Banking on REDD+: Can bank and investor risk policies on soft commodities benefit REDD+?

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KEY MESSAGES

1. The financial sector is an important REDD+ stakeholder as capital is a fundamental component of agricultural production systems.

2. Finance can be a possible lever to encourage soft commodity producers to reduce impacts on forest ecosystems and thereby help achieve REDD+ results, especially if this is mandated through government regulations.

3. In countries where producers of soft commodities have options to obtain capital through other means such as the informal market, soft commodity risk policies by banks and investors may be less effective in achieving REDD+ results.

4. The four steps identified in this brief provide a starting point for governments to assess if the financial sector can be a potential lever in their country.

1. Introduction

The UN-REDD Programme is an inter-agency collaboration between UNDP, FAO and UNEP that supports nationally-led REDD+ processes to help developing countries achieve verified reductions or removals of forest carbon emissions. The programme has grown to 60 partner countries globally as of June 2015, including more than 20 countries with UN-REDD National Programmes. As partner countries start to move from REDD+ ‘Readiness’ towards ‘Implementation’, it is paramount to identify how policies and measures (PAMs) by countries can achieve REDD+ results.

Reducing Emissions from Deforestation and Forest Degradation (REDD) is a concept to create a financial value for the carbon stored in forests, offering incentives for developing countries to reduce emissions from forested lands and invest in low-carbon paths to sustainable development. “REDD+” goes beyond deforestation
and forest degradation, and includes the role of conserva-
tion, sustainable management of forests and enhancement
of forest carbon stocks. Policy makers have many tools,
including economic and command and control instru-
m ents, at their disposal to generate REDD+ results that can
lead to results-based finance (RBF) if they can demonstrate
verified reductions or removals of forest carbon emissions
compared to a forest reference level (FRL) or forest refer-
ence emission level (FREL) that comply with the Cancun
Safeguards.¹

Land use conversion to produce agricultural commodities is
the most significant direct driver of deforestation, account-
ing for an estimated 80% of deforestation worldwide (Geist
and Lambin, 2002; Gibbs et al., 2010; Kissinger et al., 2012).²
Palm oil, soy and beef are important soft commodities³ that
are grown or produced in the tropics and clearing land to
expand production is a major driver of deforestation. Transi-
tioning to an agricultural system that decouples production
from impacts on forests such as deforestation will there-
fore be an important means of generating REDD+ results
in many developing countries.

The private sector plays an important role in the rate and
location of deforestation and forest degradation though
production, investment and purchasing decisions. While
the private sector is diverse, for the purpose of this paper
it includes those sectors associated with driving deforesta-
tion and forest degradation (Henderson et al., 2013). The
financial sector is an important REDD+ stakeholder. Banks,
institutional investors, fund managers, insurance firms and
others can influence and be influenced by corporate clients
or investee companies as capital is a fundamental compo-
nent of agricultural production systems, and the choices
that companies in the agricultural supply chain make are
influenced by the availability and cost of capital through
loans and investment. Loans and equity securities channel
capital to agribusinesses as well as food producers across
the supply chain, supporting capital and operating expend-
titure to expand the production and processing of agricul-
tural commodities.

Over the past decade a growing number of banks and
investors have developed sector-specific policies, such as for
clients in the forestry or agricultural sector, or commodity-
specific policies, such as for cocoa, palm oil, beef and soy
(Mulder and Koellner, 2011). Such policies can be used by
financial institutions to reduce reputational, legal, market
and other types of risks by stimulating or obligating
clients to reduce negative effects on ecosystems and soci-
ety resulting from their business activities. However, such
sector and commodity-specific policies by financial institu-
tions are often implemented on a voluntary basis and little
is known about the strength and scope of these policies
and the degree to which they are applied to their client
base. In addition, it is uncertain whether and to what extent
soft commodity risk policies applied by banks and investors
can help countries to achieve REDD+ results by ensuring
financing flows to activities that will help reduce or remove
forest carbon emissions. For example, could soft commod-
ity risk policies by public and commercial banks as well as
investors generate REDD+ results by constraining debt or
equity to clients or investee companies that contribute to
deforestation or forest degradation? And what policies
and measures can governments develop to incentivize or
mandate the financial industry to generate REDD+ results?

