

# How Can Commodity Trade Finance Ensure Effective Implementation of the UNGPs?

Guidance

Helping companies implement the UNGPs



The **Commodity Trading Sector Guidance on Implementing the UN Guiding Principles on Business and Human Rights (Commodity Trading Guidance)** aims to help representatives of commodity trading firms to implement the **UNGPs** in company systems and cultures.

This explainer delves deeper into one element of the Guidance - the role and responsibility of commodity trading finance in upholding human rights.

## Finance in the commodity trading sector

Financial institutions in the commodity trading sector have a key role in providing either “commodity finance” or “commodity trade finance” to trading firms. While “commodity finance” covers everything in the commodity value chain that a bank can finance, “commodity trade finance” **refers to** the financing of the underlying exchange of the commodities from supplier to buyer and is tied to the underlying asset conversion cycle.

The type of financing depends on the activity being financed. Producers in the commodity value chain typically require longer-term financing whereas traders **typically require** short-term financing tied to the asset conversion cycle of their trades. **Most trading firms seek** letters of credit (LCs)/standby LCs, traditional crediting financing, pre-finance and pre-export finance and inventory financing.

### The human rights responsibilities of financial actors

The United Nations Working Group on Business and Human Rights (Working Group) **notes that** banks can be considered to cause or contribute to adverse human rights impacts arising from their clients operations. Insufficient due diligence by a bank could contribute to human rights impacts, such as where a bank finances a project that violates Indigenous peoples’ rights or displaces communities.

As outlined in the Commodity Trading Guidance, the commodity trading sector carries numerous risks of human rights violations across the physical commodities supply chain. It is important that financiers in the commodity trading sector pay attention to the human rights impacts of activities and firms that they finance.

## Due diligence and financing

Financial institutions **should respect human rights in all their activities**, including their lending and financing practices. To do this in accordance with the UNGPs, **banks must**:

- Publicly commit to respect human rights and incorporate this commitment in internal policies and management systems;
- Implement effective human rights due diligence to assess actual and potential adverse human rights impacts;
- Address such potential impacts by using their leverage as financiers to ensure that



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borrowers and customers are engaging in responsible business conduct;

- Ensure that client's mitigation measures are based on sound international standards;
- Be transparent and publically report on the results of human rights due diligence processes.

Critically, the Working Group **has observed** that banks also have a responsibility to provide remediation and access to remedy where they have caused or contributed to human rights impacts. This may be through establishing its own grievance mechanism or engaging with external grievance mechanisms to hear the case and decide on the remedy.

The type of due diligence which a bank that is providing commodity finance or commodity trade finance engages in **depends on a number of factors**. It depends on the size of the bank, the nature and context of its operations and the severity of the potential adverse human rights impacts. It also depends on the nature of the financing. If the finance is longer-term and for the development of a fixed asset, banks should conduct detailed human rights impact assessments and due diligence. This is because fixed-asset or project development activities carry a high risk of human rights violations (such as the risk of breaching land rights or Indigenous rights in the development of a copper mine).

## Leverage

Many trading firms cannot survive without financing. As such, banks in the sector have important leverage to require firms to have effective human rights due diligence systems in place (proportionate to the size of the firm). Banks can act as an indirect “choke point” or “police” that can sift information about the underlying transaction to be financed, sort out firms and transactions that do not meet their standards, and in some cases, exercise the power to cut off some firms from financing altogether.

### Drawing upon existing due diligence systems

Most banks have customer due diligence systems in place due to mandatory requirements under anti-money laundering and counter-terrorism financing laws (AML-CTF). Under these processes, banks **are already looking into** the activities of the trading firms that they are financing. Such systems can also be useful to signal alarms or red flags with respect to human rights risks. Many human rights issues such as trafficking or modern slavery are linked to money laundering and criminal networks. By drawing upon data from AML-CTF due diligence, banks can set up certain triggers for in-depth human rights due diligence into certain transactions.

### Example of leverage together with business partners

Revolving credit is a line of credit where the customer pays a commitment fee and is then allowed to use the funds when they are needed. A trade finance bank and a trading company active in the chocolate value chain recently announced the extension of the trading company's revolving credit facility.

They communicated that the applicable credit margin would be linked to the company's sustainability performance and rating, thus encouraging the company to improve its sustainability performance.

The trading company's sustainability programme includes four targets that it expects to achieve by 2025 and that address the biggest sustainability challenges in the chocolate supply chain: child labour, farmer poverty, its carbon and forest footprints and sustainable sourcing.

# Implementing the UN Guiding Principles on Business and Human Rights

Guidance for the Commodity Trading Sector

