



14-Jun-23
White paper

**Ensuring the Effective Implementation of the EU Deforestation Regulation by
Adapting Existing Industry Best Practices**

I. Executive summary

Intercontinental Exchange (ICE), as the leading worldwide trading venue for cocoa and coffee futures, is pleased to offer support to both public authorities and industry in the implementation of the EU deforestation regulation.

The complexity of the cocoa and coffee supply chains and trade, and in particular the typically lengthy period of time from farm to consumer, generates certain challenges both in the transition period and in the ongoing application of the regulation. These issues have the potential to disrupt price stability and trade which could have a significant negative impact on farmers within producer countries. Such disruption could undermine the implementation of the regulation and its objectives.

We have three areas of concern arising from the technical application of the regulation. We propose simple clarifications that complement the intentions of the regulations and would minimize the potential for disruption. On behalf of the industry, we request that:

- Cocoa and coffee beans shipped to Europe are not immediately cleared through customs and placed on the EU market. Very often, goods which are physically in Europe may be held pre-customs for longer than the 18-month transition period foreseen by the EU deforestation.
- It should be clarified that proof of shipment and arrival into EU warehouses prior to entry into force of the regulation will be accepted as documentary evidence of compliance.
- Stocks which are produced and arrive in Europe prior to entry into application of the regulation should be exempt from full traceability data requirements.
- [The EU/whoever it should be] should provide guidance on what information will be required from operators to demonstrate the validity of goods. ICE proposes dated proof of shipment and/or receipt into a European-based warehouse as acceptable evidence.
- National competent authorities should be empowered to mandate submission of Due Diligence Statements upon completion of shipment to their jurisdictions, prior to customs clearance and prior to placing on the EU market. If this is not possible, then voluntary submission should be allowed permitting Owners who hold goods in EU ports prior to the point of customs clearance to submit a Due Diligence Statement.
- Operators who place goods on the EU market by clearing through customs should be permitted to make reference to a previously submitted valid Due Diligence Statement.



ICE is a group of regulated Exchanges whose key function is to manage fair and orderly markets, and we believe our neutral position as an exchange which underpins the financial transactions for the cocoa and coffee trade can assist greatly in the adoption of the new regulations. It is our intention to align the standards of our contracts with the new regulations, which will mean that the price references relied on throughout the supply chain will support and represent the goals of the regulation.

Our transparent markets facilitate price discovery, offer global price references, and provide price risk management tools for the industry. From farmers in origin through international trade and manufacturing through to retail and the consumer in Europe, participants in the supply chain ultimately rely on these prices and tools to manage their businesses. The markets are underpinned by the trade of stocks of cocoa and coffee in Europe.

In order to support the implementation and in the interests of all market participants, ICE seeks to clarify the application of areas of the regulation which we believe could unintentionally impact price stability and trade. In particular, we have three areas of concern arising from the technical application, for which we propose simple clarifications that complement the intentions of the regulations and would minimize the potential for disruption.

1. *The documentary requirements to demonstrate compliance with the regulation should be clarified for Stocks¹ already in EU ports prior to the entry into force.*

Significant volumes of stock currently sit in customs-bonded warehouses in Europe. The final text of the EU deforestation regulation (article 1, para 2) has already determined that stock proven to have entered European warehouses prior to the entry into force will be considered compliant.

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2. *The documentary requirements to demonstrate compliance with the regulation for stock arriving in EU ports after entry into force, but prior to entry into application, should be clarified.*

A large volume of goods physically landed in Europe but not customs-cleared prior to the entry into application on 30 December 2024 could be deemed non-compliant based on a technicality of timing rather than a principle preventing deforestation. This would include any surplus from the 2022-23 and 2023-24 crop cycles. Exclusion could be both negative and volatile for price, to the detriment of the farmer, consumer, merchants, and manufacturers.

It should be clarified that proof of shipment and arrival into EU warehouses prior to entry into application will be accepted as documentary evidence of compliance.

3. *Allow national competent authorities to mandate for submission of Due Diligence Statements for goods in EU ports prior to customs clearance and the placing on the EU market.*

¹ 'stocks' primarily refers to cocoa and coffee bean stocks but can apply to all cocoa and coffee products that fall under the regulations.



Large proportions of the industry supply chains utilize bonded warehouses and pre-customs status, to facilitate pre-customs trade and maintain efficiencies and flexibility over final location of production and retail. Subsequently, the stocks that drive the price of futures, and hence drive the global price references of cocoa and coffee, are traded in a pre-customs state.

