Shape up or ship out

Haris Zografakis examines the central role that trade finance banks can play in helping to combat emissions of greenhouse gases and ongoing global warming

Trade finance sits at the intersection of industries being disrupted by efforts to reduce greenhouse gas emissions (GHG): the production and processing of raw materials, especially those used to produce energy, their purchase and sale, and the maritime industry, which transports them.

Some of those industries are already subject to increasing governmental regulation intended to combat climate change (including local carbon taxes, emissions trading schemes and disclosure obligations), but others are not – notably international shipping.

Maritime transport is the most efficient form of transport globally by weight of cargo moved. At the same time, shipping contributes 2 per cent of the planet's man-made CO^2 emissions. On a "do nothing" scenario, that share will increase it to about 5 per cent by 2050, which could be higher than the projected share of many other polluting industries, for example the often criticised aviation industry.

The UCL Energy Institute calculates that the investment necessary to decarbonise shipping is US$1tn to US$1.4tn between 2030 and 2050. Transformational changes in the maritime industry will not happen in isolation. New ship designs will require access to new fuels such as ammonia and hydrogen, which will in turn necessitate new production and distribution infrastructure.

In parallel, the commodities industry, which is served by cargo ships, will also change. The volume of production and the trading pattern of oil & gas, mineral oil products, coal, but also other commodities transported by ships, will be very different in the years to come.

Change in the maritime industry is already under way. In 2018, the International Maritime Organization (IMO), the UN's agency for shipping, adopted the target of reducing the total GHG emissions of the industry by "at least" 50 per cent by 2050, measured against a 2008 base. That is more ambitious than it sounds because a growing global economy and the consequent increase in international trade will mean that the average emissions per ship will need to fall by around 80 per cent by 2050 to meet the targets.

The first steps towards implementation have already been taken. The IMO started collecting data on the fuel consumption of ships of over 5,000 gross tons on 1 January 2019. (They account for around 85 per cent of CO^2 shipping emissions.) International regulation is not the only driver of change. Indeed, it is probable that, in the years to come, industry initiatives will move faster and go further than regulatory measures. An example of this is the Poseidon Principles, an initiative of the Global Maritime Forum, an NGO, according to which banks active in ship finance encourage loans for sustainable ships. In its first year, it has attracted 16 signatory banks representing 30 per cent of the world's shipping loan portfolio.

> *The financiers of that cargo play just as important a role in tackling climate change as do the financiers of ships*

Important though the role of ship finance banks is, we should not forget that, at the end of the day, the reason for the very existence of cargo ships is the contract for sale of the commodities carried on board. Therefore, the financiers of that transaction play just as important a role in tackling climate change as do the financiers of ships, or the standard setters at the IMO.

Banks are certainly under pressure to help and encourage their clients to be sustainable. In trade finance that means "rewarding" clients for meeting sustainability goals. Some banks tie the terms of letters of credit to sustainability metrics. CaixaBank, in Spain, for example, says it issued the first "green letter of credit" in the European market in 2019. It was a US$129m import letter of credit used to buy photovoltaic modules.

There are also facilities like the US$725m sustainability-linked deal for the energy trader Gunvor. Under its terms, the interest payable fell if certain targets, including reducing emissions, were fulfilled. The next step could well be a "green letter of credit" linked to the sale of commodities sustainably produced and sustainably transported.

Green change is under way and trade finance has a powerful opportunity to help drive it forward. ■

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