Contributed content

How sustainability is shaping trade finance in the Middle East

ROUND TABLE

2023 was characterised by record-breaking temperatures and devastating floods, droughts and storms. However, the world is finally waking up to the climate emergency, with countries representing 92% of global GDP now committed to net zero targets. This roundtable discussion took place hot on the heels of the Cop28 UN Climate Change Conference in Dubai. Hosted at the GTR Mena event in February in collaboration with the International Trade & Forfaiting Association (ITFA), influential industry leaders discuss how the GCC region is adapting, and what is required to drive the tangible change needed.

GTR: How is the GCC approaching sustainability, particularly in the context of the transition away from fossil fuels, and what are your thoughts on the agreements and commitments made at Cop28 in Dubai?

Al Khazazleh: I think this was one of the most successful Cops so far. The number of delegations that were present, and the level of representation, were really positive. The UAE president declared this year as the year of sustainability, which gives a clear sign of where the country and the GCC is heading.

Roundtable participants

- **Haitham Al Khazazleh,** director of credit risk underwriting, information and claims, Etihad Credit Insurance (ECI)
- **John Basquill,** senior reporter, **GTR** (moderator)
- **Maninder Bhandari,** director, Derby Group
- **James Binns,** managing director, global head of trade and working capital, Barclays
- **Silvina Bruggia,** director, sustainable finance, emerging markets, LSEG
- **Ana Guyatt Del Rio,** head of GTB trade and working capital products, First Abu Dhabi Bank (FAB)
- **Semih Ozkan,** executive director, EMEA energy, power, renewables, metals and mining, JP Morgan Payments
- **Staney Pullolickel,** executive, global treasury transaction services, GE
- **Ravi Suri,** senior advisor, global infrastructure sustainable finance, KPMG

There have also been huge announcements. It was announced during Cop28 that the largest private fund is mobilising US$85bn, focused 100% on sustainable projects. The UAE managed to get the endorsement of more than 158 countries for sustainability, green projects and infrastructure investments.

For the GCC countries, sustainability is such an important topic because it's the main tool for economic diversification. We know that the GCC in general is hydrocarbon-dependent, and different countries are at different levels, but we are at an advanced stage in achieving that diversion.

For us at ECI, we have launched something off the back of Cop28 that we call the African Green Initiative, which is a commitment of almost US$2.5bn that brings in private institutions, financial institutions and export credit agencies (ECAs), as well as policymakers, regulators and governments. There is a lot of work to do to follow up on all of these announcements and initiatives, but we have a clear sign of the direction of travel for sustainability.

Guyatt: At Cop28, the UAE banking sector committed to providing Dh1tn towards sustainable finance, and we increased our sustainable finance commitment at FAB from US$75bn to US$135bn by 2030. There is a lot of talk on the supply side of sustainable finance, but discussions and change need to also come from the demand side. For example, SMEs represent a large share of corporate emissions and industrial waste production, and we need to help them with their sustainability plans so that the demand for funds also increases.

Alongside financial sector funding commitments and private and regulatory incentives, companies need to realise they have a proactive role to play. Stakeholders are looking at them and they need to look at their ESG policies to satisfy the expectations of their stakeholders. Companies need to prioritise ESG to ensure resilience, market share protection and growth, competitive finance and regulatory compliance.

Ozkan: A key outcome of Cop28 was an agreement among countries to transition away from fossil fuels in energy systems. This can be expected to influence commercial, policy and business implications.

On one hand, the region will continue to invest in existing energy systems. At the same time, continued investment into renewables and hydrogen should make

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the GCC an energy hub, maintaining its meaningful position in the new energy mix.

This can also become a catalyst for investment into renewables in Africa, for example. If we can bring some of the local UAE corporates to those markets, they will drive the SME sector and help get access to financing. The Middle East is a great place to drive costs down through scale as we note in the utility-scale renewables projects.

There will also be new essential industries and sectors in this region, developing on the back of the national visions, energy transition and new strategic imperatives. The UAE already has one of the largest carbon capture projects in the world, for example, and the willingness to test technology is there, the capital is there. We all know there are still challenges, but there are huge opportunities for the market in this region.

Binns: The availability of clean energy for SMEs is an important point, because that will enable them to meet green or sustainability-linked criteria for products they export from this region.

And, of course, thinking practically, one thing we have here is lots of sun. The UAE is building the largest single-site solar plant in the world, and initiatives like that will start to become a major competitive advantage to SMEs across the region.

You will have companies making use of one of the most abundant resources – sunshine – to produce genuinely green and sustainability-linked goods.

Bruggia: A pivotal achievement of Cop28 was integrating agriculture and health into the main agenda. It's much easier for a small enterprise or an individual to understand the real impact in terms of their diet and their health.

