

Traceability and Regulation

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A View by Nicko Debenham of Sustainability Solutions Ltd

Introduction

Parties involved in the international business of cocoa trade are facing new requirements. These requirements stem from governments or regional institutions of importing countries imposing laws that effectively may be classed as:

- requiring importers to ensure that the goods are produced in accordance with what is deemed acceptable work practices and environmental responsibility; and
- requiring traceability of goods that comply with those various obligations.

The purpose of this series of articles is to capture these legal changes in order that those involved in the trade of cocoa are less likely to be in contravention of them.

Please note: the penalty for contravention in some cases may be financially punitive. Historically, the trade has considered the risk of contract to be limited to:

- default;
- delay;
- quality; or
- weight loss.

These would generally be considered a low percentage of the value of the contract. However, contravention of these new laws may be the total value of the contract or more with the prospect of additional fines being placed which are based on a percentage of the annual turnover of the company. In particular those companies that have sensibly managed their physical price risk using the futures market may therefore be faced with enormous fines if found to be contravening these laws.

We intend to provide an overview of the various legislations for this month and then in subsequent months explore each one in more depth. We also intend to show what is the status for each legislation and what changes have been made.

Extent of the various legislations

Table 1 below shows the global situation of laws affecting commodities by country and region, some of which are still being formulated, and others while enacted are not fully operational despite imminent imposition. The highlighted parts show the legislation that directly affects the cocoa trade. This table also includes the relevant annual average import of cocoa beans and products for the country or region. Note that these numbers for cocoa products have been left as they are and are not expressed as cocoa bean equivalents. The requirement to conform to the legislation will be very much harder for the cocoa product than it will be for the beans, and that in itself will not be easy for what is essentially a smallholder crop.

Three things become apparent with this Table. First, that some of the legislation is in place and that some is in place but yet to be fully enacted. Second, that there is variation between the different legal entities so that while some of the objectives for the laws may be similar, e.g. counteracting the effect of deforestation, the methods of achieving it are different. Third, is the amount of cocoa that is affected. From the data in **Table 1**, if the cocoa products were expressed as a bean equivalent and added to the bean figure the total would be larger than the annual world crop.

Region/ Country	Date of Enforcement	Regulation	Commodity	Status	Average Annual Cocoa Imports in Metric Tonnes during 2019/20 to 2021/22				
					Beans	Liquor	Butter	Cake/Powder	Total tonnage
European Union	Jul-20	EU Taxonomy Regulation	All	Current	2,037,021	525,191	621,446	454,068	3,637,726
	2024	Corporate Sustainability Reporting Directive (CSRD)	All	Current					
	Mar-21	Sustainable Finance Disclosure Regulation (SFDR)	All	Current					
	Jun-23	European Union Deforestation Regulation (EUDR)	Cocoa, Coffee, Cattle, Palm Oil, Rubber, Soy, Timber	Current					
	Jun-23	Corporate Sustainability Due Diligence Directive (CSDDD)	All	In Development					
Germany	Jan-23	Supply Chain Due Diligence Regulation	All	Current	434,585	74,138	154,366	67,677	730,767
UK	2024	Forest Risk Commodities Regulation	Cocoa, Cattle (Non- dairy), Palm Oil, Soy,	In Development	90,731	16,398	54,583	19,806	181,518
USA	2017	Tariff Act Section 307	All	Current	391,291	79,709	104,543	170,995	746,538
	2024	Forest Act	Cocoa, Cattle, Palm Oil, Rubber, Soy	In Development					
Australia	Aug-24	ESG Climate Related Financial Disclosure	All	In Development	435	12,100	20,126	16,100	48,761
Japan	Mar-23	Task Force on Climate Related Financial Disclosure (TCFD)	All	Current	36,608	14,346	22,860	21,199	95,013
Switzerland	2020	Environmental Social Governance Regulation	All	Current	7,650	9,991	29,845	5,068	52,555

Source: Nicko Debenham and ICCO Quarterly Bulletin 49 Issue 3

Table 1

Here is a short summary of each of the regulations identified in the table.