2. Why do financial institutions develop soft commodity policies?

Various factors may affect the competitiveness of compa-
nies that have significant impacts or large dependencies
on forest ecosystems. These include: tighter government
regulations to reduce negative environmental and social
impacts in general and on forest ecosystems in particular;
increasing incidence of extreme weather, natural resource
scarcity, changing consumer preferences and demograph-
ics. Potentially material risks can include regulatory risks
such as requirements to comply with existing and new
environmental laws or regulations, social risks such as
conflicts with communities and governments, biophysic-
al risks such as decreased water quality or quantity, soil

This brief assesses whether and how soft commodity
risk policies by banks and investors could potentially
benefit UN-REDD countries to achieve REDD+ results
based on an analysis of risk policies from a range of
financial institutions. This brief has been produced in
parallel with a report by UNEP (2015) titled ‘Bank and
Investor Risk Policies on Soft Commodities: A framework to
evaluate deforestation and forest degradation risk in the
agricultural value chain’ that aims to provide greater clarity
what criteria banks and investors can adopt in risk policies
to reduce impacts on forest ecosystems from soy, palm oil
and beef production. As part of this, the Natural Capital
Declaration (NCD),⁴ a finance-led initiative to mainstream
natural capital integration in the financial sector, has issued
a qualitative ‘Soft Commodity Forest-risk Assessment’ (SCFA)
tool developed with Sustainalytics that builds on an earlier
framework developed by WWF (2008 and 2012).⁵ Financial
institutions can use the NCD’s practical Excel-based SCFA
tool to develop, evaluate or strengthen their soft commod-
ity risk policies.
erosion or crop pests, as well as reputational risks. In turn, these risks may affect the credit risk of companies active in the soft commodity supply chains if any or a combination of these risks affects financial metrics such as revenues, operational costs, capital expenditure and, through that, lead to potential delays in repayment of loans or bonds or changes in return on equity.

The increasing significance of these risks is contributing to a gradual shift in the way companies are managing risks related to ecosystem degradation beyond Corporate Social Responsibility. In 2010, the Board of the Consumer Goods Forum (CGF), an association of over 400 large consumer goods, food and beverage retailers, manufacturers, service providers with combined sales of EUR 2.5 trillion, pledged to mobilize resources to achieve zero net deforestation by 2020. More than 70% of the 50 companies, which make up the Board of the CGF and for whom this is relevant, have time bound public targets on deforestation (and more than 80% have public commitments on palm oil). Recent pledges by influential companies such as Cargill, Wilmar, Mars, Unilever, Nestlé and Golden Agri Resources to stop deforestation of high-conservation value (HCV) and high carbon stock (HCS) forest areas, as well as to stop development on peat and eliminate exploitation of the rights of indigenous peoples and local communities, will be a major challenge given the complexity of commodity supply chains. Tailored financial products, such as the Sustainable Shipment Letter of Credit by the Banking for Environment Initiative (BEI) (CISL, 2014), have been launched in an attempt to incentivize the growth in trade of sustainably produced commodities.

On the risk side, financial institutions with a significant client base in sectors with high direct or indirect impacts or dependencies on forest ecosystems, can be exposed through delayed repayments or defaults on the financial obligations if their clients are adversely affected by market, reputational or biophysical risks. A 2011 report by UNEP FI and the UN-backed Principles for Responsible Investment (PRI) found that environmental costs that are externalized to society equate to about one-third of the profits of the 3,000 largest publicly listed companies. These costs can potentially rebound onto portfolio companies or clients through inflated input prices, higher taxes, stricter insurance terms and the physical costs of environmental degradation and resource depletion that can affect the operating costs of portfolio companies.

The south of Brazil, for example, is experiencing the worst drought in 80 years as of February 2015. This severely affects São Paulo state that accounts for a third of Brazil’s economy and 40 per cent of its industrial production. The agricultural sector, including production of coffee and sugar (ethanol), has been seriously affected. The production of Arabica coffee beans for example fell 15% in 2014 (Guardian, 2015), which, given that Brazil is by far the biggest producer globally, pushed up the global price of the commodity by almost half. While rising population density and higher water consumption are among the reasons cited for water shortages, there is increasing evidence that continued deforestation in the Amazon leads to decreased rainfall (Verschot, 2015). As a result of the ongoing drought, Moody’s placed the credit rating of the Brazilian water firm Sabesp on Negative Outlook (Moody’s, 2014) and also Standard and Poor’s and Fitch have revised the outlook of the company’s credit rating.

