



UNEP Finance Initiative
Innovative financing for sustainability



REDD+ Safeguards: A Private Sector Perspective

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UNEP Finance Initiative is a 20 year old Joint Venture between UNEP and over 220 Financial Institutions

- UNEP Finance Initiative: 220 Financial Institutions (FIs) are members consisting of:
 - Banks
 - Insurers
 - Investors

- UNEP FI has a number of crosscutting work-streams looking into issues such as
 - Climate Change, Water & Biodiversity, Energy Efficiency and REDD+ and Sustainable Land Use

- New UNEP FI logo: ‘Changing Finance, Financing Change’
 - Addresses dual challenges of a) reforming how financial institutions operate and, b) financing the transition to a green economy

- Financial Institutions generally view sustainability through two lenses:
 - Opportunities
 - Risks



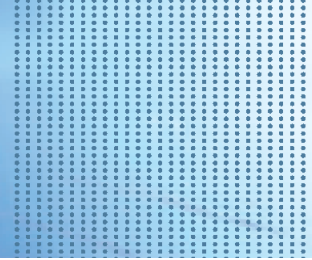
The ‘Private Sector’ is a very broad term: in the context of REDD+, we can think of two main private sector groups

Explicit Producers of Emissions Reductions

- Arguably the ‘traditional’ view of REDD+- production of Emission Reductions
- Private sector actors might include
 - Providers of up-front finance
 - Implementers, project development
 - Providers of technical advice and services
 - Buyers of carbon or other associated products
- Volume of carbon credits is one indicator of size. 26 MtCO₂ transacted in the voluntary market in 2011 with a value of USD 237 million

Supply chains of ‘forest-risk’ commodities

- Agriculture accounts for around 80% of global forest loss
- Drivers vary considerably but the main ‘forest-loss’ commodities are:
 - Palm oil, soy, beef
- Supply chains include:
 - Input providers, farmers, processors, traders, retailers and consumers
- Global soft commodity markets are very large- estimated producer value of these goods in tropical countries. Annual producer values*:
 - Palm USD 31 billion, Soy USD 47 billion, Beef USD 14 billion



Supply chains of ‘forest-risk’ commodities vary considerably but financial institutions are generally involved at different points along the chain in different capacities

Soy supply chain example



Key trends in the soy industry

- Highly consolidated into four main companies
- Most companies are vertically integrated and thus control other segments of the supply chain- traders often provide seed and credit to growers for example
- Geographical differences:
 - Private firms located in Asia and Latin America
 - Public firms located in the US and America

Potential entry points for FIs

- Banks as:
 - Providers of loans
 - Underwriters of bond and stock offerings
 - Research providers
- Investors as:
 - Equity investors- can be active (such as putting forward shareholder resolutions) or passive
 - Holders of corporate bonds/debt
- Insurers as:
 - Providers of commercial, market and political risk cover



Finance is a constant assessment of risk and opportunity and therefore safeguards matter irrespective of the pace and outcome of climate change negotiations

Risks

- Strong safeguards are an enabler although the language might be different
- Reputational risk
 - Nestle/Greenpeace, social license to operate
- Poor environmental & social risk management can lead to operating risk:
 - Production stoppages, fines, protests, license withdrawals, exclusion lists
- Legal risks
 - Legal liability for investors can remain beyond the investment term
- Stranded assets
 - Investments that become obsolete due to changes in technology, legislation or consumer preference

Opportunities

- Sustainability can be a competitive advantage
- Use of safeguards can lead to cheaper borrowing and financial outperformance
- Certification- often no price premium but:
 - Means to cheaper funding, longer-term contracts, access to more markets (FLEGT/Lacey Act) and is generally acceptable to more international investors
- New business opportunities/markets (‘Socially Responsible Investment’ market 13.6 trillion in 2012)
- Increasingly a condition to access public or private sector funds



A better understanding of these risks and opportunities has changed the landscape of finance in recent years

Key Themes

- Shift in the world's economic centre of gravity to developing world where sustainability-driven risks and opportunities are greatest
- Increased stakeholder pressure around certain issues, industries and clients
- Growing acceptance that traditional financial analysis does not paint a true picture of a company- up to 75% of value can come from 'intangibles' (PwC 2005). Poor understanding of systemic risk
- Initiatives often business-led, not waiting for Government to act (perhaps pushed by NGOs?)

