in the entity, but that also allows the organisation to reinvest in its own research and development as well as to act independently across the industry. The uniqueness of this entity would rest in the fact that it is both setting audit standards that are common, consistent and comparable and creating the data repository for testing of those standards for financial risk modelling purposes alongside it.

The third section tests the business need for such an organisation by looking at the reporting practices of 15 of the major banks in international corporate transactions and trade finance. It suggests that there are consistencies in terms of the standards that are mentioned in corporate reporting. For example, SASB and TCFD are both mentioned by many banks. However, the inconsistency in terms of what is being measured against the SASB standards in particular is remarkable.

Each bank brings its own interpretation and focus to reporting – perhaps attributable to different stakeholder expectations, regional regulations and the bank’s own strategic priorities. However, this also adds weight to the perception from interviews in the first piece of research that there is significant “greenhushing”, or under-reporting, that is evident in current compliance practice.

The final section concludes with a wake-up call for the industry to begin to work together to define these common standards and collect data. In short, the challenges of global inequality and climate change are era-defining. If we don’t succeed, the economic and social, economic and environment losses for the planet are imponderable. This is a problem that is too big for us to fail.

Section 1: What ITFA research has told us already

There are limitations of regulation as a means of managing the transition to more sustainable trade and supply chain models, according to the ITFA ESG Committee's May 2023 report^{iv}.

The research suggests that the current regulatory approach to sustainability reporting for financial institutions restricts the capacity of banks and their clients to invest in longer-term projects that prioritise a transition to more sustainable business models. More than this, there is an increased likelihood of "greenhushing", or under-reporting, to avoid accusations of greenwashing.

This is the Regulatory Paradox. In other words, the longer-term interests of global society and the planet are being disincentivised by regulatory structures that are focused on both the past and the financial risks associated with lending now.

This paradox can be captured in the graphic in Figure 1 below:

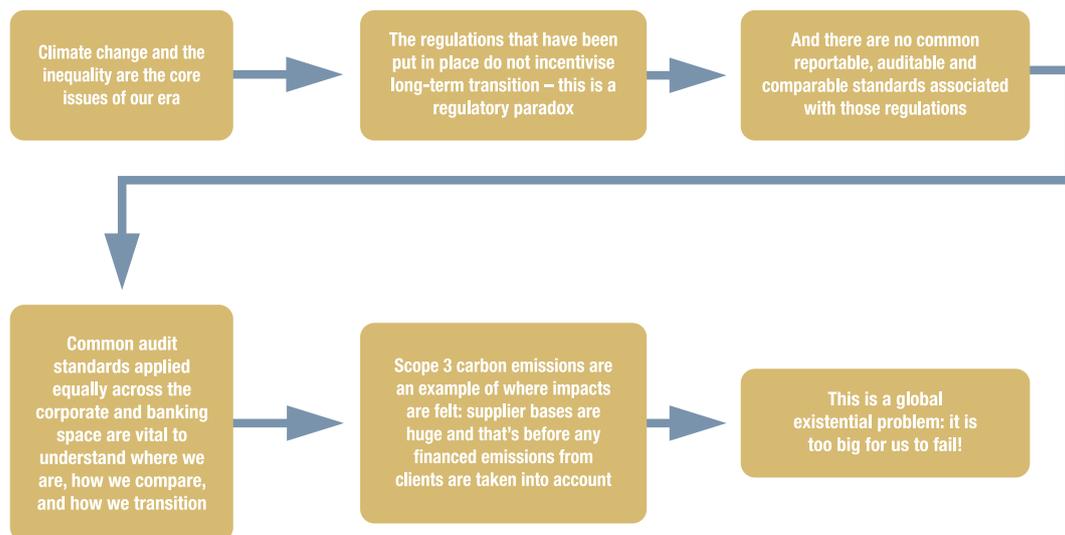


Figure 1: Calling out the Regulatory Paradox

This graphic suggests two things:

1. Because there are no audit standards that are common, consistent and comparable, there is no definition of what performance looks like and how it can be improved. This means that neither the regulators nor the regulated entities can provide fair incentivisation for transition to more sustainable business models.
2. The reason why this is happening is intrinsic to the way capital market regulation works.

Almost by definition, regulation is there to avoid financial crises in the future using the lessons of the past. Even in something as future-oriented as energy transition or decent work for everyone on the planet, the approach is, and without substantial change, always will be, backward-looking and risk-based; similarly,

capital treatment will be treated equally for all lending, whether short or long term and, more importantly, whether enabling transition or not.

