ICC Standards for Sustainable Trade and Sustainable Trade Finance

Progress update and outcomes from Wave 1 pilot

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Context

Following the launch of the Wave 1 framework in November 2022, the ICC Standards for Sustainable Trade and Sustainable Trade Finance (STFD) programme launched a pilot with a number of leading banks, corporates and technology players to test the Wave 1 framework in a real-world setting with real customers and transactions. The purpose of this brief paper is to provide an update on this pilot, key learnings, implications for the Wave 2 framework and next steps.

The objectives of the Wave 1 pilot were as follows:

- Test the Wave 1 framework in a real-world setting, with real clients and real data
- Understand how the framework should work in practice, and the practicalities of its implementation
- Gain a view of what support banks and corporates will require from ICC
- Better understand the 'distribution of outcomes' from the framework
- Identify opportunities to enhance the framework ahead of its wider launch

Overall, the pilot was a successful exercise, with over 30 leading trade banks involved over a four- to five-month period, each joining regular 'Pulse Check' calls with ICC and BCG stakeholders, as well as representatives from trade and supply chain finance technology and fintech players, and a small number of corporates. The trade banks involved typically selected a small number of clients and applied the framework to a handful of transactions to test the applicability and outcomes of the framework, reporting results to ICC.

Key findings from Wave 1 pilot

By engaging heavily with pilot participants, ICC was able to gain nuanced feedback on the Wave 1 framework and shape these into a number of insightful learnings. While feedback was largely positive in terms of the intention, scope and framework methodology, the majority of participants had concerns around the complexity of the assessment and incentives for participation, which will need to be addressed in the next iteration.

Overarching learnings are summarised below:

- **Product scope:** The Wave 1 framework was initially designed to be applied to short-term 'flow' trade products, as the majority of existing sustainable finance standards cannot be applied to such transactions (e.g. ICMA, LMA principles). While this is still the case, there was some challenge that the framework should be able to cover the full suite of trade and supply chain finance products so that no trade division (e.g. of a bank) will need to unnecessarily apply multiple methodologies. From an ICC perspective, we believe this is possible with some minor adjustments and clarifications.
- **Goods vs. manufacturer:** Participants observed that for some goods, standards apply to the manufacturer rather than the goods themselves; this is particularly the case in agriculture related to textiles (e.g. cotton farmers). As such, participants requested that the framework should allow any standards applied to a whole 'manufacturer' to be used in place of standards that just apply to the 'goods'.

- **Transaction purpose:** ICC introduced the 'purpose' of a transaction as a component of trade assessed in the framework to recognise transactions that may not involve sustainable goods, but are effectively occurring to meet a clear sustainable goal – as outlined in the Green or Social Loan Principles (e.g. transition finance to fund the development of clean energy sources, etc.). In practice, this proved very challenging, as – despite having universal standards – their application proved very subjective. For example, it was very difficult to evidence that textiles transactions had a primary sustainable purpose. As such, going forward ICC will revisit this dimension, for example, by tightening definitions further or only using it to acknowledge transition finance.
- **ICC-approved standards:** Feedback was largely positive on the ICC's list of approved standards for environmental and socioeconomic sustainability, with only a small handful of additional standards being recommended during the pilot. One challenge faced, however, was that the majority of textiles standards did not meet the ICC's bar of 'environmental sustainability'. This was because ICC set the criteria that any standard must measure impact on affordable and clean energy (SDG 7) and climate action (SDG 13), given the large regulatory focus on climate change and carbon. In reality, the majority of environmentally-led standards in the textiles sector focus on water management and pollution more prominently than climate, and hence were not ICC-recognised. Learning from this, ICC will recalibrate its criteria and potentially explore nuancing criteria by sector where necessary.
- **ESG scores:** The Wave 1 framework currently assesses transactions based on meeting industry standards for sustainability. However, an increasing number of companies and products are now being assessed using sustainability 'scores', which provide a quantitative 'scoring' of the sustainability credentials of a given transaction. Not only is this becoming more commonplace, but it is also more 'machine readable' (i.e. can be automated) than highly qualitative standards, making measurement and recording substantially easier. As such, ICC has mobilised an exercise to identify key ESG scoring mechanisms, pressure-test them and determine thresholds so that they can be recognised by the framework.
- **Evidence:** A common question from both banks and corporates was for more specific guidance on how to evidence their alignment with ICC-approved standards. Currently in the Wave 1 framework this is at the discretion of the bank, but throughout the pilot it became clear that banks would like to hold a high standard to avoid any risk of 'greenwashing'. This will be clarified in Wave 2, but may need to involve certificates where there is no central repository of certain standard holders.
- **Corporate incentives:** One of the main challenges in the pilot was that many corporates felt there were insufficient incentives to invest effort in supporting their banks complete the framework. A large number of corporates felt that supplying sustainability data to their banks is only worthwhile should they receive reduced financing costs. While ICC is not in a position to advise banks on the commercial terms they use with their clients, there is a belief that over the medium term it will no longer be sustainable to offer reduced fees for sustainable transactions. As such, we will need to increase efforts in Wave 2 to better articulate the other benefits of the framework to corporates to maximise engagement.
- **Logistics and methodology:** As expected, while participants largely found the framework, methodology and artefacts (forms, documentation etc.) clear to follow, many found the current manual process time-consuming and labour-intensive, limiting its ability to scale. As such, ICC will continue to look for solutions and partnerships to help automate large elements of the framework in the medium-to-long term.

Implications for Wave 2 framework

In line with the above, the pilot was highly insightful in terms of providing feedback on the framework, and clear direction on where to focus future efforts. With this in mind, ICC has been able to agree on five key focus areas for the Wave 2 framework:

- Incorporate **feedback from the Wave 1 pilot**, including recalibrating ICC-approved standards, being more explicit on evidence required, redesigning the 'purpose' component and reframing incentives for corporates
- Fully **incorporate 'ESG scores'** into the framework, so that these can be applied in addition to more qualitative standards
- Apply a **'graded scale' that conveys the 'degree of sustainability'** across any given component/dimension, and provide an overall 'sustainability score' for a given transaction (at least for each dimension)
- Increase the scope **to three or four additional sectors** (e.g. energy, automotive, agriculture)
- **Incorporate a 'transportation'** component into the framework

In addition to the above, ICC will also continue efforts to bring more automation to the framework and help set a longer-term operating model as the framework scales up and matures.

Next steps

In terms of next steps, ICC has now mobilised to commence work on Wave 2, engaging with pilot participants (hereon referred to as the 'Pilot Group') to test and iterate thinking as it progresses. All interested parties are also welcome to register for the 'Interest Group' (name changed from 'Review Group') to be kept to date with any developments.

From a timing perspective, the ambition is to launch Wave 2 at COP28 in November/December 2023. However, to help maintain momentum, and to allow pilot participants to continually test with clients, we plan to launch some elements of the new framework throughout the year. For example, we expect new sectors to launch – and be ready for testing – from late summer 2023.

Acknowledgments

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We are always looking for new individuals, banks, corporates, and other organisations to become involved, so please feel free to contact us at STFDpilot@iccwbo.org for more information.

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