THE ROLE OF FINANCIAL INSTITUTIONS IN REDD+

UN-REDD/FCPF Regional Knowledge Exchange on REDD+ Financing
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ABOUT UNEP FINANCE INITIATIVE

- UNEP FI is a partnership between UNEP and the global financial sector created in 1992 at the Earth Summit with a mission to promote sustainable finance.
- Over 230 financial institutions, including private and development banks, insurers and fund managers, work with UNEP to understand today's environmental challenges, why they matter to finance, and how to actively address them.
- Objective: Financial institutions finance sustainable development
- Key implementing partner for the UN-REDD Programme on private sector engagement – examining economics, enabling conditions and access to finance

NORWAY’S GOVERNMENT PENSION FUND

- Norway’s Government Pension Fund Global – owns 1.3% of global listed equities
- 2015 climate change strategy > companies with impact on forests should have a strategy for reducing and avoiding deforestation > adoption of relevant international standards (i.e. FSC)
- 2015 – divested from 11 companies in their portfolio due to involvement in deforestation and environmental damage (oil palm, pulp and paper, mining) > since 2012 the Fund has divested from 50 companies because of deforestation concerns

Cautious about the impact of divestment

ABOUT UNEP FINANCE INITIATIVE

ABN·AMRO

UniCredit

SOCIETE GENERALE GROUP

Bank of America

AVIVA

CREDIT SUISSE

BNP PARIBAS FORTIS

RBS
The Royal Bank of Scotland Group

Deutsche Bank

Itaú

citigroup

Allianz

HSBC

NEDBANK

RBC

Munich RE

BMO Financial Group

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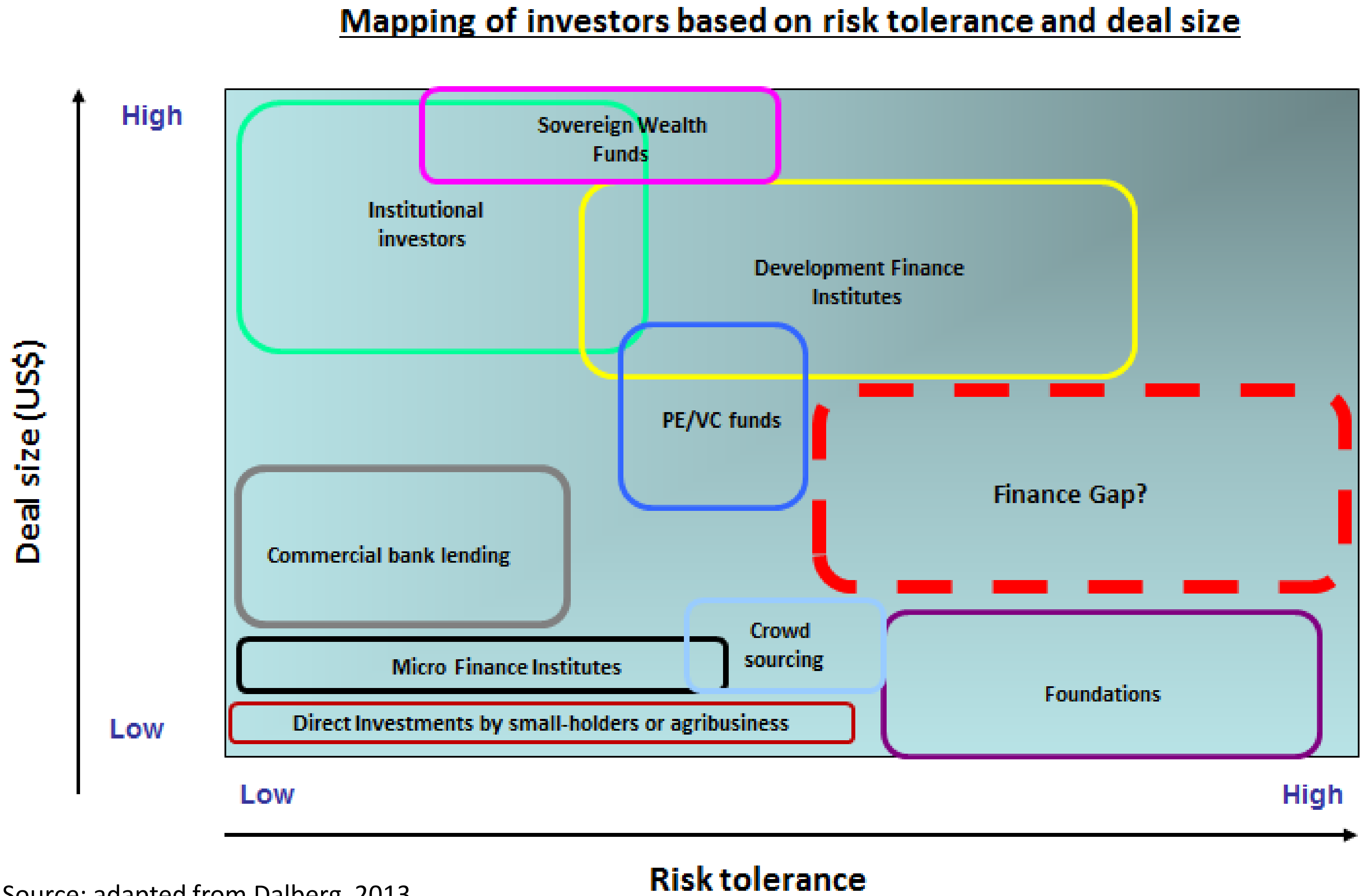
WHO ARE THE RELEVANT FINANCIAL INSTITUTIONS?