Alongside this, the regulators are becoming more punitive towards inadequate reporting^v, yet there are inconsistent reporting requirements around the world. Sustainability reporting on climate is mandatory in the UK and the EU; in the EU, sustainability reporting is not restricted to climate but instead includes a “double materiality” component whereby organisations and their financiers must report not just on environmental, social and governance risk and their mitigation, but also on what they are doing to transition to more sustainable business models in the future.

For transactions, trade and supply chain finance the results are profound. Any trade finance is complex, high frequency and multinational; it is very short term and has lower risks of default^{vi}. However, there is no differential capital treatment for trade finance generally and export, project or supply chain finance directed towards transition projects specifically. This means that practitioners will not experience any collateral benefits any from “transition” funding and the costs of funding these projects are borne by the financial institution itself.

So, the regulatory paradox in action produces a raft of unforeseen consequences which are existential for trade and supply chains across the world.

Unforeseen consequences: why this matters now

The ITFA research has highlighted a number of additional unforeseen consequences, especially affecting emerging markets. For example, the putative “Global North’s” regulations are focused on a narrow definition of sustainability that prioritises the “E”, or environmental aspects of ESG. However, the requirements of economic development in the “Global South” and particular the African continent, mean that the S, or social, aspects of Environment, Social and Governance reporting are more important. A coal mine may raise flags for an organisation in the global North, but in the Global South, that mine is a source of employment, income and social cohesion.

This means a traditional view of the win-win benefits of trade is potentially challenged, or even compromised, by regulations that are focused too stringently on climate-related financial risk rather than transition. Such a consequence for trade and the advocates of a multilateral approach to trade is unimaginable and presents risks in the form of stronger compliance and data collection requirements that may militate against their own transition.

Similarly, smaller businesses in deep tier supply chains will need to collect data and comply with regulations as well, particularly under the EU’s pending Supply Chain Act and Sustainable Finance Disclosure Reporting (SFDR). Companies as small as €150m will be affected by 2024 and if they cannot provide the appropriate data, they may well fall out of supply chains or fail to access appropriate finance. This could lead to the trade finance gap for SMEs widening – especially but not only in emerging markets.

Where the regulatory paradox starts to bite

Regulators in the EU and the UK have said that they will impose fines where regulations are not met^{vii}. In other parts of the world, the requirements are not as punitive. There is a risk, therefore, of regulatory arbitrage where businesses locate to take advantage of less stringent regimes making Europe uncompetitive over a period of time despite the best intentions of everyone.^{viii}

This is strong stuff but, based as the ITFA ESG committee research was on a representative survey of their members and 40 in-depth semi-structured interviews with regulated entities in the trade and trade finance space, the results are important. Just 18 months ago it was pointed out that only \$1 in every \$5 of trade finance is contributing positively towards Sustainable Development Goals (SDGs)^{ix}. At the time, a burgeoning international regulatory framework around sustainability offered the opportunity to be forward looking and to use capital and pricing to incentivise transition.

The Regulatory Paradox that the ITFA research has uncovered as a consequence of current regulations means that this opportunity is likely to be missed. The importance of such a miss cannot be understated for emerging economies, for the planet and for financial organisations themselves who want to enable a just transition towards more sustainable business models. This is summarised in the graphic in Figure 2

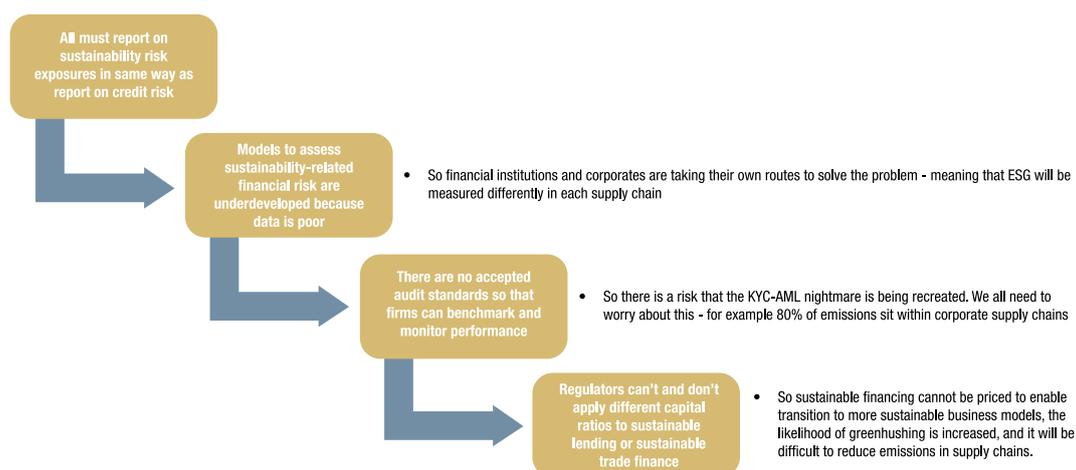


Figure 2: The consequences of the regulatory paradox for incentivising transition

