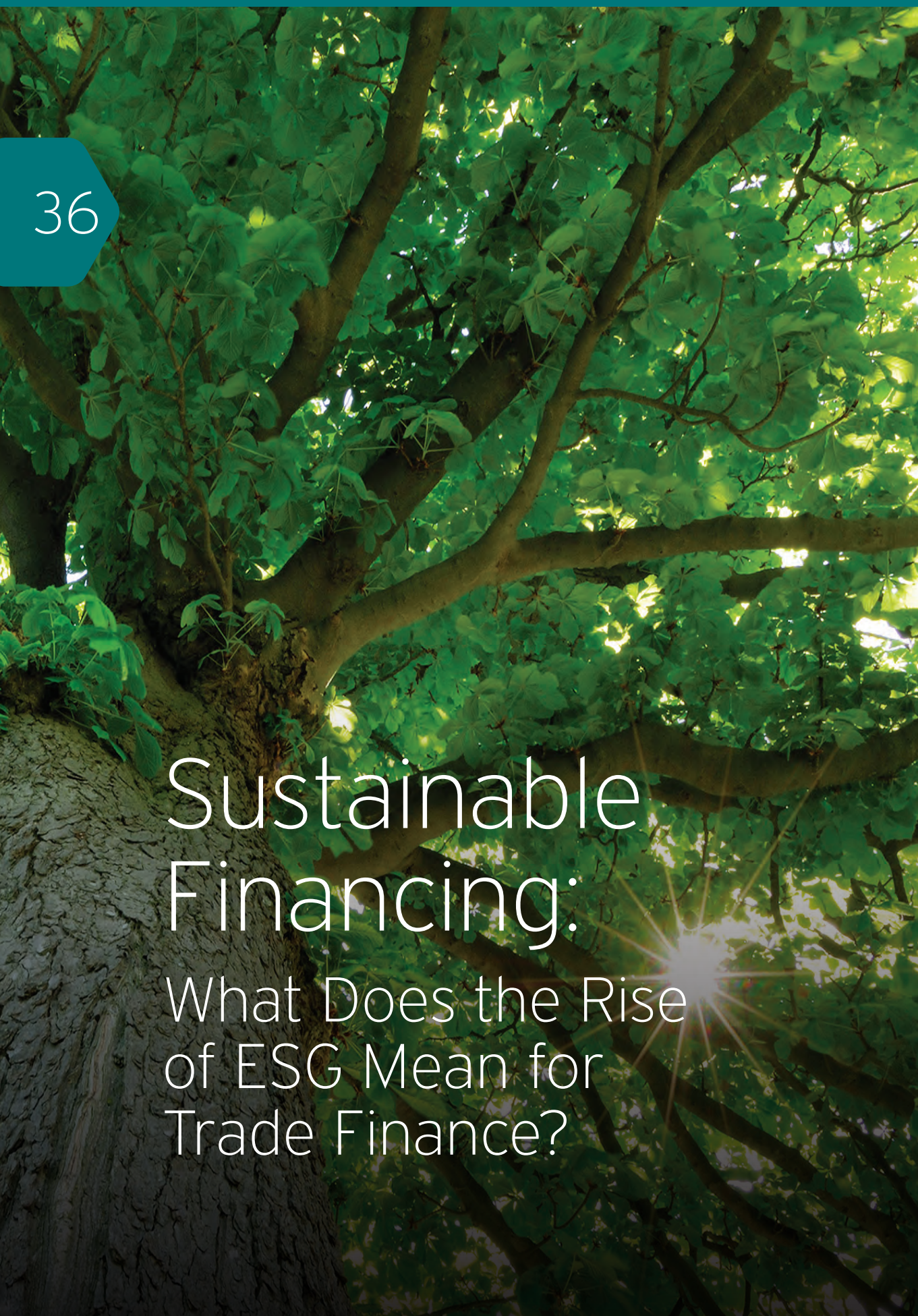

Sustainable Financing:

What Does the Rise of ESG Mean for Trade Finance?

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Consumers and corporates alike are increasingly focusing on environmental and sustainability practices when making financial decisions.

In fact, consumer demand for ethically and sustainably-sourced products has led to corporate social responsibility (CSR) commitments that reach across industries and supply chains. This in turn has led more and more businesses to consider incorporating environmental, social and governance (ESG) factors into their trade and finance decisions.

The pressure is not just coming from consumers. More and more investors are incorporating ESG factors into their investment processes. The signatories to the UN Principles for Responsible Investment (PRI) – who have publicly committed to integrate ESG factors into their investment processes – now have combined assets under management (AUM) of some $83 trillion (**www.citivelocity.com/citigps/purposeful-innovation-finance/**).

Forbes recently reported that more than 80% of mainstream investors now consider ESG policies when making investment decisions. The publication goes on to state that currently there are $22.89 trillion in assets globally being professionally managed under responsible investment strategies, which is a 25% increase since 2014.[1]

As a result, regulators are working on initiatives such as the EU taxonomy for sustainable activities with the aim to build policies around disclosure of sustainability practices and the integration of sustainability risks in the decision-making process of corporates, financial institutions and investors.

This leads to one key question for treasury and finance professionals: When it comes to world trade, with its millions of transactions across multiple jurisdictions and highly complex supply chains, how can ESG goals be met? How can success be measured, audited, reported, and made to comply with the standards of transparency the market increasingly demands?