An institutional investor may therefore be adversely affected in terms of financial performance if it owns shares or bonds of soft commodity producers, such as soy producing firms in the Amazon that are externalizing environmental costs in terms of deforestation impacts on the one hand, as well as securities of companies such as Sabesp or others that are adversely affected in areas dependent on the forests’ ability to regulate water cycles.

Some financial institutions are responding to this increased risk. Although it is difficult at present to quantify financially material natural capital risks, a number of banks and investors that are active through the NCD and other initiatives, are developing tools and methods to better understand and calculate such risks for different types of financial products (see Figure 1). In the absence of rigorous risk models for natural capital, a growing number of banks and investors are taking intermediary steps to voluntarily develop policies that require certain environmental or social practices and standards from clients and investee companies. In the context of forests and REDD+, such policies may be aimed at reducing access to financing for the most harmful activities by a corporation that lead to forest clearing or forest degradation. Policies may also stimulate clients to move towards more sustainable operations and supply chains for example through sustainable certification standards for soft commodities.
These efforts by financial institutions are a major step in the right direction. However, if a bank for example requires corporate clients to adhere to the Roundtable on Sustainable Palm Oil (RSPO) standard or another type of certification, this does not automatically lead to a (measurable) reduction in deforestation or forest degradation and,
through that, REDD+ results. Similarly, divesting from certain types of companies with high deforestation or other environmental impacts may protect or enhance the reputation of a financial institution or avoid other types of material risks, but it may not lead to a concrete environmental achievement if the company in question is able to obtain finance from another bank or investor that does not have strict environmental and/or social requirements. The effect may also be limited if the company in question is able to self-finance projects. Governments can play an important part by ensuring that certification standards or other types of relevant policies adopted by some financial institutions (see Box I) on a voluntary basis are mainstreamed throughout the industry by developing new laws or regulations requiring all financial institutions to adhere to the same standards. Mainstreaming environmental requirements throughout the financial industry may enhance the chance of achieving reductions or removals of forest carbon emissions. Some potential measures could include but are not limited to:

- Require financial institutions to develop environmental and social (E&S) policies that include provisions for clients or investee companies to reduce deforestation and forest degradation. Financial institutions should disclose how policies are monitored and implemented.
- Require credit risk departments within financial institutions to manage environmental and social risk assessments and to explain how these are applied.
- Require banks to disclosure the proportion of loans covered by forest-related policies in terms of value and number of transactions.
- Create ‘black lists’ of companies in breach of forest-related government regulations and prohibit loans in rural credit lines to companies included on these lists until they have demonstrated compliance.
- Require banks to disclose the number of transactions linked to soft commodities production and trade, as well as the number of transactions where E&S policies were breached.
- Create a national register of non-performing loans or below-average investment returns whose prevailing reasons are related to E&S risks.

**BOX I: Examples of some soft commodity policies developed by financial institutions**

**HSBC.** Under its Agricultural Commodities Policy, the bank requires growers, mills, refiners, and traders to achieve 100% certification (of either management units, or owned facilities) under RSPO by December 2018. In addition, HSBC requires customers operating in these segments of the palm oil value chain to meet certain requirements in the lead up to certification, such as developing, by December 2014, a time-bound plan to achieve 100% certification. HSBC also requires refiners and traders to develop a plan to ‘exclude palm oil from controversial sources, by providing traceability, within a set timeline’ by December 2014. By adopting a phased approach, HSBC allows customers time to complete the complex and costly process of achieving RSPO certification.

**Norwegian Government Pension Fund (Global).** The world’s largest sovereign wealth fund with total assets of about USD 882 billion,\(^{10}\) announced in 2013 that it was divesting from 23 holdings in palm oil companies following a review of its investment policies relating to deforestation. Such actions may increasingly become a factor through which financial institutions can differentiate themselves from others.

**Standard Chartered.** The bank has adopted a programme to implement and monitor compliance with its palm oil and agribusiness position statements within the organisation. The financial institution trains its employees on sustainable finance, and assigns direct responsibility for implementing and monitoring compliance with its policies to relationship managers. Standard Chartered states that “our relationship managers (or an independent technical specialist where necessary) will work closely with clients who do not currently meet these standards, to develop a time-bound action plan for compliance and to monitor the client’s progress against that plan.” Standard Chartered’s board-level Brand and Values Committee oversees sustainability management within the financial institution.
3. Status of bank and investor soft commodity policies

In order to evaluate the state of play of banks’ and investors’ understanding of and approach to deforestation risk from soft commodity value chains, the NCD developed the Soft Commodities Forest-risk Assessment (SCFA) tool. The output of the tool has at least two uses: (1) an assessment of the finance sector that can be used as a basis to develop policies and measures by countries to encourage or mandate certain (minimum) criteria for the finance industry to reduce the likelihood of deforestation and forest degradation; and (2) an assessment that can be used by banks and investors as a basis to develop or strengthen risk policies for palm oil, soy and beef.