Section 2: What do we need to do to enable a Just Transition

There are no simple answers as the magnitude of the problem is hard to under-state. But the banks who were interviewed as part of the research were uniformly agreed on the need to start somewhere with two clear priorities:

First - creation of common audit and data standards

There are only limited attempts to create a coordinated approach to regulatory audit standards and even fewer that apply specifically to trade. While this remains the case, it is more likely that regulations are applied inconsistently. Businesses, trade bodies and associations place varying priorities on ESG measurement and standardisation, on achieving net zero targets, and on developing the digital technology to enable measurement through supply chains. A cross-industry approach so that some of the unproductive formalism, that is, multiple and non-standard reporting, of the Anti-Money Laundering/Know Your Client regimes can be avoided is imperative, including working with the various rating/scoring agencies and businesses - to implement agreed audit standards, similar to what is already in place for financial reporting. This will define the “how” of compliance with regulatory reporting requirements which currently are prescriptive on what but open to interpretation on methodology.

Second - creation of a shared data repository

There will always be some ambiguity around the capital treatment of sustainability for as long as data collection methodologies and data modelling techniques are under-developed. At present, financial disclosure requirements and reporting frameworks are being standardised^x by the IFRS^{xi} by integrating the International Sustainability Standards Board, the Sustainability Accounting Standards Board (SASB)^{xii}, and the Global Reporting Initiative^{xiii}. The streamlining of standards like this will be a significant step along the road of making disclosures comparable and consistent and, since they also include the measurement of sustainability over time, they may also add to the understanding the transition towards more sustainable business models, and the financial risks during that process^{xiv}.

However, these frameworks have two main weaknesses in the context of trade finance.

- First, they are survey-based and so not scalable into the trade finance context where data needs to be collected at a higher frequency and on a transaction basis across complex supply chains that have social considerations because of their global reach as well as environmental ones.
- Second, while there are statements about what needs to be collected (data on scope 3 carbon emissions, for example), there are few signals on how to do this. As a result, every organisation will continue to measure their own data in their own way within the evolving frameworks meaning that the benchmarking and consistency may still be less than optimal.

The combination of these two factors will make it difficult to run scenario models on consistent data for some time to come. Further, at present the focus of the IFRS is on climate factors only. While this simplifies

the process of data collection and is understandable, there are limitations, both in terms of the applicability to trade and supply chain finance and, more importantly, in terms of the differing requirements of the EU Taxonomy frameworks^{4v}.

All of this makes a shared data repository imperative. Such a data repository should cater specifically for the needs of trade and supply chain finance at a transactions level and integrate the consistent and comparable reporting standards defined by the audit standards work into frameworks that cover not only ISSB but also the EU Taxonomy and emerging taxonomies in the UK, Australia, Japan and elsewhere. This would allow scenarios to be built and a greater consistency of understanding about the sustainability-related financial risks inherent to the transition towards more sustainable business models to be developed.

The establishment of common audit standards and a data repository are clearly co-dependent but there are a number of critical elements that will underpin the success of any such organisation:

1. It should be independent of any single interest group.
2. It should monitor the transition to more sustainable business models across all environmental, social and governance dimensions as an ultimate goal.
3. It should incorporate the interests of the trade finance ecosystem including smaller banks, and emerging markets.
4. It should develop modelling capabilities that demonstrably address the issues of false incentives in current ESG reporting.
5. It should foster collaborative, pre-competitive data-sharing between trade and supply chain finance organisations.
6. It should produce consensus data analytics based on a clear definition of the dimensions of sustainability, testing of models and data collection techniques and have the capacity to associate causally the climate related reporting data and financial risks.

An institutional framework around audit standards and data collection would potentially remove inefficiencies inherent in the current system and allow the exchange of best practice between larger and smaller organisations across the trade and supply chain finance ecosystem globally.

