CRÉDIT AGRICOLE
CORPORATE & INVESTMENT BANK

Supporting the sustainability transition in commodities

The global push towards the adoption of greater environmental, social and governance (ESG) practices presents unique challenges for commodity producers, which will need to innovate and rebuild their growth agenda in order to keep pace. The structured commodity finance Emea team at Crédit Agricole CIB outlines the role of banks in developing sustainability-linked transactions to help drive this change.

From crude oil to cocoa, metals and grain, companies involved in commodity supply chains are under increasing pressure to reduce their environmental and social impacts while remaining profitable. Whether it's water use in agriculture, waste reduction in chemicals processing, or human rights issues in mining, doing better on ESG – and proving it – has become vital for companies in order to remain compliant with an ever-growing number of regulations.

Increasingly, they are turning to their banks for help to embed their ESG commitments in their financing. Through the use of sustainability-linked facilities, a growing number of commodity traders and producers are tying their financing to ESG performance targets, with notable examples including Ghana's Cocobod [see box out], which signed a US$300mn syndicated facility in 2019. The financing margin was linked to indicators including the empowerment of female farmers and increased sensitivity to child labour among community leaders, making a tangible difference along the cocoa supply chain and setting a high bar for other African commodity producers.

"Back then, these kinds of deals would start with a gentle push from the bank," says Constantin Koutzaroff, global head of structured commodity finance at Crédit Agricole CIB. "We were one of the banks at the root of the launch of the Equator Principles in 2003, and as we continue along the journey, we are working hard to incentivise our clients to join us."

Crédit Agricole CIB was one of the first banks to begin phasing out financing of the coal industry back in 2019 as part of a comprehensive plan to overhaul its investment policies towards fossil fuels and finance more renewable energy projects. It ceased offering project finance in the mining and coal-fired power industries in 2015, and has also been offering structuring and investing in green, social and sustainability bonds since 2012.

"What is particularly encouraging is that today almost every company in the commodities sector sees the benefit of ESG-linked finance. As a result, clients are more interested in taking the initiative themselves," says Koutzaroff.

"The peer effect is also quite strong," adds Aude Sauty de Chalon, director, structured commodity finance, Emea at Crédit Agricole CIB. "We're now seeing that one or two transactions in a certain sector can pave the way for further requests from other clients."

ESG as a differentiator

The growing focus on ESG in commodities is about more than a desire to do good. Sustainability has risen to the top of the political agenda of late, with new regulatory climate initiatives coming out of the recent Cop26 event. Meanwhile, both the Covid-19 crisis and the recent supply chain disruptions have equipped consumers with a greater awareness of where the goods they buy come from and how they are made – creating a growing market for responsibly sourced products.

"Until recently, consumers were not really aware of global commodity flows," says Pierre Mabboux, structured commodity finance analyst at Crédit Agricole CIB. "This is changing, and more and more consumers are becoming conscious of how commodities are produced and transported. We expect to see this lead to commodity price premia, where the ESG component will have a real impact."

A bespoke approach

When it comes to structuring a sustainability-linked commodities transaction, much depends on the particular commodity in question.

"There is no holistic approach; it is really sector specific," says Sauty de Chalon. "Banks have to adapt their solutions to the maturity of the sector and how advanced their ESG transition is. In aluminium, for example, we are seeing clients with carbon management systems and science-based emissions targets in place.

She adds that the bespoke nature of commodity finance lends itself well to the complexities of ESG considerations.

"There is no such thing as a template pre-export finance transaction, for example. Our structured finance business has always been all about understanding client needs and accompanying the client in their growth, and we are now adding the ESG layer on top of that, so it is quite an exciting time."

Putting it into practice: Ghana Cocoa Board

Ghana is the world's second-largest cocoa producer, providing around 20% of the global cocoa supply. The crop plays a vital role in the Ghanaian economy, employing about 800,000 smallholder farmers and constituting one of the country's top exports. As a result, improvements in sustainability performance within the sector have the potential for a wide-ranging impact. Cognisant of this, Ghana Cocoa Board (Cocobod), a state-owned company that supervises the purchase, marketing and export of cocoa, is increasingly committed to developing a sustainable cocoa industry in Ghana, both from a social and an environmental perspective.

To support it in reaching its ESG goals, in March 2019, the company signed Africa's first ever syndicated sustainability-linked deal, in which Crédit Agricole CIB acted as mandated lead arranger and bookrunner, facility and security agent. The innovative structure introduced key performance indicators into the loan agreement, aimed at ensuring good agronomic practices and labour conditions and paving the way for similar facilities across the commodities sector.

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Avoiding greenwashing

An important factor to take into account when structuring a sustainability-linked transaction is whether the key performance indicators (KPIs) being set are sufficiently relevant or robust to justify the sustainability label.

"As soon as we start to work on a new transaction, we try to see how we can bring in sustainability metrics," says Julien Desiré, structured commodity finance associate director at Crédit Agricole CIB. "It is not always easy, as our clients are not always familiar with the energy transition and may not be aware of the possibility to structure a sustainability-linked loan. We work with a lot of state-owned entities in emerging countries, for example, so our role also encompasses of knowledge sharing around the topic."

This is where banks' expertise can come to the fore, explains Koutzaroff. "We are increasingly playing a more advisory role, helping clients explore the ESG issues that are applicable in their own industry and the evolution of the regulatory approvals that are needed throughout the world."

With increased regulatory moves to stamp out greenwashing gathering pace – such as the EU taxonomy – commodity traders and producers also need to ensure that their ESG claims can be taken seriously, or risk being left behind.

"As a bank, we want to avoid the potential for greenwashing," says Badia Taleb-Nehlil, executive director, structured commodity finance at Crédit Agricole CIB. "Whenever a client wants to do a KPI-linked facility, we work closely with our sustainable investment banking team and external consultants to determine that those KPIs are worth having."

"It's vital to have a third party on board, not only to verify that certain targets are being met, but also to provide expertise around industry benchmarking," adds Koutzaroff.

New opportunities for finance

Aside from supporting commodity producers and traders in their transition towards better environmental and social practices, a sustainability focus can also help democratise access to finance within the industry.

In recent months, commodity trade finance has been tightening amid recent fraud claims, as well as pressure from civil society on banks to withdraw from financing certain products. For those companies that can demonstrate ESG improvements, an opportunity exists to open up a broader range of funding, potentially improving pricing as well as positioning their businesses for long term sustainability.

"In the current environment, banks are seeking to take on more opportunities where the ESG component is involved," says Mabboux. "We are targeting these transactions because we see them as an important asset."

"As ESG standards become more widespread, we see growing opportunities to support clients that are smaller or are less well known, because their sustainability performance makes them more attractive from a financing standpoint," adds Jean-Briac Saillard, structured commodity finance associate at Crédit Agricole CIB.