UNIVERSITY OF CAMBRIDGE
INSTITUTE FOR SUSTAINABILITY LEADERSHIP

# Banking Beyond Deforestation

## How the banking industry can help halt and reverse deforestation

## The University of Cambridge Institute for Sustainability Leadership

The University of Cambridge Institute for Sustainability Leadership (CISL) is a globally influential Institute developing leadership and solutions for a sustainable economy. We believe the economy can be 'rewired', through focused collaboration between business, government and finance institutions, to deliver positive outcomes for people and environment. CISL convenes the Banking Environment Initiative (BEI), created in 2010 by the Chief Executives of some of the world's largest banks. The BEI's mission is to lead the banking industry in collectively directing capital towards environmentally and socially sustainable economic development.

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# 1. Executive Summary

More than 50 per cent of global Gross Domestic Product relies on the services nature provides.[1] Yet every six seconds, a football pitch of 'primary forest'[i] is lost,[2] threatening the provision of freshwater, healthy soils and climate stability.[ii] Halting and reversing deforestation remains an issue that needs focused action by organisations along the value chain, including banks.

Soft commodities such as palm oil, soy, beef and timber products are responsible for the majority of deforestation caused by commercial agriculture.[3] Banks provide a variety of finance and financial services to enterprises along these soft commodity supply chains, from term loans, trade finance and revolving credit facilities, to bond and fund structuring, capital raising, project finance and more.

The need to better understand deforestation risk and financial links along supply chains led to the foundation of the 'Soft Commodities' Compact in 2014. The 'Compact' was a company-led alliance between the University of Cambridge Institute for Sustainability Leadership (CISL) convened Banking Environment Initiative (BEI) and the Consumer Goods Forum (CGF), with the mission of helping achieve zero net deforestation by 2020.

Deforestation has not yet been halted. This paper sets out to accelerate action on deforestation by sharing lessons learnt from the Compact, clarifying banks' most important levers for change and proposing an Action Plan.

This Action Plan has been developed by CISL as an ambitious potential leadership position. It has not yet been endorsed by banks or other stakeholders.

The public commitment made by 12 banks in 2014 has led to progress in their anti-deforestation policies, monitoring and reporting. Global Canopy's Forest500 ranks Compact adopters amongst the most advanced in terms of policy – all 12 banks are in the top 30 of 150, with nine Compact banks in the top 15, based on 2019 data. CISL is aware that reporting does not necessarily mean impact on halting and reversing deforestation. For that reason, this paper also recommends and describes the innovation needed to scale sustainable supply chains. These solutions will likely utilise new data flows and therefore can improve traceability and accountability as well as leading to positive impact.

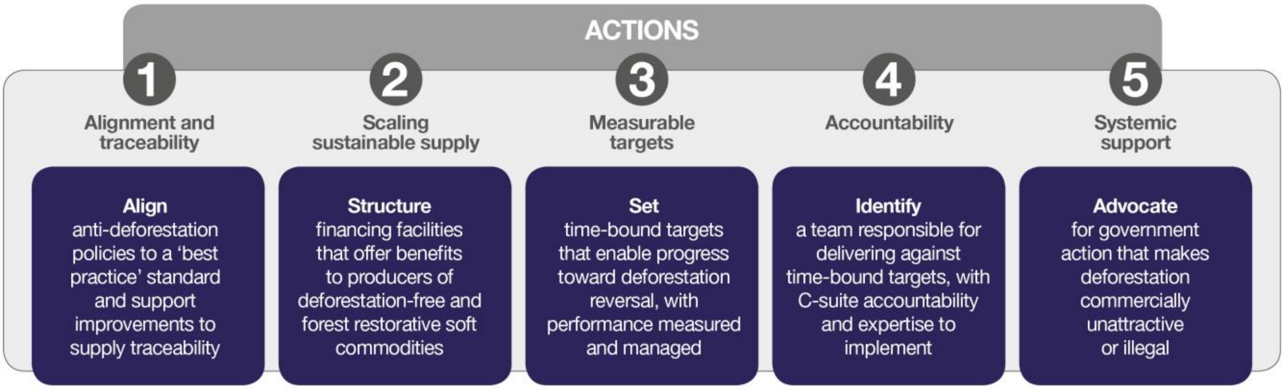
Through the Banking Environment Initiative, in addition to the Compact, banks partnered on a wider programme of value-add research into sustainable supply chains, including: Sustainable Shipment Letter of Credit (2014), Sustainable Trade Finance Council (2015), Greening the finance of China's commodity imports (2016), Catalysing Fintech for Sustainability: Lessons from multi-sector innovation (2017) and Trado: New technologies to fund fairer, more transparent supply chains (2019).

Lessons learnt from this six-year programme of work, have enabled CISL to propose the Action Plan put forward in this paper. **Collaboration** is highlighted as indispensable to solving this complex challenge; a broader range of banks, including local banks in commodity producing regions, which were not adopters of the Compact, as well as other stakeholders must come together to decouple

[i] Primary forests are 'forests in their final form', meaning a fully mature forest that can take hundreds to even thousands of years to establish itself.
[ii] Deforestation and forest degradation are responsible for 15 per cent of greenhouse gas emissions (WWF).

soft commodity supply chains from deforestation. Banks cannot do this alone. **Ambition**, alongside **pragmatism**, is important. CISL observed during the early stages of the Compact, when many other banks did not commit, that getting organisations to support ambitious action and policies can be hard but is what is needed. All 12 banks remained engaged in the voluntary initiative throughout the six years and worked towards the KPIs detailed by the Technical Guidance.[iii] It was found that **time bound targets and consequences** and **C-suite sponsorship**, both of which were part of the Compact, are important to maintain momentum and commitment.

**The Action Plan** maps out banks' role in advancing policy alignment and traceability, scaling sustainable supply, setting measurable targets and accountability, as well as enhancing the value of leading banks' evolving expertise in transitioning clients by advocating for government action on halting and reversing deforestation. Each action contains detail on the logic, role of different bank profiles, benefits to participating in collaborative action and other stakeholders recommended to ensure success.




Please note that this Action Plan has been developed by CISL as a starting point. During 2021, CISL will seek expressions of interest from the banking industry, corporates, NGOs, policymakers and funders to shape and launch the Action Plan. By consulting with the wider banking industry and other stakeholders the Action Plan can be iterated, as needed, to a form where commitment can come from as wide a group as possible – critical for future success.

[iii] Technical Guidance developed during the 'Soft Commodities' Compact elaborated on key terms and offered non-prescriptive guidance to Compact adopting banks.