In order to avoid an unnecessary break in these efficient supply chains, national competent authorities should be empowered to mandate submission of Due Diligence Statements (DDS) upon completion of shipment to their jurisdictions, i.e., upon first landing and unloading, prior to customs clearance and prior to placing on the EU market. If competent authorities cannot mandate submission of DDS at this stage, then voluntary submission should be allowed.

II. Background

ICE is the worldwide leading trading venue of agricultural futures and options markets for soft commodities such as cocoa and coffee. Our futures markets are used to discover the global reference prices for cocoa and coffee, which feed back to the farmer price in origin countries and the consumer price for chocolate and coffee within the EU. Futures markets are essential for producers and consumers alike as they allow all participants along the supply chain to manage price risk and provide transparent pricing information. Additionally, futures markets are critical for participants to be able to plan for the future, including giving farmers the ability to sell their production forward.

As a group of regulated Exchanges, ICE is responsible for creating and enforcing rules which ensure the orderly functioning of its futures markets. In performing that regulatory function, ICE establishes certain quality standards and storage practices for the commodities of market participants that underlie the ICE futures markets. All goods which are to be delivered against the futures market must be certified for delivery, in other words, independently certified by the Exchange (ICE). The certification results are published by the Exchange, creating a publicly transparent inventory of available supply in Europe. Currently there is almost 200,000 metric tons of cocoa and 150,000 metric tons of coffee held and certified in ICE licensed warehouses in ports across Europe².

In addition to market transparency, the futures markets serve a critical function as a supplier of last resort for the EU industries through their physical delivery mechanisms. If supply is short, Exchange stocks can be drawn upon by the industry to cover their needs. Certainty around the availability of these stocks for use in the EU is critical to ensure price stability, and convergence between futures prices and the spot markets for the underlying commodities. Preserving access to these critical supplies will be contingent upon maintaining a reliable path for both existing and future exchange inventories to customs clear the goods into the EU. Without this certainty, participants across the supply chain will lose a reliable and effective risk management tool to mitigate the risks of price volatility.

III. Crucial elements for an effective transition period

As stated above, ICE has an obligation to ensure orderly markets for our cocoa and coffee futures markets and prevent unnecessary price volatility. To accomplish this, ICE will need to implement rules which establish certainty around the availability of Exchange certified inventory to supply EU industry. It

² The vast majority of these stocks were produced and shipped, as proven by shipping documents and warrant records, prior to the deforestation cut-off of 31st December 2020



is therefore crucial to ensure that the 18-month transition period in article 38 paragraph 2 of the regulation provides the intended path to compliance for goods grown prior to the entry into application.

In practice, cocoa and coffee beans which are shipped to Europe are not immediately cleared through customs and placed on the EU market. Very often, goods which are physically in Europe may be held pre-customs for longer than the 18-month transition period foreseen by the EU deforestation regulation. After export from origin countries, inventories of coffee and cocoa will be held in EU customs-bonded warehouses until they are required for use, and only then will they clear customs for free circulation in the EU. This storage period will commonly cover months or even years, particularly when the underlying commodity markets are in surplus. Alternatively, some products may also be shipped from the origin to a third country for processing before they are moved to the EU (where again it may sit in a bonded warehouse for a period of time).

These common practices will not impede the effectiveness of the deforestation regulation, however, must be accounted for in its implementation, and in particular during the transition. Since farm-level traceability has not yet been implemented throughout the coffee and cocoa origin supply chains, the transition period is critical to allow the supply chains to adopt the programs required for full traceability. Necessarily, a significant portion of the 2022/23 and 2023/24 crops will not have sufficient farm level traceability data to meet the forthcoming requirement, however, it is important that these volumes have a path to compliance, in particular to ensure these farmers will be able to market their crops while the supply chain adapts to the regulation.