Action research – establishing a Sustainable Trade Foundation

For action research to be effective, it must be iterative and since the call was for a separate entity, the ITFA ESG Committee has committed to establishing a Sustainable Trade Foundation (STF), which will be independent using the UK Community Interest Company structure. Its uniqueness is in:

1. The combination of defining the “how” and the “what” behind comparable audit standards and
2. The development of the shared data repository to allow trade and supply chain finance professionals to model their own sustainability performance against an industry benchmark and understand the intrinsic financial risks associated with sustainable trade and supply chain finance.

STF Vision

The vision of the STF is to provide a common standard for ESG reporting in the interests of transparency and achieving a measurable and reportable net-zero, avoiding greenwash on one hand, enabling comparability and regulatory ease on the other.

STF Scope and Remit

The STF's remit will eventually be to cover all aspects of E, S and G. However, it is recognised that this is a monumental task, thus the STF will limit its scope in the first year to metrics around Net Zero. Additionally, the STF will focus its attention on net zero in the first instance but has a broader ambition to deliver its findings and audit standards across the ESG mix around the world. This broader ambition will be reflected in its international membership.

STF Aims and Objectives

The overall aim of the STF is to create a commonly understood and applied ESG metric or “passport” that works at both an entity and transaction level, for businesses, finance providers and regulators. The foundation would do this by achieving the following aims:

- To provide a shared and collaborative understanding of the difficulties in “auditing” for ESG, by means of Board level collaborative workshops and practitioner-led research.
- To agree core measurement standards and data for ESG such as sustainable development goals (SDGs) and taxonomy compliance.
- To utilise OECD product code metrics and other tools for their practical application at an entity and transactions level.
- To create a shared data repository to support the audit standard based on agreed, existing metrics and standards that will be supported by the industry and presented to the regulator by the Advisory Board which will be cross-industry and associated with the ITFA ESG Committee.
- To work with existing initiatives across the sector to implement these standards, (digitally, where possible).
- To ensure inclusiveness by working with practitioners and representatives from emerging markets to understand their requirements in relation to ESG standardisation.

This concept has been honed with industry and ITFA member stakeholders, including at a webinar with over 70 attendees from across ITFA membership and beyond. While it is clear that the process of setting up such an organisation will be time-consuming because of its need for independent funding, the need for it and the suitability of the CIC structure has not been contested.

Section 3: The battle for consistency in ESG reporting practice

The original research suggested that huge resources were being dedicated to ESG at strategic and compliance levels within banks. However, how ESG was viewed internally was mixed – some saw clear advantages from developing new products and having new reasons to engage with clients while others noted that the ESG agenda was itself creating conflicts internally: for example, common capital requirements across all lending means that fossil fuel projects are financially more attractive in the short term compared to transition projects even if the longer-term benefits of the latter are self-evident.

As a result, internal, operational ESG reporting practices and strategies are to a large extent “work in progress” with many financial institutions moving “gingerly” in the words of one interviewee, towards designing their own solutions. Alongside this is a real awareness that the regulators will be severe and punitive if what is articulated as sustainability strategy is found to be greenwashing. There was a reluctance to make huge claims for their strategies because of the risk of greenwashing with the perverse effect that some banks are making their targets reasonable but ultimately “flexible and undemanding.” In the words of one interviewee, “If we set reasonable standards to cover the ESG bases, our reputational and regulatory risk is also covered but by doing the minimal amount. If you are unambitious, you are at least truthful.” For some banks exposed to US markets, argued another, this “greenhushing” approach is actually to avoid any possible liability, either for greenwashing or for ESG-related externalities.

To understand how this is manifesting itself in reporting practice, this research used an AI technique developed in partnership [with Kris Makuch, founder of W-AI](#), that used four open-source generative AI approaches, including *ChatGPT4* and Anthropic/*Claude*^{svi} to match the current ESG regulatory reports from 15 major corporate and trade finance banks to the SASB standards cited above.

The matching process was conducted against these six areas defined in the *sustainability disclosure topics and metrics* section of the Commercial Banking part of the SASB standards (p7):

- Data Security
- Financial Inclusion and Capability Building
- Incorporation of Environmental, Social and Governance Factors in Credit Analytics
- Financed Emissions
- Business Ethics
- Systemic Risk Management
- Employee incentives and Risk Taking

These were cross-referenced against two other activity criteria:

- Number and value of checking and savings accounts by segment (personal and small business)
- Number and Value of loans by segment for a) personal and b) small business and c) corporate

These criteria have distinct quantitative measurements which were matched in the reports for the banks. The banks were selected on the basis of their importance within the trade and trade finance space.