When you put that together with sustainability policies, it's not just a discussion of targets in 30 years' time; you see the real-world impact of what is happening, and that changes the conversation today across the full supply chain.

Bhandari: It was a very successful Cop and now the essence of implementation will be key, especially ensuring that the corporate SMEs – which usually contribute a major portion collectively – adhere to and believe in what is being represented.

GTR: When we talk about the practical implementation of Cop commitments, who is ultimately responsible for driving that? Is it governments, trade finance lenders, borrowers, or the entire ecosystem?

Bhandari: The top-down policymaking has been fantastic and the right targets have been set, but what about the bottom-up ownership?

In my last life I ran four mid-sized companies as CEO. When I think about this question, I ask, would a mid-sized corporate put their hand up and say they are with you? That they are aligned with these policies, and these targets? Unfortunately for many of them, and for lots of wrong reasons, that is not the case. You look at these companies and they are saying, 'we need to do this, we need to do that', but they are still assessing it from a profitability perspective rather than a cause-and-effect perspective.

You need to look at how you move from that top-level policy framework, all the way through to a micro, granular-level framework. If all are not brought into it, how do we ensure full implementation?

Suri: I don't think banks and regulators can drive this alone; it has to be driven by profit. If you see the way Europe went into solar, they went in through these feed-in tariffs and it was a disaster. They've all been renegotiated.

Ultimately, it was technology that drove costs down, and this is the game changer. SMEs will come in when they see profit here, not just relying on subsidies or regulation.

The GCC is doing a lot to innovate on the scientific side, working with laboratories, working with universities, pushing AI, and ultimately driving down costs with technology. I feel the GCC is leading the world on this, because there is enough money from investors backing it up.

Your cost has to come down, whether it is hydrogen or sustainable food. There will be a curve to take, and during that curve, the government needs to support that – but just supporting the curve and not doing the R&D to drop costs down means disaster.

That's what Europe did on solar, and that's why Europe failed. The cost came down in solar, not because Europe innovated but because China innovated the cost curve and brought it down. However, that was just simple cost innovation; here we need chemical innovation and technology as well.

Guyatt: It is true that profits need to be there to attract private initiatives. The problem is that if we rely only on private initiatives, the transition we need won't happen fast enough. Governments and regulators have a role to play in speeding all this up and there are tools they can use. For example, they can look into pricing externalities via taxes, setting timeframes, or providing incentives for technology implementation.

We also look at technologies to solve environmental problems, but these are costly technologies at a time of high borrowing rates. Many projects are not viable without public-private partnerships. This is another example of how the private and the public sector and banks need to come together.

We are all interconnected, but governments around the world have a key role and it's critical that they think long term and beyond the limited horizon of their domestic political agendas.

Al Khazaleh: Certainly, the point around economics is extremely important, and we need to find the right balance. I have seen some transactions where the EPC contractors expect aggressive pricing and indemnity levels for the transaction to make economic and financial sense. Insurers, lenders and project sponsors need to find the right balance to make transactions work for everyone.

That means there has to be real investment in technology, research and development to bring down the cost for everyone and make the transaction work for the private market, the developers, the financial institutions and the insurers.

Pullolickel: From a corporate perspective, there are two aspects to this. There is technology and there is economics. You can support development of technology, and there is a lot of capital going into research and development around efficient technology on sustainability.

The great thing about this discussion, particularly after Cop28, is that financial institutions and corporates are now speaking the same language. Everyone's on the same path when it comes to sustainability, and getting to that point is really important.

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Bruggia: Tripling the flow of finance is essential, and progress is evident. There is a sense of urgency, an awareness that there are a lot of things to do, and lots of discussion around different models like blended finance or impact investment to complete the proposition. However, in assessing the total investment volume, it's critical to distinguish among its various components.

First, with green finance, we can see progress and I'd say we are in good shape in the region. It's easier to fund a new renewable plant or a project that generates carbon credits.

Second, there is the transition. It is a challenge for banking to put a transition process in place, a specific project with milestones and reporting, and much more funding needs to be committed to this.

Third is the role of emerging markets. We need to make sure we leave no one behind, and that requires adaptation and mitigation finance, which necessitates a totally different approach, different skills and different amounts of money.

When you look at the investment already happening, there is a concentration in certain countries, which means these initial steps are not happening everywhere at the pace they should be.

Bhandari: I agree some are being left behind. What is important is that we all believe in the same and come forward; the collective contribution will be a game changer.

GTR: Do you see the world moving away from voluntary transition plans towards a mandatory sustainability regime? If so, what should that look like, and what are the challenges?

Binns: I think Europe is setting some really good examples at the moment in terms of regulation. For example, there is the Sustainable Finance Disclosure Regulation, which covers the disclosures that financial markets, participants, banks, insurance companies, funds and so on have to make, so investors know what they're actually investing in.