EU Taxonomy Regulation

This regulation can be described as a green classification system which is a transparency tool that introduces mandatory reporting obligations for companies and investors, requiring them to disclose their taxonomy aligned activities in relation to six environmental objectives relating to climate change, water, circular economy, pollution and biodiversity.

Corporate Sustainability Reporting Directive (CSRD)

This regulation requires companies to report on actual and potential impacts on sustainability-focused topics including environment, social responsibility, human rights, anti-corruption, board diversity related to the companies' operations as well as across their value chain including products, services, business relationships and supply chains as well as how those topics affect the companies (Double materiality).

Sustainable Finance Disclosure Regulation (SFDR)

This regulation aims to enhance transparency in the sustainable investment market. Its purpose is to prevent misleading environmental claims (greenwashing). It is to ensure that the investment market is supporting truly sustainable investments.

European Union Deforestation Regulation (EUDR)

The European Union (EU) Regulation on deforestation-free products (EUDR) – entered into force during June 2023 – prohibits companies from putting products on the EU market unless they are deforestation-free and legally produced. It will also be illegal to export such products from the EU.

The EUDR applies to wood, palm oil, soy, coffee, cocoa, rubber and cattle as well as most of the derivatives which, under cocoa, applies to beans, products and chocolate.

Corporate Sustainability Due Diligence Directive (CSDDD)

The CSDDD is an EU proposal that will require companies to exercise due diligence in their own business and in their supply chains to prevent human rights or environmental risks. The timing of implementation will depend on the outcome of the parliamentary vote and the speed in which the member states bring the directive to being a regulation but is likely to be during 2027.

Germany's Supply Chain Due Diligence Regulation

The Supply Chain Act imposes on companies' due diligence obligations which must be complied with, with the aim of preventing or ending human rights or environmental violations. The due diligence obligations along the supply chain extend to the company's own business area and direct suppliers as well as less strict criteria indirect suppliers.

Forest Risk Commodities Regulation (FRCR)

On 9th December 2023 the UK Government published further details of its Forest Risk Commodities Regulation (FRCR). The regulation aims to tackle deforestation by making it illegal for larger companies (£50 million global turnover or greater than 500 MT of the relevant commodity per year) operating in the UK to use relevant forest risk commodities produced on land illegally occupied or used. The companies that are in scope will have to undertake due diligence and report annually.

The relevant commodities include cocoa along with non-dairy cattle products (beef, leather), palm oil and soy.

The indication is that the regulation will be published imminently.

Tariff Act Section 307

This is a USA regulation that prohibits importing any products that were mined, produced or manufactured wholly or in part by forced labour, including forced or indentured child labour. US Customs and Border Protection (CBP) enforces the prohibition.

Forest Act

The FOREST Act would prohibit products that have been linked to illegal deforestation from entering the US, building on the Lacey Act, which prohibits illegal timber and wildlife from entering the country. The bill would create the ability for the US to prosecute people and organizations driving illegal deforestation. The bill would also create a fund to help countries transition away from deforestation and create effective enforcement and conservation programs.

Australia's ESG Climate Related Financial Disclosure

The draft legislation seeks to introduce mandatory requirements for large businesses and financial institutions to disclose their climate related risks and opportunities.

Japan's Taskforce on Climate Related Financial Disclosure (TCFD)

Under the rules, all listed companies in Japan are required to disclose sustainability related information using the TCFD pillars (Strategy, Metrics, Targets, Governance and Risk Management).

Switzerland's Environmental Social Governance Regulation

The regulation requires that relevant companies under Swiss law are obligated to report matters relating to the environment, particularly CO₂ targets, social and employment matters, respect for human rights and combatting corruption.

May 2024 Installment

A deep dive into European Union Deforestation Regulation.