Without disclosing the names of specific entities, the results of this matching process can be summarised as follows:

Alignment around ESG reporting regulations:

The sustainability financial disclosure reports mentioned an alignment with the reporting standards as listed in Figure 3:

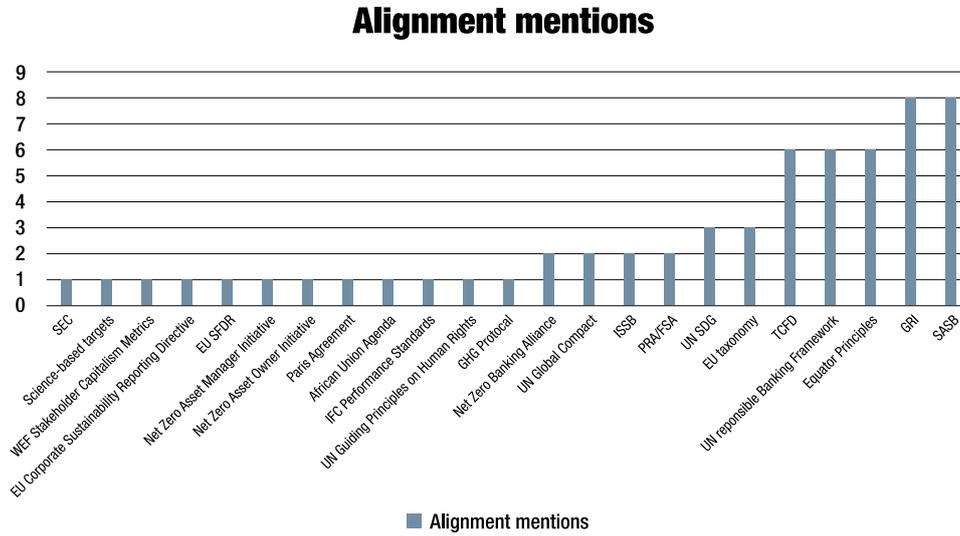


Figure 3: Alignment with reporting standards

Source: W.A.I and author's calculations from SASB matching

It is clear that the TCFD, GRI and SASB are the most important standards and, now that these are aligning more closely, the reports to be published at the end of 2023 may show greater consistency. However, because the banks were international (based in the US, Europe and some emerging markets, including Africa) the inconsistency of reporting standards alignment is very clear. No one standard has complete alignment across all banks.

This is similarly the case when it comes to reporting methodologies illustrated in Figure 4 which shows that there is much closer alignment of reporting methodologies.

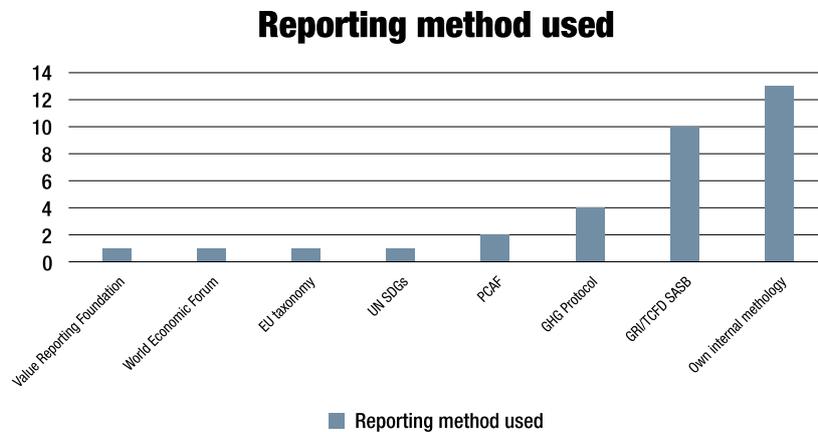


Figure 4: Reporting methodologies used

Source: W.A.I and author's calculations from SASB matching

What Figure 5 tells us is that the primary concerns of the regulatory reports is governance. Words like “disclosure”, “risk” and “data” dominate the language in the reports and words like “emissions” whilst mentioned, are less important relative to the mentions of management-related areas.