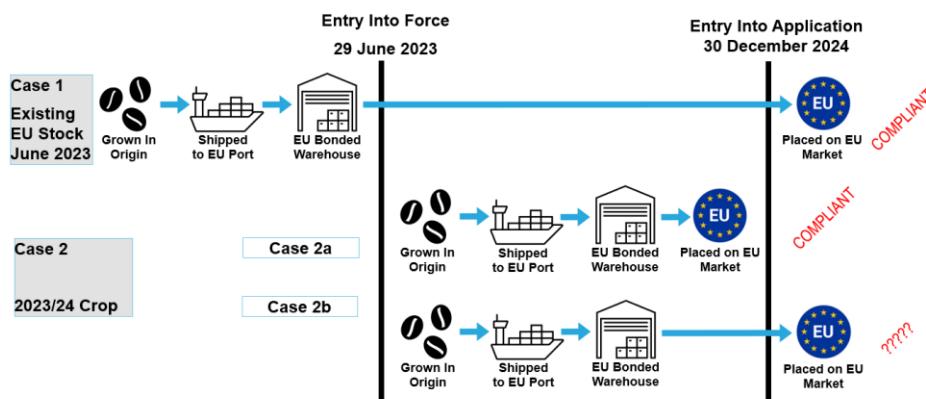
The below diagram outlines three scenarios that will commonly occur during the transition period, both for existing inventory, and crops that will be produced prior to the entry into application.

Case 1 refers to stocks which are already in Europe when the regulation enters into force (29 June 2023). There is a large volume of coffee and cocoa that will have been produced within origin countries before the entry into force, without full traceability data, which will be stored in the EU. These goods, however, may not technically be placed on the EU market until after the entry into application (30 December 2024). Since the goods were produced before the entry into force, the regulation states they are compliant (article 1 paragraph 2).

ICE requests guidance on what information the EU and National Competent Authorities will require from operators to demonstrate the validity of these goods. ICE proposes dated proof of shipment and/or receipt into a European-based warehouse should be acceptable evidence, which will be reliably available to operators and traders.

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Diagram 1 - complexities through the transition period



Cases 2a and 2b illustrate scenarios that could occur with surplus crops from the 2023/24 crop cycle. In both cases, surplus goods are likely to lack traceability data because fully traceable goods will be consumed first. Note that the goods in both 2a and 2b are produced and shipped in the same period, with the same impact from a deforestation perspective.

Under Case 2a, goods are produced after the entry into force, shipped to Europe, stored in a bonded warehouse and Placed on the EU Market (clear customs) prior to the entry into application. These goods are clearly compliant according to the regulation (article 38, paragraph 2).

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In Case 2b, the goods are not required for manufacturing and so are not customs-cleared until much later, after the entry into application. Even though the goods are produced and shipped in the same period as in 2a, due to the technicality of the timing of the customs-clearance there is uncertainty over whether they will be deemed compliant. Considering that goods are only customs-cleared at the point



that they are required for manufacturing, it follows that surplus stock remaining from the 2023-24 would likely fall into this scenario.³

ICE requests that these goods which are produced and arrive in Europe *prior to entry into application* should be exempt from full traceability data requirements, whether they are placed on the EU market *before or after* the entry into application. ICE proposes dated proof of shipment and/or receipt into a European-based warehouse should be acceptable evidence, which will be reliably available to operators and traders.

IV. Practical elements for on-going compliance and trade - Pre-customs liability

In order to encompass the broadest set of supply inventory, we believe it is crucial to allow the option for the initial owner who first physically lands relevant commodities on EU territory to file a Due Diligence Statement (DDS) in accordance with the EU deforestation regulation requirements. Ideally, national competent authorities would make this a mandatory requirement, otherwise it could be voluntary. Relevantly, in cocoa and coffee supply chains this would include the common scenarios where the initial owner is not the operator who ultimately places the goods on the Union market (i.e. clears the goods through customs for free circulation in the EU).

If authorities only allow the operator who custom clears the goods (i.e. placing them on the Union market) to meet the requirements of the EU deforestation regulation, the registration of traceability into the EU will be delayed, which could significantly impair the effectiveness of the regulation. To ensure the integrity and reliability of the traceability data, it is critical to allow the data to be recorded at the earliest possible time, and in a form that can be acceptably passed with the goods as ownership changes. Delayed registration of data also increases the risk of deforested goods being traded and stored pre-customs in European ports and increases the likelihood that the chain of custody and completeness of the required information is broken. In simple terms, to track compliance it is better to stay closer in time and closer in the chain of ownership to the source of the goods and information.

In the context of National Competent Authorities requirements under '**Article 24 - Controls**' and specifically under '**Article 14a - Relevant products calling for immediate action**', control processes will be much more effective if shipping and landing documents (i.e. 'traceability data' including **dates of arrival, crop years, export dates**) can be recorded and submitted under a DDS at the earliest possible time. The earliest possible time is at first physical landing of the goods on EU territory. All trade, post this will continue to demonstrate traceability irrespective of whether goods have cleared customs or not. National Competent Authorities requirements under '**Article 21 - Interim measures**' and the timing of such measures, could be compromised if goods are kept on EU territory for significant periods of time before a DDS is submitted at customs clearance.