Numerous and varied actors in the financial sector are dealing with a broad array of financial transactions with different risk profiles.



Source: adapted from Dalberg, 2013

WHO ARE THE RELEVANT FINANCIAL INSTITUTIONS?

Within financial institutions – key role of banks and institutional investors/asset managers and how they can shape the behavior of their clients and of the companies they own and invest in.

- **Banks as:**
  - Providers of credit/loans
  - Underwriters of bond and stock offerings
  - Research providers
- **Investors as:**
  - Equity investors/owners of company stock – can be active (such as putting forward shareholder resolutions) or passive
  - Holders of corporate bonds/debt

The role of banks and investors is less relevant in markets where informal sources of finance play a predominant role; or where companies mainly use their own money to finance their activities.

WHY ARE FINANCIAL INSTITUTIONS RELEVANT TO REDD+?

FIs > financing activities associated to drivers of deforestation > also providing finance for land-use activities compatible with REDD+ (zero deforestation commodity production; SFM; commercial reforestation; productive restoration).

Key contribution of private finance for forestry and SFM > 1.7 billion in 2011 (PROFOR, 2014)

FIs > enabling role in land-use change and the functioning of commodity supply chains.

Agriculture requires significant and sustained investments (smallholders financing gap alone > US$ 450 billion) – huge private finance and investment opportunity? – But:

- 'Green' investments are subject to:
  - Larger upfront costs with longer payback periods (at least 3-5 years for positive return)
  - Not all positive benefits that can be monetized

WHY ARE FINANCIAL INSTITUTIONS RELEVANT TO REDD+?

The enabling role of finance along supply chains – FIs involved at different points of the chain in different capacities

Supply Chain

Producers / Aggregators → Processors → International Traders → Markets

Enabling Role of Finance

Direct financing
- Working capital /Lending
- SME lending
- Capital raising

Trade finance
- Letters of credit
- Payment processing
- Country risk mitigation
- Loans
- Capital raising

Corporate finance
- General lending/working capital
- Term finance
- Capital raising

Source: Adapted from Banking Environment Initiative, 2015

FINANCIAL INSTITUTIONS IN REDD+

Understanding their motivations – FIs can be motivated to engage in REDD+ processes mainly for three reasons:

- Risks – i.e. risks affecting the performance of the companies they provide credit to or that they own and invest in
- Opportunities – i.e. new business opportunities/markets for sustainable/certified products
- Corporate Social Responsibility – i.e. purchasers of VERs in the voluntary markets

FINANCIAL INSTITUTIONS IN REDD+

Sustainability issues through two different lenses – risks and opportunities . There is growing understanding of the impacts of deforestation on a company's performance through:

Operational risks

- 51% of the 171 companies responding to CDP (a corporate disclosure initiative backed by 300 investors) recognized that deforestation in the sourcing of commodities could pose an operational risk for their supply chains

Legislative risks

- Singapore – Transboundary Haze Pollution Act
- Lacey Act, FLEGT
- France's Biodiversity Bill – Oil Palm Tax

Reputational risks

- Social license to operate
- Increased focus of NGOs on banks' and investors' deforestation footprint

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EMERGING TRENDS IN THE SECTOR - OPPORTUNITIES

Growing recognition of the importance of deforestation risks and the opportunities to address them has started to shape the finance landscape.