Alignment around the SASB reporting frameworks

Finally, each report was matched to the specific aspects identified by the SASB reporting framework for commercial banks. This yielded a few consistencies as follows:

- Most banks provide at least some disclosure on data security, financial inclusion, ESG integration in lending, and business ethics. However, the level of detail and quantitative metrics varies.
- Very few banks disclose absolute financed emissions or the methodology used to calculate emissions associated with lending and investments.
- Most banks do not report their G-SIB scores or details on stress testing practices.
- There is limited disclosure from most banks on variable compensation structures and clawback policies.

Close compliance with standards:

- Two banks provide metrics on community development lending and accounts for unbanked customers.
- One bank discloses financed emissions associated with South African operations.
- One bank reports extensively on financial inclusion initiatives.
- One bank discloses the number of privacy complaints and account holders affected.

Compliance generally is weak:

- Majority of banks do not disclose financed emissions, methodology, and assets included.
- Most banks lack disclosure on data breaches, account holders impacted, and percentage involving PII.
- Few banks provide details on incorporating ESG factors into credit risk analysis.
- Minimal reporting from banks on variable compensation and clawback policies.
- G-SIB scores and stress testing practices rarely disclosed.
- Very little disclosure from most banks on monetary losses from legal and compliance issues.

This suggests that there is plenty of scope for improvement around financed emissions, data breaches, ESG integration into credit risk management, human resource management and incentivisation, stress-testing and strategic impact of risks identified and analysis of the costs associated with legal and compliance breaches. The summary of the results by each financial standard is illustrated in table form in Figure 6.

It would be possible of course to criticise the list of metrics within the SASB reporting framework. Not all appear to be associated directly with sustainability in the comprehensive way in which it has been interpreted by the majority of banks in the ITFA work. However, this is not the purpose of Figure 7 – rather it is to present the actual practices as espoused in bank sustainability reports in the public domain against the criteria that are set out by the SASB framework.

Topic	Compliance	Non compliance
Data security	3 banks have detailed approaches to data security and risk mitigation	Majority have little or no compliant measurements on data breaches or PII incidents or account holders affected
Financial Inclusion & Capacity Building	2 banks disclose lending to unbanked/underserved groups; 1 bank has significant detail on financial inclusion initiatives	Most other banks have limited or no other metrics on financial inclusion and community lending
ESG Factors in Credit Analysis	2 banks provide some detail on incorporating ESG into credit risk management	Most banks give only limited or no information on analysing ESG factors in lending decisions
Financed Emissions	Only 1 bank discloses financed emissions associated with operations	Most banks do not report emissions or assets included in calculations
Business Ethics	1 bank gives significantly more information than others on compliance issues and complaints	No bank discloses monetary losses from legal/compliance cases
Systemic Risk Management	2 banks disclose G-SIB scores and stress testing details	The majority of banks do not include G-SIB scores or stress tests in their sustainability reports
Employee Incentives and Risk Taking	Only 1 bank notes a link between remuneration and client outcomes	Majority do not record metrics on variable pay, clawbacks or rewards for risk takers

Figure 7: Compliance with SASB regulatory frameworks

Source: W.A.I and author's calculations from SASB matching

Why this is now too big for us to fail

There is more resource globally being committed to reducing emissions and helping communities adapt to climate change, but even if every country in the world delivers on its current climate pledges, the challenge is colossal. For example, the International Panel on Climate Change calculates that the world will still not avoid levels of warming about the critical 1.5°C above pre-industrial levels to mitigate the worst impacts of climate change^{xvii}, including destruction of jobs, environmental-related migration and conflict^{xviii}. For example, in 2022 alone, climate disasters displaced some 32.6m people around the world^{xix} with inevitable consequences for human rights, and equitable economic development^{xx}. In effect, climate change is creating a major foreign policy challenge^{xxi}. This will itself undermine the social priorities that are so central to the future sustainability of world trade and supply chains, especially in emerging economies.

The evidence presented here at best shows that there is a long way to go before we can say that the commercial banking and trade and trade finance sector is complying with regulations. At worst it would be possible to contend that the frameworks available through the SASB are not especially directed towards the issues of climate change or sustainability more generally, and, more importantly, are not addressing the needs of bankers to work with their clients to move towards more sustainable business models.

All of this is tantamount to suggesting that, without action, and soon, green-washing will be replaced by green-hushing that is the direct result of very limited compliance with the common standards that are emerging, albeit with the best of intentions at a strategy level.

Why do we have to take sustainability reporting seriously?

