Sustainable Import Guarantee:
Scoping Study
Executive Summary

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Consultancy Report – Executive Summary

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For and on behalf of Efeca Ltd

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Executive summary

This scoping study is intended to contribute towards the broader evaluation of the proposition for a Sustainable Import Guarantee (SIG) that is being carried out through the SIG Working Group, led by BEIS, Efeca and the Green Finance Institute.

A sustainable import guarantee

The SIG was one of 14 Recommendations of the Taskforce of the Global Resources Initiative (GRI), an industry-led initiative to define recommendations for how the UK and international partners can increase trade in sustainable commodities and reduce the deforestation impact of UK supply chains, which published its Final Recommendations Report in March 2020[1].

The SIG proposal presents an opportunity to develop an innovative green financial product to: incentivise sustainable sourcing; support the banking sector to increase sustainable lending and investment; and to encourage the banking sector to increase transparency and due diligence processes inherent in tracking sustainable supply chains, which could pave the way for wider due diligence across bank portfolios. This mechanism could have applicability across various sectors and commodities.

In this scoping report we looked only at the applicability of the SIG at the 'forest-risk' commodities palm oil, soy and cocoa traded by large companies. Sustainably sourced commodities typically cost more than conventionally sourced commodities and this additional 'green premium' can act as a barrier to the uptake of sustainable commodities in supply chains. A SIG works to reduce the cost of sustainable commodities by reducing the cost of trade finance used to buy and trade sustainably sourced commodities. A guarantor, in the GRI recommendation the Government, provides a guarantee on bank lending (i.e. lending for buying verified sustainable commodities). This reduces the cost of lending for banks, and this saving can then be passed onto importers or buyers of sustainable imported commodities. Government guarantees, such as those delivered by UK Export Finance can offer this reduced cost of financing at no or little cost to the taxpayer.

The SIG is therefore intended to incentivise the import of sustainably produced commodities over 'conventionally' produced commodities, by helping to reduce or eliminate these 'green premium' costs. From a financing perspective, the SIG aims to reallocate capital to more sustainably sourced commodities. It is assumed that a SIG could be applied to certain forms of trade finance such as revolving credit facilities or letters of credit, used to finance commodity procurement.

Scoping methodology

This report investigates:

- whether and how companies in the palm oil, soy and cocoa supply chains (particularly importers, and manufacturers buying imported commodities) use trade finance in the procurement of commodities, and whether a SIG can be used to reduce the cost of this finance;
- whether and how a guarantee could be applied to banks' trade finance transactions; and

[1] https://www.gov.uk/government/publications/global-resource-initiative-taskforce

- whether a guarantee would drive behavioural change towards greater take up of sustainably produced commodities.

Efeca interviewed buyers and finance teams within eight large palm, soy and cocoa traders and supply chain organisations, and spoke to a range of other commodity experts and with trade finance bankers. Several manufacturing companies buying imported commodities were subsequently contacted,.

Through a series of workshops and interviews, the Green Finance Institute (GFI) explored whether leading banks and trade financiers in the UK and globally believed that there was a market for such a guarantee and whether clients would avail of it.

Using a SIG to import or buy imported palm oil, soy and cocoa – findings

This study identifies five key findings:

1. **The market for sustainable commodities is developing but would benefit from an incentive to complete the transition to 100% sustainably sourced.** There was significant interest from traders and manufacturers in the idea of a financial incentive that could reduce the cost of a green premium for sustainably sourced agricultural and forestry commodities, in order to drive the transition to sustainable commodities.
2. **Well established sustainable certification systems exist for palm, soy and cocoa that could be used as a basis from which to develop suitable SIG sustainability criteria.**
3. **However, for the most part the large companies which import the vast majority of palm, soy and cocoa in the UK are self-financing and are not significant users of banks for trade finance**. Without having relevant lending to apply a guarantee, it may not be possible to apply a SIG to the largest importers of these three commodities. This may limit the scale of uptake and impact of a SIG.
4. **It is also unclear whether other parts of the supply chain would benefit from a SIG.** The potential scope of the SIG was extended beyond these direct importers to include companies further down the supply chain that use imported forest risk commodities. These large ingredients, product and feed manufacturers also reported not using trade finance in a way that a guarantee can easily be applied to. Additionally, for these manufacturing companies, commodities are a small proportion of their overall costs, therefore the potential SIG cost saving is smaller.
5. **On the other hand, banks spoken to unanimously believed the SIG could provide a useful financial benefit for several of their clients and incentivise them to source more sustainably.** The banks believed a SIG could provide a useful mechanism to help drive transparency and disclosure within the banks, to strengthen due diligence practices and to better address deforestation risks in their trade finance lending portfolios. Further information is required on the characteristics of bank clients that would potentially be interested in a SIG to better understand this opportunity and to understand whether it is applicable to deforestation commodities or more applicable to other supply chains.

Potential cost saving

This study also provides an estimate of the reduction in lending costs created by a guarantee to understand the potential size of the SIG cost saving. To put this saving in context, it can be compared with an estimation of the 'green premium' for palm oil, soy and cocoa, i.e. the additional cost that importers must pay for sustainable versus 'conventionally' sourced commodities. The report concludes:

- The estimated potential cost savings derived from a SIG could range from 0.14% to 2.5% of borrowing costs. The size of the potential cost saving depends on the credit risk of the company receiving the loan, the proportion of lending that is guaranteed, and the size of guarantor's costs. The traders (importers) and manufacturers we spoke to confirmed that cost savings of this order would be of interest, given the narrow margins under which they operate.

- The estimated 'green premiums' for palm oil are currently estimated to be of the order of 2-5% (versus a typical cost for conventional palm oil of £500/tonne), 1-3% for soy (versus a typical cost for conventional soy of £300/tonne), and 5-10% for cocoa (versus a typical cost for conventional cocoa of £1,800/tonne). Thus, the SIG cost saving as estimated above does not entirely cover the "green premium" cost of sourcing sustainable commodities. Traders felt that despite this level of SIG savings, combined with other financial and non-financial incentives and drivers, could provide a potentially compelling additional incentive for sustainable sourcing.

Potential next steps

The report proposes possible further avenues to explore or better understand how a guarantee could be used to reduce the cost of sourcing sustainable commodities:

1. Wider engagement with a larger sample size, including exploring the potential impact on SMEs

2. Widen the scope of the SIG to other commodities which may be linked to environmental degradation at the point of production.

3. Consider other financing entry points or markets, such as providing upstream support to farmers, producers and exporters or explore other products at the UK importer level.

4. Develop a pilot to build the evidence base and client interest in this product