In the SCFA framework, banks and investors were evaluated on three main criteria:

1) **Policy scope**
2) **Policy strength**
3) **Implementation, monitoring and reporting.**

More information about the SCFA tool, including a detailed description of each indicator, weights and results, is available in the UNEP report “Bank and Investor Risk Policies on Soft Commodities: Framework to Evaluate Deforestation and Forest Degradation in the Agricultural Value Chain” (UNEP, 2015). Overall results from the assessment, as well as snapshots of results per category are provided below.

**Overall results**

- On average, the 30 financial institutions that were evaluated scored 58 across all three categories out of maximum score 100, providing an initial benchmark against which financial institutions can evaluate themselves.
- 14 out of the 30 financial institutions evaluated encourage or require companies to avoid land use conversion in High Conservation Value (HCV) areas, and to respect the rights of local communities. However, legal requirements such as in Indonesia where plantation law (39/2014) means that companies forfeit land where HCV forest is preserved, highlights the challenging predicament that soft commodity producers can be in. Only one of the financial institutions require companies to avoid land clearance in High Carbon Stock (HCS) areas, while few require them to conduct impact assessments, or improve supply chain transparency.
- 37% of the financial institutions that were reviewed refer to legal compliance in their soft commodity risk policies. Some financial institutions include this requirement in agreements with clients rather than in public documents. Publicly disclosing requirements for compliance in financial transactions can provide an important signal to borrowers or investee companies, particularly in countries with weak regulatory enforcement.

- 13% of financial institutions that were reviewed have developed financial products and services aimed at promoting the production and trade of sustainable commodities. The International Finance Corporation (IFC), the Dutch development bank FMO, HSBC and Sumitomo Mitsui Trust Bank have developed products and services to support the transition to sustainable commodities production and consumption, often through preferential terms.

**Policy scope**

Half of the 30 financial institutions reviewed apply their policy to all of their financial activities, and 47% apply it to a subset of activities. BNP Paribas, Rabobank, Standard Chartered, Sumitomo, and Credit Suisse all clearly state that their soft commodity policy (or statement) applies to all of their financial activities. Rabobank states that its position statements on palm oil and soy apply to all commercial banking services and Credit Suisse states that its Sector Policies and Guidelines apply to “all business activities relating directly to companies operating in those sectors, regardless of whether the company is in a direct contractual relationship with Credit Suisse or the object or target of a Credit Suisse client.” Six financial institutions evaluated explicitly state that their policies cover advisory services.

**Policy strength**

Of the 13 financial institutions that require or encourage certification, the majority of which are banks, five explicitly require companies to achieve or commit to a time-bound plan to achieve certification. Setting time-bound action plans to enable companies to address challenges in shifting to sustainable practices, while ensuring progress is monitored. Credit Suisse, for example, explicitly requires that its clients achieve certification under the RSPO or commit to a time-bound plan to achieve certification. HSBC, Rabobank and UBS disclose similar requirements. The remaining financial institutions encourage, but do not require, certification. For example, among the finan-
cial institutions operating in UN-REDD Programme Partner
countries, BNI, an Indonesian bank, recommends that palm oil companies, which have applied for or secured loans
from the organisation, obtain ISPO or RSPO certification.

Implementation, Monitoring and Reporting
A number of financial institutions use quantitative metrics to demonstrate their progress in implementing their policies. For example, BNP Paribas disclosed that in 2012, more than 1,500 employees were trained on analysing transactions in sensitive sectors, including palm oil. BNP Paribas also disclosed details on its engagement efforts with palm oil companies, stating that since March 2011, it has maintained dialogue with eight palm oil companies in Southeast Asia. HSBC disclosed the percentage of its customers that fall under each of its four sustainability risk classifications: leader, compliant, near compliant, and non-compliant. BNI, an Indonesian bank, discloses the number of its clients that have achieved Indonesian Sustainable Palm Oil (ISPO) and Roundtable on Sustainable Palm Oil (RSPO) certification and the total value of loans made to these clients. How some other financial institutions in UN-REDD partner countries apply social and environmental risk standards is briefly highlighted in Box II.