[1] Source: https://www.forbes.com/sites/susanmcpherson/2019/01/14/corporate-responsibility-what-to-expect-in-2019/#5196d08690f4

Treasury's important role in shifting to sustainable finance

Treasurers have an opportunity to steer their businesses toward sustainable finance, partnering with banks to meet critical ESG objectives. More recently, we have seen a significant increase in the number of multinationals who are interested in exploring such financing opportunities.

In the last twelve months, a wide variety of clients have reached out seeking support from their banking partner in achieving their sustainability goals. In the consumer and FMCG sector, notably food and beverage, lifestyle and fashion companies, sustainable practices are at the forefront of brand strategies as they seek to address concerns of environmentally aware client bases.

Meanwhile in the industrial and energy sectors, attention is focused on how supply chains may adopt alternative resources. For example, automotive companies are looking into reconfiguring their supply chains to buy batteries instead of exhaust systems; miners are considering designing mines that can be operated with the aid of robotics allowing for higher working temperatures and less emission-heavy air conditioning; while power stations are converting coal generation units to biomass.

This practice often plays out in sourcing policies where corporations commit that their ingredients may be more sustainable, their fabrics can be ethically sourced, and the agricultural workers who harvest their raw materials should have good working conditions. To be able to prove to the market that these policies are being met, data is required – and data costs money. Suppliers must be audited, goods must be carefully tracked from source to product, and third parties must be engaged to act as independent arbiters of compliance.

If a supplier is asked to allow an environmental auditor into her business on a regular basis to track these requirements, there needs to be a recognition that they potentially may incur additional costs as a result. And that's where the bank comes in.

Citi has been a leader in these efforts with a long-standing history of embracing corporate social responsibility standards and practices in promoting business and progress worldwide.

With thousands of suppliers already receiving financing through Citi's global supply chain finance platform, the technology is already fully capable of assigning individualized pricing per supplier. Where supplier finance is traditionally used to provide a financial benefit to suppliers alongside working capital or cost initiatives, it can now be used alongside ESG initiatives too.

The independent auditor's assessment of a supplier may be used to qualify them for preferential pricing, and thus not only mitigate the cost of compliance but create a practical financial benefit for that supplier.

Leading by example

Most major banks are engaging in sustainable finance solutions in support of clients' increased focus on ESG. Citi has been a leader in these efforts with a long-standing history of embracing corporate social responsibility standards and practices in promoting business and progress worldwide.

For example, Citi was one of the first global institutions to embrace the UN's Sustainable Development Goals with a commitment to lend, invest and facilitate a total of $100 billion to finance green initiatives, sustainable growth and a reduction in the environmental impacts of the bank's own global operations and supply chain by 2023.

Citi expects to hit that target this year, having already made $95 billion in green investments. These sustainable investments include projects that have saved 4.5 million metric tons of CO_2, equivalent to the annual green-house-gas emissions of more than 800,000 passenger vehicles; financed renewable energy projects with output equivalent to powering more than 300,000 homes; and financed water-quality projects reaching 43.6 million people in the U.S.

Going a step further, in July of this year, Citi became the first major U.S. bank to endorse the "Principles for Responsible Banking," which have been developed by the banking industry itself, as part of the United Nations Environment Program Finance Initiative (UNEP FI). Citi has been a part of this initiative since 1997. This follows the bank's release last year of its first climate disclosure report, *Finance for a Climate-Resilient Future,* in response to the recommendations set forth by the G20 Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD).

Banks, such as Citi, are at the forefront of building a foundation of standards around green trade finance for the future. Now it is incumbent on the industry to provide better solutions to enable corporates to meet their ESG goals.

The need for market standards in green trade finance

Today, ESG-linked loans and green bonds are readily available based on well-recognized market standards that define sustainable activity. However, no such market standards exist for trade finance, which creates a challenge for the marketplace and a risk that any offering by financiers is seen as little more than "greenwash."

Right now, if a company wishes to issue a green bond, or a corporation takes out a green loan, there are reasonably well-recognized market standards; however, there are no specific market standards for trade finance, and it is not easy to "lift and drop" the existing rules to apply to treasury and trade transactions yet.

For example, if a bank writes a guarantee facility, allowing for the issuance of a series of individual guarantees to support the construction obligations of a contractor for a wind farm, does this qualify? Even though the end application of those funds is for renewable energy, a guarantee is a contingent instrument so it will not meet the green loan standard for use of funds, and there are many nuances which could factor into how this may or may not be considered sustainable financing.

What is needed is the development of accepted industry standards that meet the core principles of sustainable purpose, independent accountability, and transparent reporting, demonstrating that the green benefits of these solutions are authentic. The creation of an ICC trade finance committee to work on international standards for sustainable trade finance is a step in the right direction; so are other initiatives, such as the green trade frameworks developed by multilateral institutions like EBRD and IFC.

And this is far from being a trade-specific problem; the corporate treasurer must deal with similar issues in many areas of his/her responsibility. "For example, in the money market fund industry there is not yet a consistent or common set of criteria on what qualifies a fund as an ESG investment option," said Michael Berkowitz, Citi's Global Liquidity Product Head. "Across asset managers there are an array of different strategies, and it can be challenging for clients trying to make an apples-to-apples comparison across different funds."