# 2. Introduction

## Nature is in decline

More than 50 per cent of global Gross Domestic Product (GDP) relies upon services provided by nature, including freshwater, healthy soil and clean air.[4] One million species are threatened with extinction[5] and every six seconds, a football pitch of 'primary forest' is lost.[6] Covid-19 has underscored the urgency of tackling this decline, with habitat loss increasing the likelihood that viruses transmit from animals to humans.[7]

Halting and reversing deforestation remains an issue that needs focused action by organisations along the value chain, including banks. This paper focuses on soft commodity-related deforestation.

## How banks are connected to soft commodity-related deforestation

Soft commodities such as palm oil, soy, beef and timber products are responsible for the majority of deforestation caused by commercial agriculture.[8] Banks provide a variety of finance and financial services to enterprises along soft commodity supply chains, from term loans, trade finance and revolving credit facilities, to bond and fund structuring, capital raising, project finance and more. Some banks also have indirect connections to deforestation risk through, for example, their financing of traders and other off-takers, who can be a major source of finance for producers.[iv]

This connection led to the 'Soft Commodities' Compact, a company-led alliance between CISL's Banking Environment Initiative (BEI) and the Consumer Goods Forum (CGF), the goal of which was to lead the banking industry in aligning with the CGF's resolution to help achieve zero net deforestation by 2020. A target that has not yet been achieved.

## Our focus: how banks can combat deforestation

This paper shares the lessons from the Compact, informing a five-part Action Plan for the wider banking industry to combat deforestation. By doing so, the aim is two-fold:

1. **Empower and catalyse a large and diverse group of banks to support ongoing anti-deforestation efforts.**
2. **Inform the wider banking industry and other stakeholders, from NGOs to corporates, of the most valuable roles that banks can play in tackling deforestation.**

So that a more diverse group of local, regional and global banks can utilise the learnings of the Compact, each part of the Action Plan explains how different types of banks take action and how they benefit from doing so.

To ensure practicality, each part of the Action Plan also identifies the specific roles that need to be involved from the bank and why those individuals benefit from taking action.

[iv] Corporates provided 32.5 per cent of the finance for soy production in 2016/2017 (WWF-Brasil)

### What is out of scope

This paper builds on the scope of the Compact, rather than extending into new territory. It therefore focuses on forests, soft commodity supply and finance. It does not speak to habitat, ecosystem, land restoration nor social themes.

The role of non-bank stakeholders including corporates and soft commodities traders is also not the focus. However, the Action Plan recognises their role and signposts where their involvement is needed.

## Methodology

This paper is the result of CISL's research, based on the learnings from the Compact and consultation with associated stakeholders from across our programme of work on soft commodities, finance and deforestation. CISL has also consulted stakeholders from NGOs, finance and corporates to ensure the relevance of the Action Plan.

The final form of future action will be determined after the publication of this paper. This Action Plan is a proposal by CISL for consultation and iteration.

## Key concepts: moving beyond 'zero net deforestation'

The objective of the Action Plan is to enable banks to contribute to halting and reversing deforestation. This means going beyond the "no net loss in forest area" principle of 'zero net deforestation'[v] and would see banks align with the EU framework.[9]

### Halting deforestation

At the individual producer or *landscape*[vi] level, *halting deforestation* is akin to a *no-deforestation* concept, which the Accountability Framework Initiative define as "commodity production, sourcing, or financial investments… do not cause or contribute to deforestation." [10]

The *deforestation-free* soft commodity concept used throughout this paper is equivalent and is used by the *Forest Positive* agenda of the Consumer Goods Forum.[11]

### Reversing deforestation

*Reversing deforestation* would involve the restoration of forest at a producer or landscape level. This is called *forest restorative* soft commodity production throughout the Action Plan. It could involve restoring degraded farmland with agroforestry at the producer level or larger areas of natural habitat at the landscape level.[12,13]

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[v] "No net loss in forest area between two points in time, taking into account both losses from deforestation and gains from forest regeneration and restoration. Zero net deforestation would typically be assessed with reference to a given geographic area (e.g., a district, state, nation, or globe) and a given timeframe." (Accountability Framework Initiative)

[vi] A landscape is a fixed geographic area containing many producers. If managed according to the agreed upon standards a landscape can become what IDH calls a 'verified sourcing area'.

# 3. Lessons from the 'Soft Commodities' Compact

By taking industry-leading action through the 'Soft Commodities' Compact there is now a stronger understanding of the ingredients needed for banks to contribute to averting deforestation. In this paper, CISL shares these learnings, which form the foundation of a proposed five-part Action Plan for a diverse group of local, regional and global banks to combat deforestation.

### Compact bank leadership

Using Technical Guidance developed in consultation with banks and other stakeholders, Compact banks enhanced their anti-deforestation policies and began reporting the level of compliance. This has helped these banks to become industry leading, with Forest 500 ranking Compact adopters amongst the most advanced in terms of policy – all are in the top 30 of 150 financial institutions.[14]

In addition to raising banking standards, the Compact explored how to finance the transformation of supply chains.[15] Individual examples of leadership have emerged, with Compact adopters, BNP Paribas, pioneering the Tropical Landscape Financing Facility, and Rabobank being a driving force behind the Agri3 Fund. Both provide concessional finance that improves rural livelihoods and promotes sustainable agriculture.