- Increased adoption of zero-deforestation policies by banks, investors, and insurance companies
- Pressure from investors on companies to disclose relevant sustainability information including deforestation (CDP, Forest 500)
- Industry networks demonstrating leadership in integrating deforestation and other natural capital considerations into their decisions:
  - Soft Commodities Compact
  - Natural Capital Declaration
  - Principles for responsible Investment (PRI) – Investor working group on sustainable palm oil

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EMERGING TRENDS IN THE SECTOR - OPPORTUNITIES

Development of specialized products (Sustainable Letter of Credit); and a few banks offering differential rates to clients adopting Good Agricultural Practices

Creation of national sustainable banking networks and green investment guidelines

- Roundtable of Sustainable Finance Paraguay – examining how to reduce deforestation from the soy supply chain
- Green investment guidelines – China, Indonesia

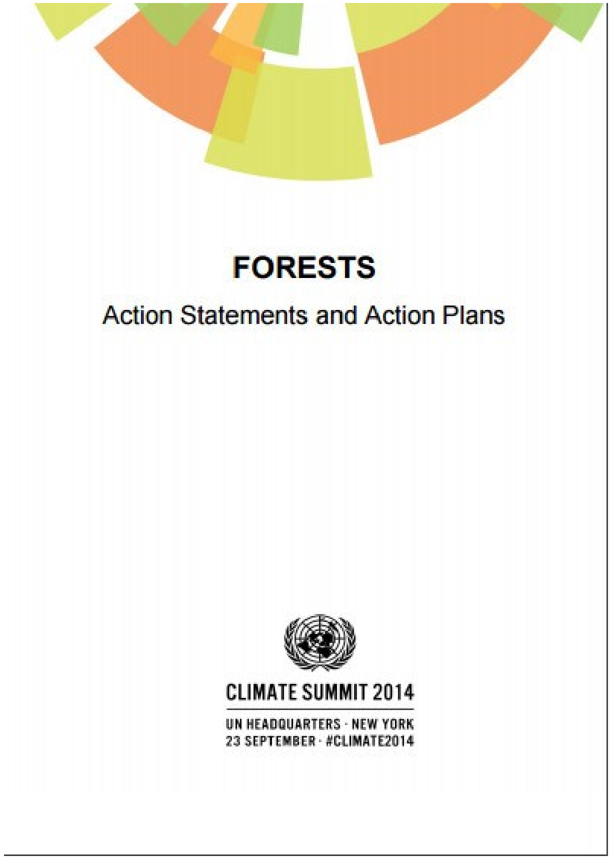
Yet – most action is still voluntary and not mainstreamed

THE NEW YORK DECLARATION ON FORESTS – ACTION AGENDA

FIs > demonstrating leadership in removing deforestation from commodity supply chains and conserving forests

NY Declaration Commitments:

- Develop financial instruments to support sustainable commodity production and trade > deforestation-free banking operations and standards
- Invest and purchase commodities from countries and jurisdictions with ambitious plans to halt deforestation
- Evaluate and disclose the deforestation footprint of their sectors and organizations > greater transparency and understanding
- Support and promote sound forest governance and strong forest policies



BRAZIL'S RESOLUTION 3,545

Impact on deforestation of stricter environmental requirements to access rural credit – conditional credit policy

- In Brazil – subsidized official rural credit is an important source of finance for producers (30% of finance needed in a harvest year come from rural credit)
- Brazilian Central Bank Resolution 3,545 (2008) – requires that borrowers of official rural credit in the Amazon Biome present proof of compliance with environmental regulations
- About US$1.4 billion in rural credit was not contracted in the 2008-2011 period > preventing 2,700 km^2 of forests from being cleared (15% decrease in deforestation)
- Main impact where cattle ranching is the main economic activity > impact was limited in crop producing areas

From CPI, 2013

ENGAGING WITH THE FINANCIAL SECTOR

- Understanding the drivers of deforestation and forest degradation and whether the national financial sector is enabling those activities
- Mapping the local financial sector and examining whether it can play a role in financing the activities being promoted in the REDD+ strategy (size, interest rate and repayment period) and what are the bottlenecks preventing finance from reaching those activities