Recent Financial Sector Trends

- Emergence of financial Principles & Criteria
 - Banking –Equator; Investment- Principles for Responsible Investment (PRI) etc
- Increased pressure from investors and regulators to disclose
 - Forest Footprint & Carbon Disclosure Projects
- Dedicated new players entering the finance space to measure and audit
 - Trucost, RiskMetrics, Bloomberg
- Development of specialist in-house capacity

But Challenges Remain

- Signing Principles and Declarations doesn't mean immediate change
- Structural issues need to be addressed such as 'short-termism' and incentive mechanisms
- Concerns over 'fiduciary duty'
- Confusing landscape- which? for what? What language, metrics and expectations?
- Misguided perceptions
 - E.g. Sustainability 'arbitrary and subjective' vs. 'precision' of interest rates, or 5 year projections



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Case Studies



Banking case study: Rabobank's innovative lending policies in Brazil incentivise customers to adopt more sustainable agricultural practices

- Rabobank International Brazil S.A. is one of the main banks operating in the Brazilian food and agribusiness sectors
- Has a substantial share of the SME market since focussing on rural finance in 2005
- Rabobank's lending policies are guided by Social & Environmental policies at two levels:
 - Exclusion criteria- minimum social and environmental policies, laws and regulations
 - No illegal deforestation, compliance with protected areas etc
 - Eligibility criteria and best practise
 - Risk management system grades borrowers against bank established criteria
 - Annual analysis encourages long run adoption of best practise
- Rabobank also offer 'sustainability field days' where clients and non-clients are invited to spend a day on a model farm
- Basic risk management: a client who complies with the environmental law decreases Rabobank's risks- banks can be fined for their customer's legal infringements





An increasing body of work is looking at the cost benefit analysis of safeguards. WWF look at the financial impacts of implementing the Principles & Criteria of RSPO



Primary Benefits

- Reduction in social conflicts
- Operational improvements through documentation and better management practices
- Improved staff morale and reduced labour turnover
- Increased revenues and access to markets and capital
- Improved yields for smallholders

Primary Costs

- Identification and management of HCV areas
- The audit and certification process
- Engaging smallholders
- Segregation costs

Conclusions

- Each category of benefit could potentially outweigh the RSPO implementation costs
- This often occurs through unexpected or indirect channels
- More evidence required- no 'one size fits all' solution



Investor case study: CalPERS are a long-term US pension fund who appreciate the impact of environmental, alongside social and governance, issues on LT returns

Towards Sustainable Investment TAKING RESPONSIBILITY



CalPERS

- CalPERS (pension fund for state employees) manage USD 232 billion for 1.6 million members invested in stocks, bonds, cash and alternative investments
- They have long term liabilities- the graduates of today expect a pension in 40 years time
- First US pension fund to produce a standalone sustainability report
- Realistic approach- sustainability issues are complex and can be global- no single actor has the power to solve them
- Acceptance that sustainability is a journey involving different issues across many different asset classes
- There are many challenges involving a range of different international standards, conventions, principles and criteria that vary over time and space
- The 'CalPERS effect' indicates that interventions driven by ESG delivers positive impacts. 5 year performance of companies on the 'Focus List'

The CalPERS effect





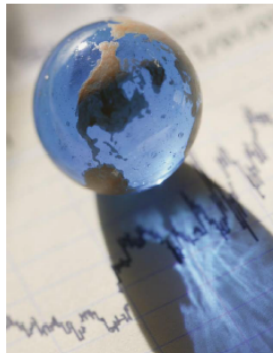
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Empirical evidence supporting the CalPERS effect- high scoring companies on ESG factors access cheaper funding and generate superior risk-adjusted returns