### The Compact made other pioneering projects possible

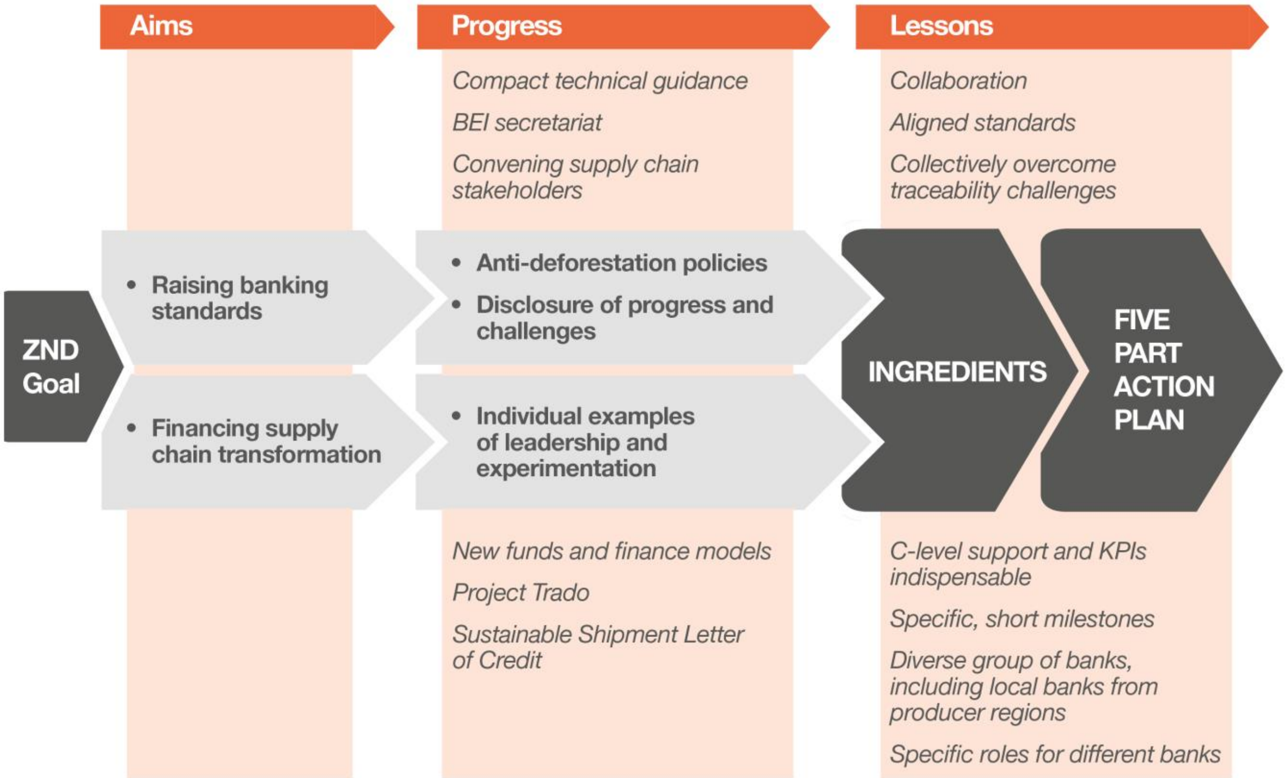
The public commitment by Compact banks led to a wider programme of value-add work. CISL convened stakeholders, conducted research and delivered pilot transactions focused on financial mechanisms and supply chain transformation. This generated additional knowledge about the contribution that banks can make to halting and reversing deforestation. The programme of work included:

- Sustainable Shipment Letter of Credit (2014)
- Sustainable Trade Finance Council (2015)
- Greening the finance of China's commodity imports (2016)
- Catalysing Fintech for Sustainability: Lessons from multi-sector innovation (2017)
- Trado: New technologies to fund fairer, more transparent supply chains (2019)

## Ingredients for banks to support the reversal of deforestation

The Compact contained ingredients essential for making progress on the deforestation challenge, including C-suite support and specific KPIs. However, for banks to accelerate action on deforestation new elements are also needed, such as the active participation of local banks from producer regions.

*Figure 1: Aims, progress and lessons from the 'Soft Commodities' Compact*




## Collaboration is the key ingredient for progress

To make progress towards the zero net deforestation goal, collaboration was critical; internally within banks and between banks, clients and other stakeholders. To realise a deforestation-free future, banks and other stakeholders can go further, building financial mechanisms and industry standards that transform supply chains.

| | |
|---|---|
| Involving a variety of banks: | Collaboration between a diverse group of local, regional and global banks is indispensable. It allows financial institutions to share their unique expertise and market connections (to producers and capital markets). |
| Involving corporates: | During the Compact, banks engaged with corporates to understand deforestation risks. Today, there is more alignment and commitment by corporates to a deforestation-free future. The *Forest Positive Coalition of Action* at the CGF, *One Planet for Biodiversity* initiative and the *Soft Commodities Forum,* both at WBSCD, are prominent examples with which banks can engage going forward. This corporate support for future bank action is critical for success. |
| Involving investors and insurers: | By collaborating with investors and insurers, such as those who threatened to divest Brazilian government bonds if Amazon destruction was not halted,[16] banks could create financial |

mechanisms that incentivise deforestation-free soft commodity production.

Last of all, collaboration for positive environmental outcomes is today being embraced in some regulatory circles. In the Netherlands, the head of the Consumer and Markets Authority (ACM) has indicated that those companies that collaborate to achieve positive sustainability outcomes do not have to fear fines on competition law grounds.[17]

### A diverse group of banks is needed, including local banks from producing regions

The Compact was adopted by 12 global banks, with geographical footprints primarily in import countries for commodities, rather than origin countries. Although these banks are connected to soft commodity supply chains, for the banking industry to support the halting and reversal of deforestation, local banks from producing regions also need to be part of the collaborative action.

The Action Plan addresses the need for bank diversity and why it is desirable for banks. Each part of the Plan specifies how different types of banks can take action and the unique benefits they receive for doing so.

### Aligned standards

The Compact was not prescriptive about how banks support the zero net deforestation goal, such as the standards adopted or implementation method. Whilst anti-deforestation policies have improved according to each Compact bank's business model, globally aligned sector-wide standards have not been established.

Now that leadership positions in policy, disclosure and financial mechanisms have emerged, alignment could be possible. Aligned standards could be the basis for better identification of unsustainable business practices and for developing scalable financial mechanisms that incentivise an established standard of sustainable land management.

Action 1 therefore explores how banks could align deforestation risk management policies and why this is in their interest, whilst Action 2 details how the availability of standardised data about deforestation risk could form the basis for finance that incentivises deforestation-free production.

### Collectively overcome traceability concerns

One method for compliance verification was to use certification like that of the Roundtable on Sustainable Palm Oil (RSPO) as a proxy for compliance. However, several banks were concerned about the extent to which certification could be traced to impact and the prevention of deforestation. Soy proved a particular challenge because banks found it difficult to determine the level of coverage of their client's soy certification. Where client disclosure was available, banks felt it was often overly simplistic or optimistic due to a lack of data on what was happening on-the-ground, or because of the traceability challenges of complex supply chains. Similar traceability and certification concerns are reflected in the lack of reporting on beef.

Sadly, the absence of confidence-inspiring data, plus the cost or challenge of obtaining it, means that the most ambitious risk management policies have been the most difficult to report upon.

Fortunately, technologies to better understand the nature of soft commodity supply are improving and becoming less costly. Developments in satellite monitoring, remote sensing and data science can be used to help better understand client deforestation risk.[18] They are not silver bullets given the complexity of soft commodity supply chains, but they offer transparency which banks may benefit from significantly.

Lastly, because deforestation risk management policies are not aligned, there was duplication assessing to what extent clients (often shared by multiple banks) were exposed to deforestation risk.

This again supports alignment of standards by the banking sector but also a commitment to gather and share information about supply chain compliance (explored by Action 1).