Between the regulators and the trade finance providers there is scope to use the day-to-day transactions and supply chain finance system to address this profound difficulty. Trade and supply chain finance has a unique position in the process of moving towards more sustainable business models. Trade finance and insurance constitutes around 80% of the value of world trade and banks finance around 40% of global trade according to McKinsey^{xxii}. In 2022 World Trade was estimated to be some US \$32 trillion^{xxiii}. This is some \$25.6 trillion in total finance, and \$12.8 trillion of Bank Intermediate Trade finance that could help move the world's supply chains to more sustainable business models over time. At present it is estimated that just \$1 in every \$5 of trade finance contributes positively to sustainable development goals^{xxiv} - this is an opportunity for trade finance to make a real difference to the sustainability agenda.

At present it is clearly a problem that is too big for the world's policy makers, regulators, corporates and financial institutions collectively to fail.

The "too big to fail" phrase is often associated with the rescue of systemic banks during the Global Financial Crisis. Arguably this is precisely the basis of moves now to regulate the global financial institution so that its financial stability is assured even if there is a climate disaster. In short, the broad frameworks accept that there are difficulties assessing the link between climate events and financial risk, not least because the rate of climate change itself is uncertain but is likely to grow over time^{xxv}. The goal therefore is to protect the financial system from systemic risk exposure rather than to regulate for the causes of climate change^{xxvi}.

Considered against the existential threat to the world represented by climate change, this may seem an inadequate response. However, regulators, especially in the EU and the UK, are becoming more stringent in their assessment of the adequacy of sustainability reporting and risk mitigation with the US following swiftly behind^{xxvii}. Moving ahead on the basis of a precautionary principle to “do no harm” and understand and mitigate risk reflects the “we have to start somewhere” approach that is so frequently articulated in trade finance circles and was reflected in the recent ITFA report focused on the challenges of regulatory reporting.^{xxviii}

Concluding comment: **action needed to set up the STF with a focus on standards**

The research conducted over the last six months has clearly shown that the regulatory system and the banks need to work more closely together to address an existential issue for the planet, but also for trade and trade finance. To summarise:

1. There is a regulatory paradox that comes about because of the short-term and risk-based approach to reporting standards that is currently emerging.
2. There are inconsistent reporting standards that will undermine the readiness of banks to address the issues of transition towards new business models with the urgency it requires. There is strong and acknowledged evidence of green-hushing in the reporting behaviours of banks.
3. The action research identified a need for a separate and independent entity to start to work across industry to look at the “what” and the “how” of regulatory reporting by setting the common audit standards and developing the methodologies for measuring those standards through a data repository that has the capacity to model sustainability-related financial risk.

This research started with from the premise that the common audit standard was beginning to evolve from the SASB framework. However, testing this against the practices of 15 large trade finance banks suggests that both the framework is inadequate and, more importantly, the banks are generally using their own frameworks which are non-compliant with the SASB one.

In other words, this work has established that reporting is divergent and not reduce the risk of fines and non-compliance unless this is addressed with some urgency. The STF and the frameworks suggested in this report should start with the SASB framework, the requirements listed and the feasibility of gathering data industry wide. Whether banks like it or not, they have been put in the position of leading the charge of achieving the ESG targets being set by governments. If they are to succeed, and the burden shared equitably with the finance sector, there is no time to wait for the standards to evolve: we need the “what” to measure and the “how to measure it” now for the sake of the planet.