| BOX II: Application environmental and social risk frameworks by financial institutions in some UN-REDD countries. |
| National or regional banks operating in UN-REDD Programme partner countries demonstrate environmental and social risk frameworks of varying levels of sophistication and, in some cases, disclosure is limited. Ecobank, a Pan-African bank demonstrates an understanding of sustainability risks in the summary of its Environmental and Social Policy and Procedure Manual (ESPPM). However, the full manual is not publicly available. Banorte, a large private bank in Mexico, has implemented a Social and Environmental Management System (SEMS) for Corporate Banking projects valued at more than US$1 million. Sudameris, which operates as a commercial bank in Paraguay, has an environmental and social questionnaire that clients are expected to complete, but a more formal, detailed policy is not disclosed. In December 2013, the African Development Bank (AfDB) adopted its Integrated Safeguards System (ISS), which is a tool used to identify and assess the environmental and social risks and impacts associated with projects that the bank finances. Under the ISS, the bank has adopted Operational Safeguards (OSs), which outline environmental and social requirements for clients or investees, including those involved in the production of agricultural commodities. |

4. Can soft commodity policies by banks and investors support UN-REDD countries to achieve REDD+ results?

Bank and investor soft commodity risk policies can potentially contribute to reduced deforestation and forest degradation levels under certain conditions. The effectiveness depends for example on the need for supply chain actors to obtain credit or seek equity investments from development banks or commercial financial institutions as opposed from the informal financial sector. Furthermore, it is important to develop quantitative methods to evaluate and measure the positive impacts of risk policy implementation by financial institutions. In addition, policymakers can play an important role in addressing the need for financial institutions to consistently and systematically apply soft commodity policies across the board by creating a level playing field so that banks that implement soft commodity policies are not ‘penalized’ by clients obtaining finance from competitors that do not apply forest-related criteria in their loans or investments, thereby avoiding leakage and having higher chances of achieving REDD+ results. The following steps can help countries that seek ways to reduce deforestation and forest degradation to understand the degree to which soft commodity risk policies can be a useful tool to help generate REDD+ results.

**Step 1. Understand the drivers of deforestation and forest degradation**

In order to effectively use finance and investment as a lever to help produce REDD+ results, it is important to understand how business-as-usual agricultural commodity activities are linked to greenhouse gas emissions from forests. These will vary across different geographies and scales. It is also necessary to understand i) the alternative agricultural practices that are consistent with a lower forest footprint; and ii) the financial characteristics of these activities in terms of types and scale of finance required, sources of finance, credit-worthiness of the potential customer, return, risk and investment time horizon.
Step 2: Map the national financial landscape

The structure, capacity and practices of the national financial sector are important to understand. Are financial markets able to provide (private) finance if a set of more sustainable agricultural practices have been identified that could contribute to REDD+? For example, financial institutions might offer insufficiently long loan tenors for an activity such as rehabilitating palm oil plots, or a preference may be observed for lending to larger firms and a reliance on collateralized lending when smallholders without access to collateral may be the key REDD+ actors who require capital.

Step 3: The nexus between supply of capital and demand for capital

Once the demand for REDD+ related capital has been compared to the relevant availability or supply of capital, the gap analysis will reveal whether banks and investment firms are able to finance the transition to more sustainable methods of agricultural commodity production. This is possible if they are the dominant providers or supplies of capital. It should be noted that it is not a given that financial institutions are involved in financing land-use activities. This could be due to a variety of factors, such as large corporations using cash reserves on their balance sheets, or due to producers who are involved in value chain financing, where credit is provided to users of land by non-bank actors such as input suppliers or traders. In these instances, criteria by financial institutions for producing soft commodities sustainably would be very difficult to implement directly.