Sustainable Investing

Establishing Long-Term Value
and Performance

June 2012



Green paper available online: <http://www.dbca.com/research>



Carbon Counter widget available for download at:
www.Know-The-Number.com

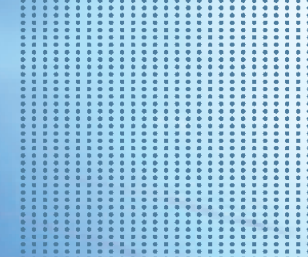
DB Climate Change Advisors 
Deutsche Bank Group

“...we looked at more than 100 academic studies of sustainable investing around the world.”

“There is **overwhelming academic evidence**, within all (100%) of the studies that we have found, showing that firms with high ratings for Corporate Social Responsibility (CSR) and Environmental, Social and Governance (ESG) have a **lower cost of capital** in terms of debt (loans and bonds) and equity. In effect they are a **lower risk** in a fundamental. In some ways this is the most impressive result as it **puts the issue of Sustainability into the office of the Chief Financial Officer.**”

“There is **compelling academic evidence** that **strong CSR and ESG factors** are correlated with **corporate financial outperformance** 100% of the studies showed firms with high ratings for CSR exhibit financial outperformance, while 89% of the studies we found show firms with high ratings for ESG exhibit market-based outperformance”

Source: DBCCA, June 2012. www.dbadvisors.com/content/_media/Sustainable_Investing_2012.pdf



There is considerable overlap between the safeguards in the Cancun Agreement and the CalPERS Investment Policy

Cancun Agreement

CalPERS

Consistency with objectives of national forest programme, and relevant international conventions and agreements



Transparent and effective national forest governance structures



Respect for the knowledge and rights of indigenous peoples and members of local communities



The full and effective participation of relevant stakeholders, in particular IP and local communities



Conservation of natural forests and biological diversity and enhancement of other social and environmental benefits

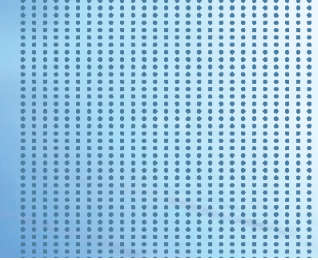


Actions to address the risk of reversal



Actions to reduce the displacement of emissions





Development of investment tools: screening tools are being developed which rely to some extent on safeguards to determine how capital is allocated

Sustainable Forest Finance Toolkit

This Toolkit has been developed jointly by PricewaterhouseCoopers Business Council for Sustainable Development (WBCSD). It is a resource designed to help financial institutions support the management of resources through sustainable and legal timber production and for carbon and other ecosystem services.

The Toolkit incorporates detailed input from some of the world's leading banks, forestry companies, certification bodies and NGOs.

Included within are practical resources to manage risks and opportunities at policy and individual client level, and further contact points for more information.