Equally, you've got corporate sustainability reporting directives that are starting to come through, as well as the whole ESG taxonomy, which is starting to drive different levels of tariffs on goods being imported into the EU. A lot of that regulation is best practice and will really start to drive behaviour all the way down through the supply chain.

I see so many parallels between this and topics like digitisation in trade. The big one here is there are pockets of best practice all over the world, like the regulation and reporting requirements in Europe, or the technology being delivered in the Middle East, and the trick is collaborating to recognise where that best practice is.

Then you can work towards a more consistent, common adoption of various standards, technologies, policies, regulations and the provision of funding.

Ozkan: On the energy side, it's an essential and unique sector, and it's evolving. There are so many players in this network, delivering the resources needed every day. This is a whole ecosystem, involving financial institutions

and corporates, but also governments, ECAs and development finance institutions, to manage the risks and keep the system balanced.

It is critical how this system trades, settles and manages the risk. As the energy transition progresses, energy traders and producers continue to seek the most cost-effective sources and forms of financing while also leveraging real-time treasury, ie the modernisation of treasury management with a focus on real-time data and operations.

Bhandari: There was a survey in the latter half of last year on how much capital investment funds are committing to ESG financing, going month-by-month to see how much fresh money was going in and how much was being drawn. The survey found that funding was moving in a negative direction in H2 last year. Investors pulled US$5bn out of ESG-focused sustainable investment funds last quarter.

That was the fund side – whereas from the banking side, it was positive – but what is the net result here? That's why you need to start regulating this to ensure people conform. You need something saying that if you do not have a certain percentage of investment in a certain space, you're going to be deprived of some benefits or given additional charges – or alternatively, provided with an incentive for contributing to the cause.

Suri: There are two challenges with regulation, and they are really big challenges. The first is around banks measuring their carbon footprints. For any big bank, measuring carbon is very tough, even for scope 1 and 2, let alone scope 3.

Banks could put more effort towards measuring carbon, but even if you can do that and drive those levels down, there is still a challenge on financing these projects going forward. Solar can be financed because banks understand the technology risk, it's proven, but the new transition technologies come with new risks, and banks are not prepared for that.

The only way this can be financed in my view is if banks work side-by-side with insurers who can issue instruments covering technology risk. The coexistence of banks and insurers is going to be the future for this kind of financing.

Al Khazaleh: Until this data becomes something we have to embed within our underwriting, in the mechanism of how we select transactions, it is difficult to report.

One thing we have done that is relevant to Cop28 is that ECI has become a member of NZECA, which is the Net-Zero Export Credit Agencies Alliance. That includes some of the larger ECAs, many from Europe, and we're trying to bring the best practices of those ECAs into the Middle East.

That certainly enhances reporting, in terms of how we declare or even look at transactions. So it's not yet there, but I do believe this will happen.

GTR: A huge part of transition planning involves monitoring and reporting sustainability data, such as carbon emissions across a supply chain. Why is this proving so complicated, and how can the industry rise to the challenge?

Ozkan: Standardisation of reporting continues to evolve. Banks are measuring and monitoring this kind of data, but at the moment every bank has a different approach. For example, some will cut financing based on absolute carbon emissions, while some will look at carbon intensity across the portfolio – and those things are evolving all the time.

While it remains too early for standardisation, we are starting to see some commonalities. There are regulations coming in the US and the EU, and a more integrated approach through the International Financial Reporting Standards. This is great for encouraging investment and for providing decision-useful information to investors, but also will bring other markets along with it, and that will be a key requirement on banks when it comes to allocating capital.

Bruggia: Annually, FTSE Russell, a division of the LSEG group, conducts a survey with asset owners and managers around the world. Last year marked its seventh iteration, revealing a consistent trend: the highest barrier to adoption of sustainability frameworks is the lack of data or standardisation of data.

From the investment side, there have been many challenges over the years, such as talent and knowledge, that are being solved. But every year, data is still a problem, and we need this common language.

It's more complex now to report, because it's not just about what you are doing, but also what people you are doing business with are doing – especially when we're talking about banks. Reporting is also moving away from the operational metrics of a company, and more onto outcomes and the overall transition journey. It requires a lot of effort, so companies understand better what material has to be reported.

Sometimes it seems as though individuals are hesitant to act, but instead are taking a step back to see which technology will win or what kind of reporting will be required. In this scenario, given the speed of change needed and where we need to get to, taking no action is not the right move. You need to take small steps at least to roll out some kind of measurement and standardisation.

Pullolickel: From a corporate perspective, the sustainability reports that we put out include stories on what we've done and who we've worked with.

We then try to translate that into practical numbers, with constant feedback from our investors and our analysts, to try and respond to what they are expecting from us.