Step 4: Understand the effectiveness of risk policies for soft commodities to tackle the drivers of deforestation

At present it is not possible to say if and how much the use of soft commodity risk policies leads to a reduction in deforestation and forest degradation compared to a business-as-usual scenario without policies. This is an area for further analysis and development. It is also clear from the ‘Bank and Investor Risk Policies on Soft Commodities’ report by UNEP that many financial institutions are dedicating insufficient resources to assessing the degree to which their portfolios are covered by risk policies and the extent of the causal relationships between soft commodity risk policies and actual deforestation and forest degradation. This is also an area for further development and analysis. This shows that in order to create a level-playing field and increase the likelihood of soft commodity policies that lead to verified reductions or removals in deforestation and forest degradation, governments may benefit from actively stimulating this through a variety of measures or even mandating it through legislation. This can include outlining expectations of financial institutions in terms of respecting laws, requiring legal reforms, regulations and standards as well as conducting due diligence ensuring that lending and investment operations do not end up financing illegal or unsustainable activities. Box III shows an example whereby the Brazilian Government, through the Central Bank, imposed a restriction to financial institutions to refrain from providing credit to clients that do not comply with environmental laws.

BOX III: Evidence from Central Bank regulation in Brazil on deforestation

Some evidence from Brazil shows that the development and enforcement of conservation policies contributed to approximately half of the deforestation that was avoided in the Amazon in the 2005 through 2009 period. The deforestation rate in the Brazilian Amazon decreased sharply in the second half of the 2000s, falling from a peak of 27,000 km² per year in 2004 to 5,000 km² per year in 2011. One of these policies, by the Brazilian Central Bank, placed a condition on rural credit in the Brazilian Amazon Biome. To access credit borrowers had to present proof of compliance with environmental regulation. CPI estimates that approximately US$ 1.4 billion in rural credit was not contracted in the 2008 through 2011 period due to restrictions imposed by Resolution 3,545. This reduction in credit prevented over 2,700 km² of forest area from being cleared, which represents a 15% decrease in deforestation during that period (Assunção et al., 2013).

In addition to specific country regulation, Box IV highlights how governments can also use the Cancun Safeguards, which can be regarded as an important piece of internationally-agreed environmental regulation on forests in the context of REDD+, to advocate for banks, investors and other institutions that are in the process of developing or updating risk policies to ensure these are aligned with the Cancun Safeguards to the extent possible and relevant.
BOX IV: Link with the Cancun Safeguards

At UNFCCC COP 16 in Cancun, Mexico, in 2010, Parties agreed to promote and support a set of ‘Cancun safeguards’ when undertaking REDD+ activities. Countries are requested to provide information on how safeguards are being addressed and respected through a Safeguards Information System (SIS), one of the four components identified in decision 1/CP.16, also agreed in Cancun, and on which the Warsaw Framework provided further guidance. The safeguards aim to ensure social and environmental risks are minimized and benefits enhanced, covering a range of issues:

- Consistency with existing national forestry objectives and international agreements (safeguard (a))
- Transparent, effective forest governance and sovereignty (safeguard (b))
- Respect for knowledge and rights of indigenous peoples and members of local communities (safeguard (c))
- Full and effective participation of stakeholders (safeguard (d))
- Conservation of natural forest, biological diversity and enhancement of benefits (safeguard (e))
- Risk of reversals (safeguard (f))
- Displacement of emissions (safeguard (g))

The Cancun safeguards differ from bank and investor risk policies in a number of ways. Firstly, their formulation is more general than that of most bank and investor risk policies, as it is seeking to address an undefined portfolio of governmental actions rather than a well-defined set of investment types. Second, while countries are requested to “promote and support” the Cancun safeguards there is no clear obligation of result from that provision. However, the communication of information on how the safeguards are “addressed and respected” is a pre-condition to receiving result-based payments. Countries therefore have flexibility in deciding the way in which they apply the safeguards as long as they provide information on them. The emphasis of not only risks, but also benefits is a further difference: safeguard (e) for instance states that REDD+ implementation should be used to enhance “other social and environmental benefits” beyond sole emission reductions.

Despite these differences, governments seeking to influence bank and investor risk policies as a means to engage the financial sector in REDD+ efforts could benefit from a broader reflection on how these policies can contribute not only to REDD+ results in terms of emissions but also to the promotion of the Cancun safeguards. The content of the Cancun safeguards could inform the development of risk policies aimed at reducing the negative impact of investments on forests, but also recommendations for best practice on broader social and environmental requirements. In turn, for investors, alignment with the Cancun safeguards could work towards reducing reputational risk especially vis-à-vis governments of REDD+ countries that they are investing in.