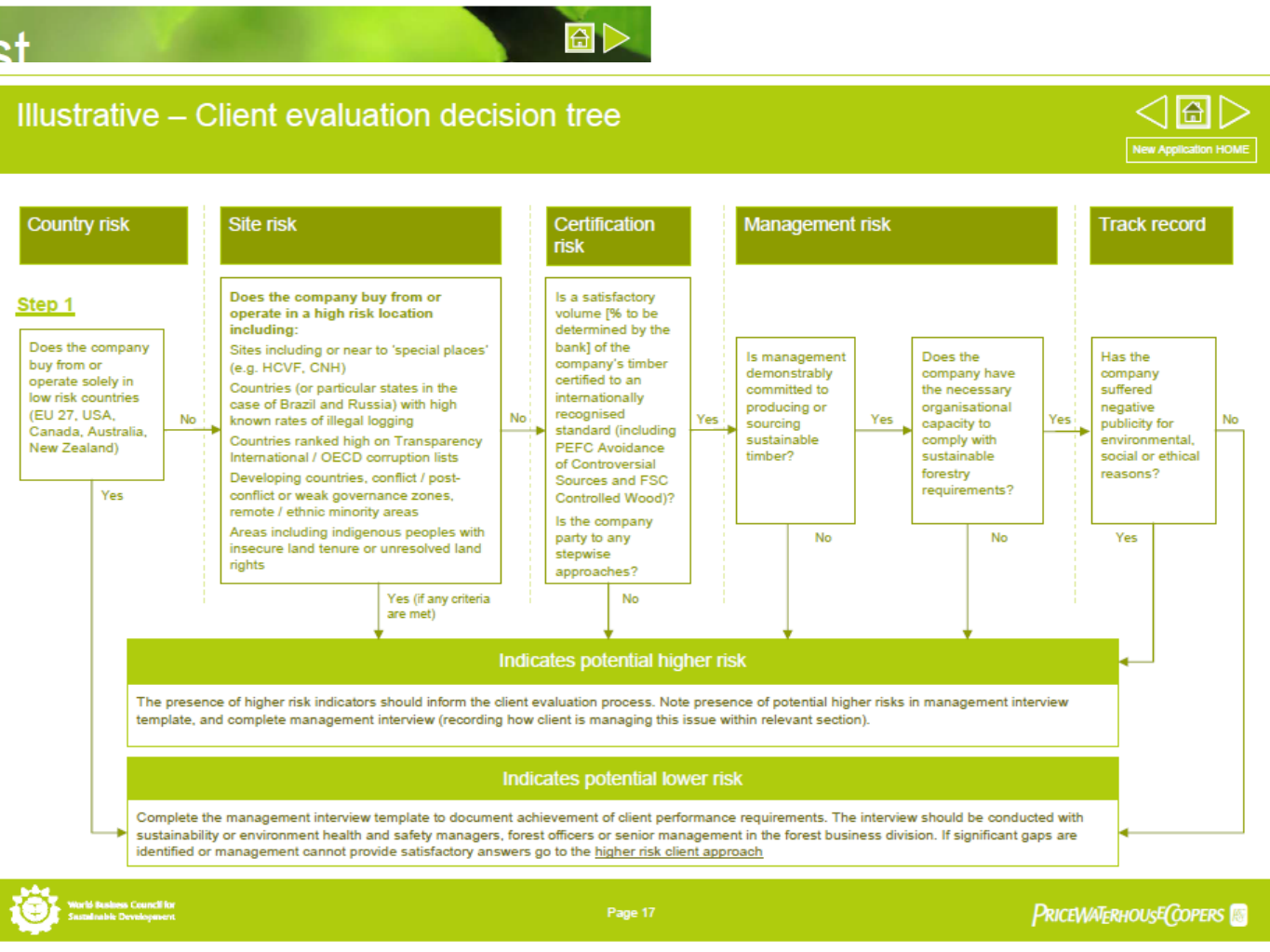
- Background > [Guidance for using the toolkit](#)
- > [Document map](#)
- > [Background information](#)

1

New Application

2

Portfolio Management





Conclusion: Safeguards are increasingly important to the private sector/finance community and this trend seems unlikely to reverse

- ✓ The safeguards in the Cancun Agreement are very much aligned with what the leaders in the finance community are demanding
 - ✓ Although definitions and scale vary and different language is used, there is a common goal of striving to minimise risks and maximise benefits
 - ✓ Both approaches share common elements e.g. Policies, Laws and Regulations and variations on 'information systems'
 - ✓ Both arenas of work are in their relative infancy
-
- ➡ Environmental and social issues are not a traditional core competency of financial institutions. We need to simplify, clarify and standardise to ensure broader uptake
 - ➡ The best-in-class are making progress but a key challenge will be closing the gap between the industry leaders and the rest
 - ➡ More empirical evidence is needed- what does this mean for the bottom line?



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Questions?