GTR: Even with these potential reforms on the horizon, and rapidly changing strategies within the industry, do you see any gaps in the wider industry approach to ESG?

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Pullolickel: I don't see much recognition in the financial markets of the 'S' and 'G' in ESG. There is a huge focus on the 'E', and that's more measurable and quantifiable to an extent, but there is a risk 'S' and 'G' will be ignored.

Binns: That's coming, though. If you look at the sustainability-linked loan market, and sustainability-linked trade and supply chain finance, then the increase of provision of funding linked to 'E', 'S' and 'G' is much faster than for pure green finance.

Suri: At the most basic level, this is also because 'E' is the most pressing concern. It's a real crisis, it's something that has to be done on a war footing.

Pullolickel: I would beg to differ on that. If you look at Iraq and Libya, the 'S' and 'G' are far more important.

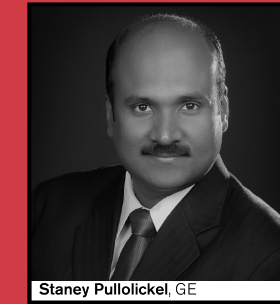
Binns: And 'G', governance, impacts how you manage 'E'.

Guyatt: I think this depends on your point of view. They are all valid. 'E', 'S', and 'G' are interconnected, and they need to advance together. Without an ecosystem, there is no economy and without a healthy economy there can be no progress on the social aspects. It is also true that without a strong 'S' and a strong economy, it's difficult to make good consumer choices and business decisions to protect the environment because they simply can't be afforded. That is why the work done on the 'S', such as supporting education and women-owned enterprises in many developing countries, helps society. The economy is so important to support good environmental decision-making.

GTR: Putting aside potential intervention from regulators or governments, or changes in end-user and corporate behaviour, what would you like to see from the banking sector in terms of driving change?

Ozkan: For banks working with energy, renewables, metals, mining – all of that is happening on the back of the transition. That means you're not only talking about oil and gas, renewables and metals in silos. They are all linked now, and that means we need to bring that sector knowledge and leadership to have a bilateral conversation in the same language.

We will need more of that, to find areas where we can each add value from different sectors and understand where the cross-functional opportunities are, with all the stakeholders around the table bringing something.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Pullolickel: Again, I would ask banks to journey with us from the start of a project, work as consultants, to understand how we can shape what we want to do and set an end objective, rather than just be transactional.

We would also like to see penetration of ESG considerations across all products. For some products, everybody wants to talk about ESG, but when it's trade, like letters of credit, it's still not there.

Finally, what we see today is that banks present solutions that bring pricing advantages to the table. What we would like to see more is effort going into ESG around credit decisions, rather than just pricing.

Binns: I think that's starting to come. A really good example of this is where you've got traditional retail businesses that haven't developed online businesses. Increasingly, some banks are seeing those as risky businesses to be investing in now.

The same is probably going to start happening as we move further into the carbon transition, as banks start to view corporates that have not started to make the right moves, have not put the right transition plans in place, as being riskier in the long term.

But overall, there are three key things banks need to do. They need to set clear, transparent sustainability plans and agendas, with clear measurable targets. They need to establish strong governance around the application of those agendas. And they need to make sure they have the right data, aggregated data, to measure progress.

Al Khazaleh: Some transactions take a very long time to close, like in green hydrogen. Maybe it's because of technology people don't understand, maybe it's economics, but ultimately we need to sit together and make sure we understand our roles, make commitments for the longer term so that the transaction makes sense for everyone, and give comfort to the stakeholders who ultimately take the risk.

It's difficult sometimes, because some technologies are not tried and tested and so do not have a track record. But we all have to work together as an ecosystem to make these transactions happen faster.

Guyatt: Banks have a big role to play in driving change. Banks need to look at their own carbon footprint and the impact of their investments. They also need to take positive environmental action and are in a great position to support their customers with training and awareness.

Bruggia: I agree on the importance of awareness and building capacity. I'm seeing a lot of banks, especially regional banks in the GCC, investing in educating their clients. From there you can create platforms that can produce reports, produce analytics and provide consultancy that really helps with the transition.

Suri: For banks, the whole risk-return dynamic needs to be looked at again. It's a completely new dimension now in this transition era. I don't think banks will take more risk; I think they need to understand risk and price it appropriately.

That's why insurance for the technology side has to go hand-in-hand with this. Banks can say they're doing ESG, they're doing this, they're doing that, but it's only when they relate risk and return, working with insurers on the technology side, that the financing will flow.

Bhandari: From a corporate perspective, the banks need to step forward, go down the line and not work only with the big boys.

At the end of the day, banks are setting an example. In some countries, 70% of contributions to emissions happens from the mid-market, but banks are only playing on the top levels. Until they address that, the transition will not happen the way we need it to.