### C-suite support indispensable

The initial C-suite commitment to the Compact ensured individuals tasked with delivery were empowered to do so. Thanks to the senior management support, all 12 adopter banks have remained engaged throughout the six year collaboration, despite changes in personnel and diverse skillsets being needed at different stages. It also ensured that those across the bank who needed to consult with clients and gather data were able to do so alongside other business activities.

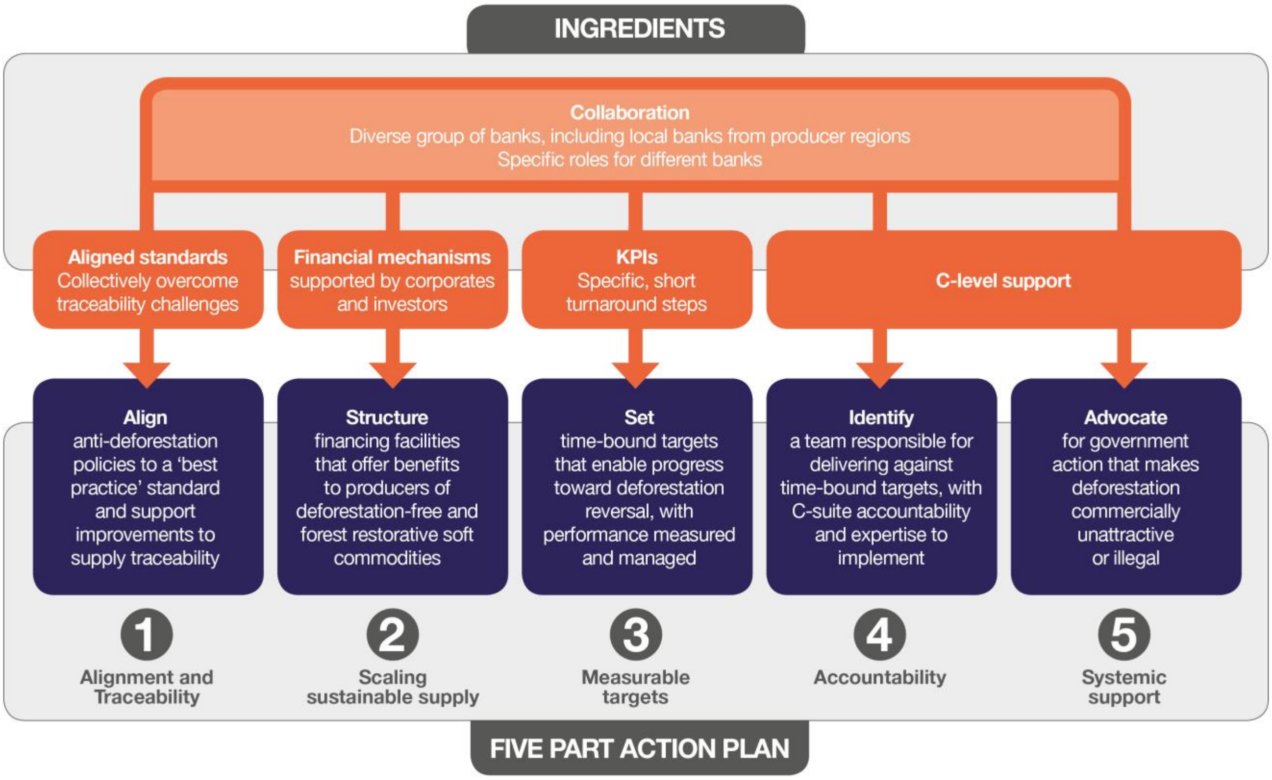
The vital role that C-suite support provides is reiterated in the Action Plan to combat deforestation, detailed by Action 4.

### Specific, short milestones and KPIs that acknowledge different responsibilities and roles

The zero net deforestation objective was too broad a goal when set in 2014. The achievement of the goal relied on partners outside of the collaboration. It is important to acknowledge what sits within the sphere of control of any given stakeholder as regards barriers, associated solutions, actionable steps and milestones. The Action Plan aims to facilitate better multilateral engagement by highlighting the most valuable points of contribution for the banking sector to halt and reverse deforestation. The overarching objective could have been improved by working-level steps – steps that could be implemented over the course of months, not years. The key performance indicators (KPIs) of the Technical Guidance were created in 2015 partly to address this gap, providing a method to follow and communicate internally.

The specificity of roles and responsibilities in the subsequent Action Plan, as well as the time-bound milestones articulated by Action 3, aim to provide granular, short horizon targets that drive action in complex organisations like banks.

*Figure 2: Connection between Compact lessons and the proposed Action Plan*




## Lessons from the broader CISL programme on sustainable supply chains and finance

### Sustainable Shipment Letter of Credit (2014)[19]

This project created a template for commodity buyers to issue a Letter of Credit (LC) in favour of suppliers with sustainability credentials.

RSPO certification was used for the pilot template, included as an additional clause in the LC,[vii] and the International Finance Corporation offered guarantees to advising banks.[20] As such, the LCs offered an information transfer in which the bank could prioritise the trade of sustainably produced commodities.

The sustainable LC template failed to gain traction in the market for two reasons:

1. Low cost trade credit entering the market at the time, particularly from Asia, is likely to have made the accompanying discount less attractive.
2. The additional administrative steps involved, which appear to have been an obstacle in a highly price competitive environment.

As the digitisation of trade progresses, the administrative burden should lessen and lower this barrier to uptake.

[vii] Under field 46A of MT700.

However, the first lesson about price competition remains relevant. Reducing the cost of sustainable finance for global corporates gained popularity in 2019 in the form of sustainability linked loans (SLLs).[21] Although SLLs are usually applied to general corporate purpose finance facilities, rather than trade finance, the lessons are similar:

- To set up a SLL a bank bears additional administrative costs, pays to discount the loan itself and exposes itself to the risk of future reputational and client relationship damage should the sustainability KPIs of the loan not be met.
- These burdens are borne in the face of price competition from rival products that have no sustainability covenants. This reflects the need for aligned standards, per Action 1.

Recent research undertaken by CISL as part of UNEP-WCMC's 'TradeHub'[viii] about the Brazil-China soy trade concludes similarly. Soft commodity traders and bankers interviewed for the research stated that SLLs were not sufficiently attractive, were easily undercut on price and did not lead to actions that traders were not already planning to take ('additionality'[ix]).[22]

To make SLLs more effective in combatting deforestation, the research suggested a focus on producers, where partnership between traders and banks could help by improving producers' access to long-term, less costly finance that sets conditions around forest preservation.[23]

This recommendation is reflected in Action 2, which focuses on banks mobilising and distributing financial benefits to producers to incentivise them becoming deforestation-free.