Endnotes

- i IFRS Foundation welcomes culmination of TCFD work and transfer of TCFD monitoring responsibility from 2024: <https://www.ifrs.org/news-and-events/news/2023/07/foundation-welcomes-tcf-responsibilities-from-2024/>
- ii EFRAG-GRI Joint Statement of Interoperability (23rd August 2023): Interoperability between ESRS and GRI Standards. <https://efrag.org/Assets/Download?assetUrl=%2Fsites%2Fwebpublishing%2FMeeting%20Documents%2F2307280747599961%2F03-02%20EFRAG%20SRB%20%20230823-%20draft%20statement%20EFRAG%20GRI%20on%20interoperability.pdf>
- iii Bradbury, H. (2015). The SAGE handbook of action research. SAGE Publications Ltd, <https://doi.org/10.4135/9781473921290>
- iv Dr. Rebecca Harding and the ITFA ESG Committee (May 2023): The Regulatory Reporting Reality of Making Trade Sustainable” <https://itfa.org/the-regulatory-reality-of-making-trade-sustainable-may-2023/>
- v <https://www.bankofengland.co.uk/prudential-regulation/publication/2022/june/the-bank-of-englands-climate-related-financial-disclosure-2022>
- vi <https://iccwbo.org/news-publications/policies-reports/icc-trade-register-report/>
- vii <https://www.fca.org.uk/publication/correspondence/dear-ceo-trade-finance-letter.pdf>
- viii Dr. Rebecca Harding and the ITFA ESG Committee (May 2023): The Regulatory Reporting Reality of Making Trade Sustainable” <https://itfa.org/the-regulatory-reality-of-making-trade-sustainable-may-2023/>
- ix Dr. Rebecca Harding (May 2022): Trade’s Sustainability Challenge <https://flow.db.com/trade-finance/trade-s-sustainability-challenge>
- x <https://www.ifrs.org/news-and-events/news/2023/06/issb-issues-ifrs-s1-ifrs-s2/>
- xi <https://www.ifrs.org/content/dam/ifrs/publications/amendments/english/2023/issb-2023-b-ifrs-s1-general-requirements-for-disclosure-of-sustainability-related-financial-information-accompanying-guidance-part-b.pdf>
- xii https://www.sasb.org/wp-content/uploads/2021/09/SASB-Standards-XBRL-Taxonomy-Preparer-Guide_2021-08-23-Final.pdf
- xiii <https://www.globalreporting.org/public-policy-partnerships/sustainable-development/integrating-sdgs-into-sustainability-reporting/>
- xiv <https://www.reuters.com/sustainability/sustainable-finance-reporting/esg-watch-investors-hail-end-alphabet-soup-sustainability-disclosure-with-new-2023-07-31/>
- xv <https://www.eba.europa.eu/risk-analysis-and-data/reporting-frameworks/reporting-framework-3.0>
- xvi <https://www.anthropoc.com/>
- xvii Intergovernmental Panel on Climate Change (March 2023): Climate Change 2023 – Synthesis Report – Summary for Policy Makers https://www.ipcc.ch/report/ar6/syr/downloads/report/IPCC_AR6_SYR_SPM.pdf
- xviii <https://www.unhcr.org/what-we-do/build-better-futures/environment-disasters-and-climate-change/climate-change-and>
- xix https://www.migrationdataportal.org/themes/environmental_migration_and_statistics
- xx United Nations Human Rights Commission, 2022: The Slow Onset of Climate Change and Human

Rights Protection https://www.migrationdataportal.org/themes/environmental_migration_and_statistics

xxi Mia Prange (December 2022): Climate Change Is Fuelling Migration. Do Climate Migrants Have Legal Protections? Council on Foreign Relations <https://www.cfr.org/in-brief/climate-change-fueling-migration-do-climate-migrants-have-legal-protections#:~:text=Why%20is%20climate%20migration%20on%20the%20rise%3F&text=Climate%20migration%20occurs%20when%20people,seas%20and%20intensifying%20water%20stress.>

xxii McKinsey and Company, Financial Services, (November 2021): Reconceiving the Global Trade Finance Ecosystem <https://www.mckinsey.com/industries/financial-services/our-insights/reconceiving-the-global-trade-finance-ecosystem>.

xxiii Bloomberg, December 2022: Global Trade Surges to \$32 trillion in 2022, UN Says <https://www.bloomberg.com/news/articles/2022-12-13/global-trade-surges-to-32-trillion-record-in-2022-un-says>

xxiv Rebecca Harding (2023): “Measuring the World – economists can’t ignore sustainability.” <https://rebeccanomics.com/rebeccas-blog/f/measuring-the-world-economists-cant-ignore-sustainability>

xxv BIS methodologies: Basel Committee on Banking Supervision – Climate related financial risks – measurement methodologies (April 2021): <https://www.bis.org/bcbs/publ/d518.pdf>

xxvi Update to PRA climate change report March 2023: <https://www.bankofengland.co.uk/prudential-regulation/publication/2023/report-on-climate-related-risks-and-the-regulatory-capital-frameworks>

xxvii Financial Conduct Authority: <https://www.fca.org.uk/publication/correspondence/dear-ceo-letter-esg-benchmarks-review.pdf> and <https://www.ing.com/Newsroom/News/How-the-US-is-slowly-catching-up-with-Europe-on-ESG-and-climate-policies.htm>.

xxviii ITFA ESG committee and Dr. Rebecca Harding (2023): The Regulatory Reporting Reality of Making Trade Sustainable” <https://itfa.org/the-itfa-esg-report-the-regulatory-reality-of-making-trade-sustainable/#:~:text=It%20argues%20that%20the%20current,globally%20in%20the%20long%20run>