Furthermore, governments of REDD+ countries could seek ways to collaborate with the financial sector on integrating the monitoring and reporting of some aspects of their risk policies within the national level communication of information to the UNFCCC Secretariat on how they address and respect Cancun safeguards.
5. Conclusion

Finance can be a possible lever to encourage soft commodity producers to limit impacts on forest ecosystems and thereby help achieve REDD+ results, especially if this is mandated through government regulation. The latter may be necessary to ensure a level playing field is created, whereby soft commodity producers will find it difficult to borrow money from banks, or otherwise obtain capital, without the same environmental (and social) conditions attached to it. The example from Brazil where a policy from the Central Bank required borrowers to present proof of compliance with environmental regulation in order to obtain rural credit in the Brazilian Amazon biome highlights that the financial sector could possibly be used as a means of enforcement. Furthermore, 37% of the 30 financial institutions that were analysed for this project refer to legal compliance in their soft commodity risk policies.

Another potential lever is when companies that produce beef, soy, palm oil and other commodities in developing countries depend on capital from (franchises of) internationally operating banks with relatively strict soft commodity risk policies. In this case, these soft commodity producers may increasingly be required by their financiers to reduce their impacts on (primary) forests resulting from their activities. A benchmark of 30 financial institutions revealed that 14 institutions encourage or require companies to avoid land use conversion in High Conservation Value (HCV) areas, and to respect the rights of local communities. However, in countries where producers of soft commodities have other options to obtain capital in a relatively easy way, including from domestic finance institutions with little or no environmental risk requirements or through their families or the informal market, the expected positive effect in terms of a reduction in deforestation and forest degradation may be limited.

These findings show that the financial sector could be a potential lever to achieve REDD+ results in some UN-REDD countries. This can be the case when soft commodity producers are among the main agents that drive deforestation or forest degradation in a country and whereby the majority of them depend on acquiring debt or equity from banks and investment firms that either already have soft commodity risk policies in place or which could be stimulated or required to do so through government regulation. The four steps identified in this brief provide a starting point for countries to assess if the financial sector can be a potential lever in their case.
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Endnotes

1. The ‘Cancun Safeguards’ were agreed at the UNFCCC COP 16 in Cancun, Mexico, in 2010 with the aim to ensure that social and environmental risks are minimized and benefits enhanced when implementing REDD+. More information is provided in Box IV.

2. FAO estimates that greenhouse gas emissions from agriculture were 5.3 Gt CO2-eq per year in 2010 with another 4.0-5.0 Gt CO2-eq per year from the forestry and other land use activities such deforestation, biomass fires and peat degradation (FAOSTAT, 2013).

3. Soft commodities generally refer to commodities that are grown, rather than those extracted such as metals, minerals and fossil fuels.

4. The NCD has been signed by more than 40 CEOs of financial institutions and is supported by more than 30 non-financial organisations. The initiative is managed by UNEP FI and Global Canopy Programme.

5. The framework builds on previous work by WWF, including key performance indicators used in a Bank Policy Benchmarking Tool developed in 2012 to anonymously assess banks’ environmental and social policies for high-risk sectors.

6. There is not one uniform definition of corporate social responsibility (CSR), but one way to define it is ‘a company’s sense of responsibility towards the community and environment (both ecological and social) in which it operates’ (Business Dictionary). Depending on the definition that one uses for CSR it can be criticised for being disconnected from a company’s main activities. In order to deal with ecosystem degradation, including deforestation, a better model might be to focus on how impacts and dependencies by a company on the natural environment, and the resulting exposure to risks and opportunities, can affect its operations in a financially material way. Linking ecosystem degradation directly to a company’s business operations brings greater clarity to the fact that it is in the company’s self-interest to deal with impacts and dependencies on a continuous basis through operations and supply chains.


9. In the context of this report natural capital is defined as ‘the stock of ecosystems that yields a renewable flow of goods and services’ (such as timber, other forest products, water regulation, carbon sequestration, etc). This definition of natural capital excludes non-renewable natural resources such as metals, minerals and fossil fuels (Mulder et al., 2013)


11. Although preferential terms by large or universal financial institutions are an interesting financial incentive for borrowers to produce more sustainably, the cost of capital provided by domestic financial institutions or other sources of finance (often without specific environmental and social conditions tied to loans) may still be cheaper and therefore more financially attractive.

12. It is important to note that it is typical of national and regional banks to only make information available in the local language, which was a constraint for this study.

13. It is important to note that not all finance is provided by the formal banking sector. A study on Riau in Indonesia showed that for independent smallholders which are responsible for 60% of forest clearing, 90% of their finance needs are self-financed or provided through family networks.