### Project Trado: New technologies to fund fairer, more transparent supply chains (2019)[24]

Emerging from the BEI's 'Fintech Taskforce', Project Trado piloted a data-for-benefits swap in which preferential trade finance was provided for sustainability data about tea produced in Malawi. Delivered as a pilot in a consortium arrangement, the benefit was paid for by corporate buyers, in this case Sainsburys and Unilever, and the transaction executed by BNP Paribas using digital trade finance platform, Halotrade. The project was also supported by Compact banks Barclays, Rabobank and Standard Chartered.

The pilot demonstrated that a data-for-benefits swap is technologically and mechanically possible. The buyer and financiers received greater visibility over the supply chain and the supplier benefitted financially. Such sustainability data could be used to demonstrate and understand progress toward anti-deforestation standards, per Action 1.

As well as distributing financial benefits (Action 2), the onboarding process for Trado created digital identities for smallholder farmers, enabling financial inclusion, and showed how financial technology could reduce the cost of distributing benefits.

Project Trado also highlighted the importance of a local non-governmental organisation (NGO) as an expert partner, in this case the Ethical Tea Partnership, to ensure financial benefits create the desired positive impact and are distributed appropriately.

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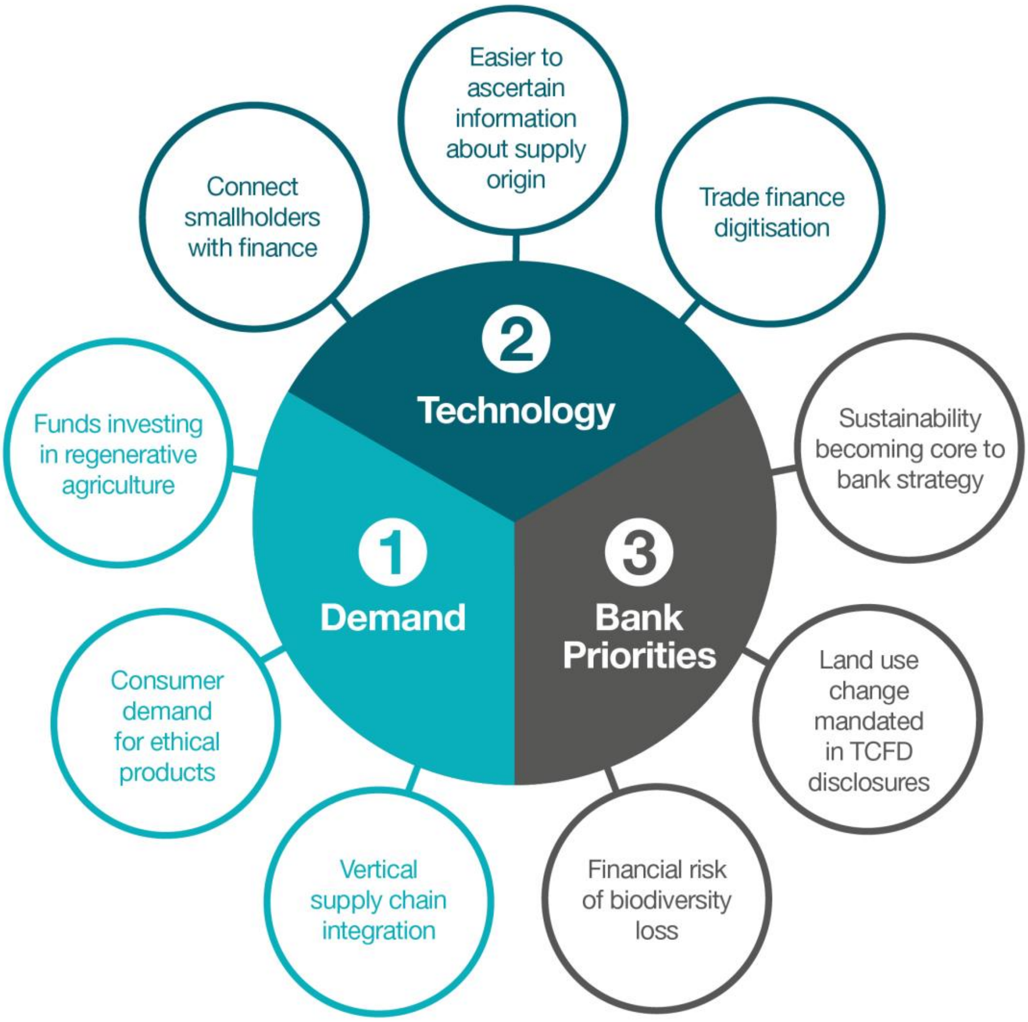
[viii] The UK Research and Innovation Global Challenges Research Fund (UKRI GCRF) Trade, Development and the Environment Hub.
[ix] Meaning action by a business in the real economy, with tangible results, that would not have occurred without the financial incentive.

# 4. What conditions support bank action?

Since the creation of the Compact in 2014, the context in which banks operate has changed. Despite ongoing challenges and complexity, it is now easier and less costly to take action that reverses deforestation. CISL's observations point to three themes that support bank action to help halt and reverse deforestation:

*Figure 3: Three themes that help banks take action to halt and reverse deforestation*




1. Demand from clients and consumers

- Some bank clients are responding to consumer demand for ethical products by seeking greater confidence about supply origin.[25] Identifying embedded carbon emissions in the food supply chain is also driving the desire for visibility.[26] By gathering and sharing information about commodities handled or produced by clients, banks can support improvements in traceability. (Supports Action 1).

- To obtain data and improve profitability, some consumer goods companies and traders are vertically integrating their supply chains. This presents an opportunity for banks, which could connect capital or ratings for these companies, with a financial benefit for producers that expands deforestation-free supply (e.g. 5+ year offtake agreements).[27] (Supports Action 2).
- The growth of funds investing in regenerative agriculture and other nature based solutions, as well as increased demand for carbon credits[28], can also be a source of capital that banks can blend to fund financial benefits for producers.[29] (Supports Action 2).

2. Technological advancement

- Advances in remote sensing, satellite monitoring and data science mean banks have greater opportunities to establish and build trust in the origin of their clients' soft commodity supply, and hence the activities that their financial support funds. (Supports Action 1).
- Aggregating smallholder and SME producer finance to the landscape level, known as spatial finance, can create transaction sizes that permit access to global capital markets (US$ 10m upwards).[30] (Supports Action 2).
- Trade finance digitisation is an opportunity to transfer data about soft commodities along the supply chain. At least 29 per cent of bank clients use some form of digital trade finance, rising to more than 50 per cent at global banks.[31] (Supports Action 1).

