TRADE FINANCE AND GREENWASHING

As 'green' and sustainability-linked trade finance has surged in the past two years, so too have risks of greenwashing.

In our latest briefing, Olivier Bazin and Jason Marett discuss how commodity traders and other users of commodity trade finance instruments can reduce greenwashing risks.

On the morning of 31 May 2022 German police raided the Frankfurt offices of German investment fund DWS and Deutsche Bank as part of a probe into allegations of greenwashing. This followed an investigation by BaFin, the German financial regulator and a probe by the SEC in the US. In October, HSBC was censured by the UK Advertising Standards Authority for making environmental assertions that omitted material information about its financing of activities that contribute to GHG emissions.

These enforcement actions are focussed on prevention of fraud and investor protection in financial services and it is clear that trade finance is not immune. As 'green' and sustainability-linked trade finance has surged in the past two years, so too have risks of greenwashing. Put simply, greenwashing occurs when a company falsely claims that something is greener that it really is. Everyone can agree that greenwashing is bad - it hurts investors as well as those companies engaged in genuinely 'green' or sustainable activities or financings. Ultimately greenwashing makes it harder to improve the sustainability of our economies because the legitimacy of genuine sustainability efforts is undermined.

Until recently there have been relatively few consequences for companies that engage in greenwashing. We are now seeing an increasing risk of civil claims (eg from NGOs) or regulatory action against companies that make misleading green claims.

How to ensure trade finance products are free of greenwashing?

Finance, transportation and commodity trading collectively play an important role in tackling climate change and the rise of 'green' trade finance instruments is a natural and very welcome development. For example, in the agri-trading sector, trade finance instruments like letters of credit or working capital facilities can be linked to, or include, sustainability goals and criteria. This may include goals relating to the supply chain, for example to reduce deforestation risks or emissions, or to improve the traceability of origin of products like soy, palm oil and cotton. The producers of coffee and cocoa are often smallholder farmers with little market power. Trade financing for the production or processing of these products may include goals relating to the protection of farmers, for example ensuring that producers receive a minimum price or are certified by standards such as FairTrade[1]. Sustainability criteria are also increasingly common in financings of other commodities, such as metals and minerals and oil & gas[2].

However, traders need to be aware of the risks of greenwashing in trade finance. Sustainability KPIs embedded in trade finance products need to be selected carefully to ensure that any targets are material, robust and meaningful. The Loan Market Association (LMA), the London-based syndicated loan market body, has issued its latest guidelines in March 2022 which set out the principles for selecting and calibrating targets in sustainability-linked loans[3]. Assuming KPIs are appropriate, traders will still need to be careful about making broader green and sustainability assertions to make sure these can be backed up. Discussions and cooperation with banks in the sector are an integral part of the process, however traders should take care not to rely on a financier's own sustainability frameworks when making sustainability or green

1 HFW has advised Geneva-based coffee company Sucafina on its sustainability-linked global borrowing base facility, currently US$740 million which, since 2019, includes certain environmental and social targets relating to farmer certifications, carbon efficiency and deforestation. (https://group.sucafina.com/news/news-updates/sucafina-successfully-closes-oversubscribed-sustainability-linked-borrowing-base-facility/)

2 Geneva-based Gunvor in 2018 was the first energy commodities trading company to close a financing linked to ESG targets (https://gunvorgroup.com/news/gunvor-closes-innovative-us-745-million-facility-linked-to-sustainability-targets/)

3 https://www.lma.eu.com/sustainable-lending/documents#sustainabilitylinked-loan-principles140

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assertions about a trade finance product or underlying goods.

The global regulatory landscape is likely to evolve rapidly over the next 6 to 18 months. A package of EU regulations and directives relating to sustainable finance, including the EU taxonomy[4], SFDR[5] and the proposed CSRD[6], already provide tools for holding companies to account for their sustainability and green claims. The Swiss financial regulator FINMA published a paper in November 2021 setting out its expectations to clamp down on greenwashing (*"ecoblanchiment"*) with a focus on the Swiss asset management sector. In a significant development, the UK Financial Conduct Authority (FCA) has on 25 October 2022 published proposals to clamp down on greenwashing[7]. The proposals include a general 'anti-greenwashing' rule that would apply to all regulated firms, including those providing trade finance products. According to the FCA, this would give the regulator powers to "challenge firms that we consider to be potentially greenwashing their products or services, and to take enforcement action against them". Other jurisdictions are implementing similar rules.

Until now, there has been limited regulatory sanction for greenwashing in the context of sustainable or green trade finance instruments. The International Chamber of Commerce (ICC) has, in November 2021, proposed voluntary standards for sustainable trade finance which, if widely adopted by the market, would help to provide industry guidelines and a common language for assessing sustainability claims of trade finance products. Until there are clear rules and market standards to regulate sustainable trade finance instruments, market participants will need to be cautious about greenwashing risks.

Suggested Actions:

Do ensure any 'green' or sustainability-related claims are specific and verifiable. Be cautious of making broad claims about the 'sustainability' of financed commodities, or your business. If the goods being financed are certified under specific 'sustainability' standards - for example the RTRS Standard for Responsible Soy Production[8] or the RSPO certification of sustainable palm oil[9] - then ideally limit any claims you make to your compliance with those standards.

Check that your sustainability claims can be backed up. Ensure there are processes in place to make sure that financed goods comply with any sustainability standards you are asserting in your loan or other trade finance documents, and that compliance can be verified.

Be aware of any relevant voluntary guidelines that your lender and other stakeholders may expect you to follow. For example, for loan products which incorporate sustainability incentives, the voluntary principles set out by the LMA require that KPIs relating to sustainability must be material, robust, ambitious and meaningful.

Be careful about making broad sustainability or green claims about trade finance products, for example 'green' letters of credit or loans. The way some banks label their 'green' trade finance products may not necessarily match investor or regulator views of sustainable or green products. Use these labels with caution.

Review how legal liability is allocated in the event of a greenwashing claim. For example, who is liable in the case of fraud or error in the sustainability criteria or certification process. Get specific advice from your advisers on the wording of any sustainability assertions you make.

Consider who has scrutiny over sustainability assertions in your business. For example, does the relevant legal, marketing or business team have the necessary information and authority to make those assertions? Consider the internal process for verifying and whether, for example, such statements need C-suite scrutiny.

4 Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088 (https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32020R0852)

5 Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector (https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32019R2088)

6 https://finance.ec.europa.eu/capital-markets-union-and-financial-markets/company-reporting-and-auditing/company-reporting/corporate-sustainability-reporting_en

7 https://www.fca.org.uk/publication/consultation/cp22-20.pdf

8 https://responsiblesoy.org/certificacion?lang=en

9 https://rspo.org/certification

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