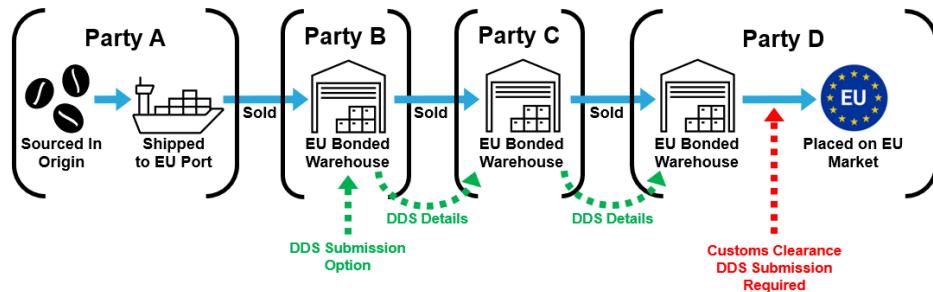
³ Alternatively, owners could choose to clear goods through customs 'early', e.g. before they have a requirement for use. This possibility would reduce flexibility and efficiency for the owner of the stock, and require them to incur a tax (including VAT) liability without a corresponding value-added use. Incurring this liability on the goods would impact their value (and price) by limiting their potential uses to only those within the EU. Further, if surplus stock was 'forced' to customs-clear prior to entry into application, the value of those goods could be significantly distorted as the deadline approaches, as the supply would mismatch with the timing of the demand.

In practice, inventories of goods are held in bonded warehouses on EU soil and are only imported at the point in which they will be used. These inventories can remain stored pre-customs for several years, during which time ownership may change hands many times. Such inventories are generally reserves of stock which are released and maintain market stability when supply runs low.

By only checking DDS for compliance at the point of customs clearance, a problem is also created for future new regulations or changes to existing regulations. Stocks stored in pre-customs state for long periods will be unlikely to be compliant, or be able to be proven compliant, against future regulations despite being produced and shipped prior to entry into force of the regulations. The problem repeats, and can already be foreseen for the proposed regulation on prohibiting products made with forced labour.

The below diagram illustrates a scenario where voluntary Due Diligence Statement submission can help facilitate compliance with the regulation, while also providing certainty for the supply and stability of the price. In the scenario Party B, who is the first to physically bring the product to the EU, is permitted (but not required) to submit a Due Diligence Statement. As the product is traded between different parties, reference to this Due Diligence Statement would be passed on through the supply chain (shown in green). At the point that the product is customs-cleared and placed on the EU market a Due Diligence Statement is mandatory (illustrated in red). ICE suggest that that in this case Party D's submission is able to refer to the Due Diligence Statement submitted by Party B.

Diagram 2 - Proposal to facilitate trade in pre-customs state (bonded warehouses)



To ensure that the maximum amount of goods in the EU are covered by the regulation and to safeguard the integrity of the chain of custody of deforestation traceability data, we therefore strongly recommend that:

- National competent authorities should be empowered to mandate submission of Due Diligence Statements (DDS) upon completion of shipment to their jurisdictions, i.e. upon first landing and unloading, prior to customs clearance and prior to placing on the EU market.

If competent authorities cannot *mandate* submission of DDS at this stage, then *voluntary* submission should be allowed by permitting Owners who hold goods in EU ports prior to the point of customs clearance to submit a Due Diligence Statement.



We further recommend that:

- **Operators who place goods on the EU market by clearing through customs should be permitted to make reference to a previously submitted valid Due Diligence Statement (according to article 4 paragraph 9).**

The recommended solution would support stable markets as compliance with the EU deforestation regulation and liability would be signaled as soon as possible to market participants, which would enhance predictability and certainty.

V. Conclusion:

The implementation of the EU deforestation regulation will be most successful if it takes into account the specificities of trade in the individual commodity markets. Otherwise, disruptions will occur which will not only cause harm to farmers at origin, EU operators and EU consumers, but that will limit the ability of the EU to impact the goal of curbing deforestation and forest degradation.

ICE is ready to support implementation efforts of the industry as well as public authorities and remains at your disposal for any questions you may have.

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