3. Evolution of bank priorities

- The BEI Bank 2030 research signalled that sustainability is becoming central to the strategy of some leading banks.[32] As sustainability moves up the agenda, banks are allocating resources to deliver transition agendas with clients. (Supports Action 3 and Action 4).
- Biodiversity loss represents an unmeasured and unmanaged financial risk in bank portfolios. Biodiversity tipping points, such as the spontaneous conversion of the Amazon rainforest to savannah, in addition to the significant effect on global climate could more immediately damage established agricultural industries and create sovereign debt risk in South America.[33] To facilitate progress in this space, CISL's Banking Environment Initiative and Investment Leaders Group are working on assessing the *Financial risks of biodiversity loss and land degradation*. The soon to be formalised Taskforce for Nature-related Financial Disclosures (TNFD) further supports the awareness of the financial sector in the need to better understand these risks. This should further incentivise bank action to support client transitions away from deforestation-linked soft commodities. (Supports Action 3).
- Mandated disclosures about financed emissions (vis-à-vis TCFD), including those linked to land use change, would require some banks to measure and tackle financed deforestation in their portfolio. As deforestation and forest degradation make up 15 per cent of global greenhouse gas emissions, it will not be possible to reach net zero without addressing this.[34] (Supports Action 3).

# 5. Five actions every bank can take to help halt and reverse deforestation

CISL's proposed Action Plan builds on the lessons learnt during the 'Soft Commodities' Compact and the associated programme of sustainable supply chain work.

The proposal casts banks as intermediaries for financial incentives that grow the supply of deforestation-free or forest restorative soft commodities. Banks can assume this role in the halting and reversal of deforestation because they have:

- **access** to businesses along the supply chain and to diverse sources of capital, such as investors seeking impact;
- **expertise** to assess counterparty risk and structure capital;
- **data** about client operations.

These three levers mean banks can:

1. Support improvements to soft commodity traceability by working with clients to implement anti-deforestation standards.
   - Banks can use their **access** to businesses along the supply chain and **data** gathered in risk management processes to assemble information about the nature of soft commodities produced or handled by clients.
2. Mobilise and structure funds that channel finance and incentives to soft commodity producers in exchange for commodities that are deforestation-free or forest restorative.
   - Banks can act as intermediaries, using their **access** and structuring **expertise** to connect producers with capital that incentivises sustainable production.

By contributing in these ways, banks support broader efforts in the economy to decouple soft commodity production from deforestation and gather the data that proves it.

Please note that this Action Plan has been developed by CISL as a starting point. It has not yet been endorsed by banks or other stakeholders. During 2021, CISL will seek expressions of interest from the banking industry, corporates, NGOs, policymakers and funders to shape and launch the Action Plan. By consulting with the wider banking industry and other stakeholders the Action Plan can be iterated, as needed, to a form where commitment can come from as wide a group as possible – critical for future success.

## The Action Plan

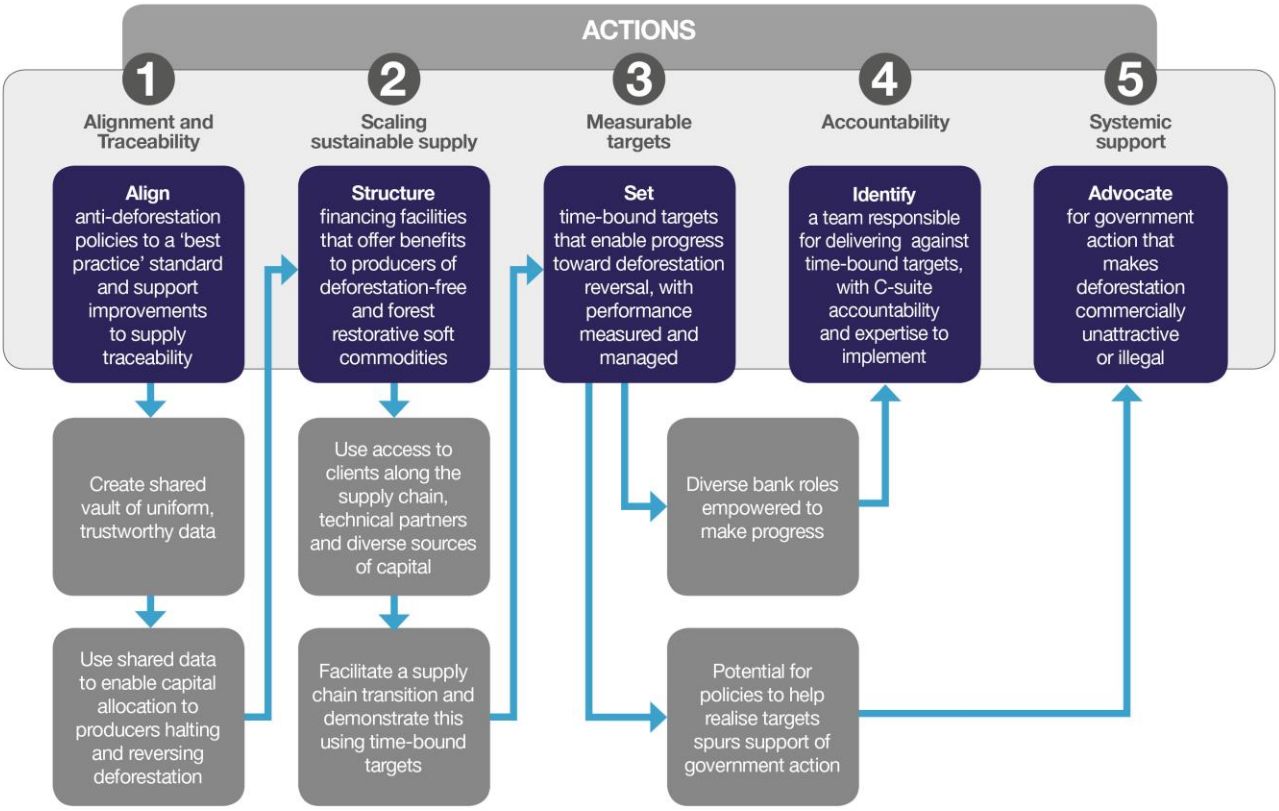
The first Action is for the banking industry to align anti-deforestation policies to best practice standards. This can facilitate data verification by multiple banks, enabling them to populate a shared data vault with collective knowledge about deforestation risk along the supply chain. This vault can then be used to identify opportunities for banks to support clients to remove deforestation from soft commodities produced or purchased.

This support for clients comes in Action 2, in the form of financial benefits that incentivise production of deforestation-free or forest restorative soft commodities and pay for data that proves the status of supply. Banks play a facilitation role, mobilising and structuring the benefits and underlying finance to which they are attached. They can also source funds to pay for those benefits from impact investors, government, development banks and corporate off-takers.

To make progress, accountability and public time-bound targets are essential. Action 3 details specific time-bound milestones to make halting and reversing deforestation possible and Action 4 pinpoints suggested roles for implementation.

By publicly setting robust targets, it becomes in the interest of banks to advocate for supportive global policy. As explored in Action 5, by occupying the role of facilitator, banks rely on other parties, including governments. A supportive policy landscape can spur action along the supply chain.

*Figure 4: Five part Action Plan for banks to support the halting and reversal of deforestation*

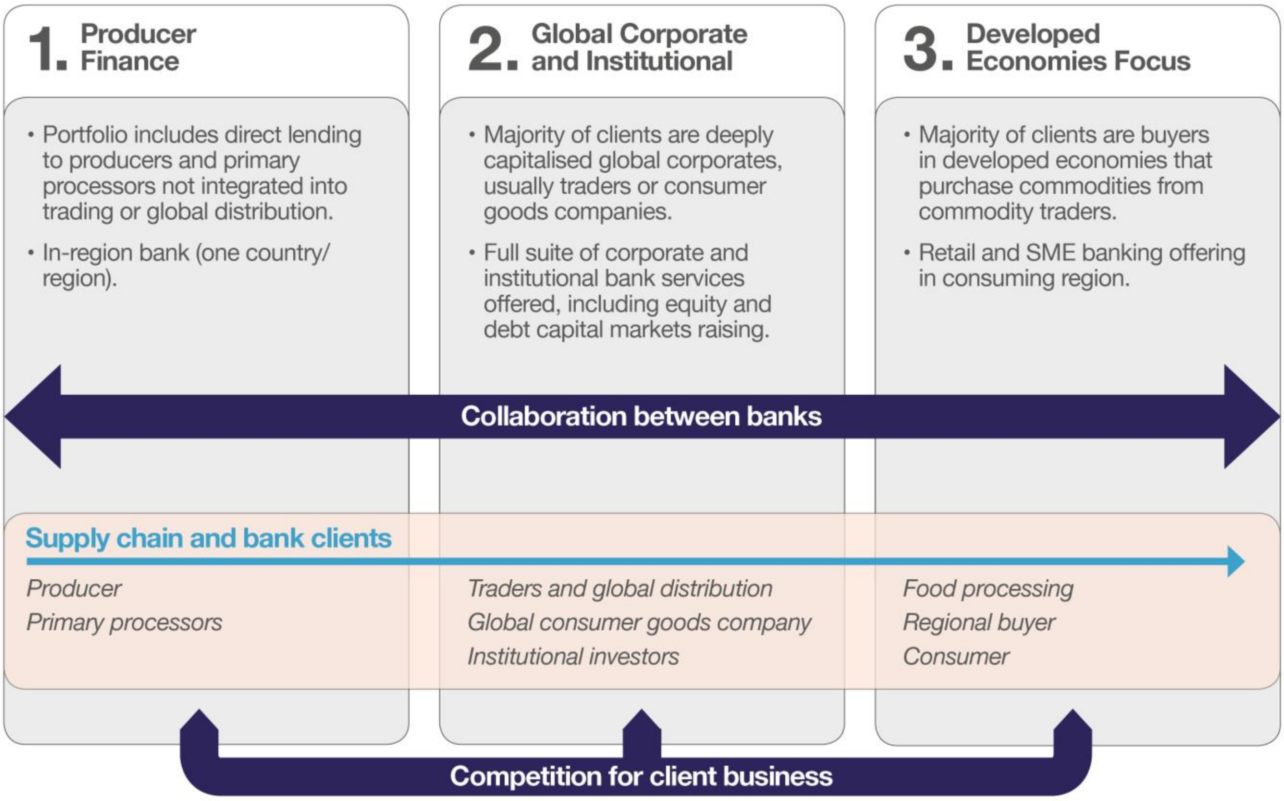



## The need for collaborative action

The bedrock of this Action Plan is collaboration between local, regional and global banks along the supply chain. By collaborating, these banks share costs and expertise, enhance due diligence, reduce the likelihood that deforestation leaks to another financier and can create standardised, scalable financial solutions that reduce transaction costs and enable scale. For example, local banks gain access to structuring expertise and capital markets from global banks; whilst global banks receive a pipeline of data and producers/landscapes capable of being deforestation-free toward which they can mobilise finance (financial benefits).

Meanwhile, competition continues between these banks as they bid for business.[35] To offer clarity on where banks collaborate and where they compete, Figure 5 details three bank business profiles and maps their position in the supply chain.

*Figure 5: Bank business profiles along the soft commodity supply chain*




Collaborative action can create structural change by generating new markets and possibilities, with first mover advantages for those involved. This competitive advantage attracts new and more diverse participants, scaling towards systemic change.

As new participants with different profiles join, asymmetries are also created that could grow market participation and opportunities further. For example, the more producer finance banks join the collaboration, the more financing opportunities there can be for global banks to structure; this, in turn, attracts more global banks to the collaboration, theoretically increasing the availability of financial benefits for producers; in turn attracting more banks that finance producers; and so on.

### Specific steps within the Action Plan are intended to be illustrative, not prescriptive

The purpose of articulating the three bank business profiles is to offer banks relevant guidance about their most valuable role in halting and reversing deforestation than has previously been available. CISL recognises that in this complex and often novel context for many financial institutions and businesses, one size and pace of change will not fit every organisation. The level of specificity aims to complement the existing efforts of those such as the Global Resources Initiative and Tropical Forest Alliance, who have covered the role of the wider financial system and other stakeholders in tackling deforestation.[36]

# Action 1: Align anti-deforestation policies to a 'best practice' standard and support improvements to supply traceability

## [ALIGNMENT AND TRACEABILITY]

The Compact's Technical Guidance was not prescriptive about banks' standards, implementation and due diligence processes. Whilst anti-deforestation policies have improved according to each Compact bank's business model, globally aligned sector-wide standards have not yet been established. Alignment on best practice anti-deforestation standards would establish a level playing field, reduce leakage of deforestation to another source of finance and provide a common foundation on which to build financial solutions that tackle deforestation (Action 2).

By aligning risk management policies, data gathered can also be stored in a shared data vault and accessed by organisations subscribed to the commitment, supporting enhanced risk and opportunity identification.

### Why this action is needed

As banks are connected along supply chains exposed to deforestation risk, creating an aligned position amongst these banks and others along the supply chain can be a powerful mechanism for transforming the nature of trade.

### Support improvements to supply traceability

CISL hypothesise two pathways to use the shared data vault and build confidence in the deforestation-free or forest restorative status of supply; both begin with banks engaging clients about the benefits of collecting data that proves sustainability status. Benefits include access to financial benefits for producers or opportunities to pool resources that scale access to forest restorative supply for buyers (detailed in Action 2).

Pathway 1: Digital transformation enabling existing financial flows to carry more information about soft commodity supply origins.

This would involve client agreement to utilise third party monitoring methods, such as Starling Verification or Satelligence, to build up a series of sustainability 'data tags'[x] about the landscape from which commodities are sourced. Each time a financial product or service is used by a purchaser or handler, that original data tag is carried with the commodity, informing the next buyer along the chain. The tag could

[x] Data tags are pieces of information attributed to a product or client within a database. As such, they are the identifiers that make up Product Master Data and Client Master Data – the datasets that are the 'single version of truth' about a product or client.

therefore pass along the supply chain, from one buyer to the next, helping both corporates and banks better understand their deforestation risk exposures.

This creates a new flow of data where banks (a) help clients – both producers and buyers – demonstrate their sustainability credentials and (b) flag deforestation-linked soft commodity hotspots to buyers and institutional clients, who could support change through the use of targeted financial incentives.

Pathway 2: Since Pathway 1 would take time, banks could for now focus on working with third parties and clients along the supply chain, such as TRASE Finance, to establish the status of commodities produced and traded.[37] Financial flows would not carry additional data along the supply chain.

By implementing either method, a shared data vault could host constantly updated information about deforestation risks associated with specific sourcing areas and associate that information with buyers (bank clients) along the supply chain. This would enhance supply traceability.

Costs for establishing the standards, IT architecture and ongoing verification could be shared between banks, in partnership with clients where possible (e.g. traders, corporates and impact investors).

## How banks can participate in Action 1 [Alignment and Traceability]

*All banks*

1. Work across the banking sector, in consultation with third party experts, to agree upon best practice standards to ensure that financing is not flowing to deforestation-linked activities, and instead is supporting business operations that are deforestation-free or forest restorative.
2. Map and agree what supply chains and commodities the standards apply to, supporting relevant traceability developments.
3. Use existing reporting channels and monitoring technologies to attribute sustainability standards (data tags) to soft commodity producers and handlers.
4. In accordance with data regulations, populate the shared data vault with information, such as soft commodity produced or purchased, landscape of origin, etc.
5. To enhance trust, report progress toward the anti-deforestation standards at least annually.

| Producer Finance | Global Corporate & Institutional | Developed Economies Focus |
|---|---|---|
| • Map soft commodity producing clients and associated financial products.<br>• Work with local NGOs and technology providers to establish reporting and verification mechanisms for producers.<br>• Apply data tag to the producer and primary processors in the shared data vault. | • Map soft commodity buying clients and associated products.<br>• Apply data tag to the commodity buyers in the shared data vault. | *Same as Global Corporate and Institutional* |

### Steps for different banking roles (Action 4 contains role definitions)

#### C-suite Sponsor

- Communicate progress and challenges at executive committees.

#### ESG Risk and Policy

- Coordinate to collectively agree the best practice standard and viability of the method for verification; consult with third-party experts on deforestation drivers.
- Quantify time and monitoring cost of measuring client progress if pursued unilaterally. This could be used to justify investment.

#### Legal

- Enable data sharing by ensuring it aligns with existing regulation.

#### IT Change and IT Operations

- Own relationship with third party creating the shared data vault.
- Ensure technical compatibility with the shared data vault.
- Lead organisational implementation of data vault technology.

## Who else needs to be involved for this action to succeed?

- Commodity **buyers** (corporates and traders) and **suppliers** (producers) to (1) support rather than resist the standards agreed amongst banks and (2) agree to sharing data about product origin and production method.
- A **solution architect** whose role is to coordinate the policy alignment and engagement between banks, clients, NGOs, data providers and technical partners, as well as ensuring competition and data privacy laws are adhered to. This partner, such as the Environmental and Social Agency of Financiers, could also oversee the development of supporting IT infrastructure and host the shared data vault.
- **NGOs** and **technical partners** to support the design of best practice standards and verification methods; methods will vary depending on the production context.
- Third party **monitoring service providers** to verify client data.

## Benefits to banks of taking Action 1 [ALIGNMENT AND TRACEABILITY]

| Producer Finance | Global Corporate & Institutional | Developed Economies Focus |
|---|---|---|

*All banks*

- Alignment means data only needs to be gathered and verified once, with costs shared. At present, each bank checks client status against their own policies, despite sharing many clients. This is costly and time-consuming.
- Gathering data for the collective reduces friction between bank and client because the client will only need to supply information once.
- Data tags could enhance supply chain traceability and support impact measurement.
- The shared data vault can be used to identify producers to incentivise deforestation-free and forest restorative soft commodity production Action 2.
- Allocation of financial benefits to producers Action 2 need monitoring costs to be negligible to enable scale. Sharing costs and standards helps this.
- Enable targeted client engagement thanks to better data for counterparty risk assessment.
- Option for data vault to incorporate additional sustainability information to support other causes.
- Provides citizens (retail customers) with better information about commodity source, increasing pressure to improve remainder of supply.

| Producer Finance | Global Corporate & Institutional | Developed Economies Focus |
|---|---|---|
| • Access to shared resources to implement and monitor risk management policies. | *Same as 'Developed Economies Focus' banks* | • Ability to disclose how a wider variety of clients in the supply chain, such as livestock farmers in Western Europe buying soy-based animal feed, are not connected to deforestation. |

### Benefits for different roles (Action 4 contains role definitions)

#### ESG risk and policy

- Time spent verifying client status greatly reduced.
- Access to the knowledge of third parties and other banks about halting financial flows to deforestation.

#### C-suite sponsor

- Use data to report to investor relations, supervisory board, non-executive directors and regulators.
- Able to demonstrate enhanced risk management and positive impact to a high level of confidence.

#### Credit risk

- Additional stream of data helps credit risk management to understand which clients have risk to biodiversity health or fragile supply chains.[38]

#### Senior coverage banker and ESG solutions

- Banks acting together reduces risk of losing clients.
- Opportunity to engage clients and support them to become deforestation-free or forest restorative.
- Opportunity to engage and support clients to comply with net zero emissions commitments by enabling them to show how business activities can support forest restoration.

# Action 2: Structure financing facilities that offer benefits to producers of deforestation-free and forest restorative soft commodities

## [SCALING SUSTAINABLE SOFT COMMODITY SUPPLY]

Using experiences in and around the Compact, such as the Sustainable Shipment Letter of Credit and Project Trado's data-for-benefits pilot, this Action addresses how different banks can be part of building scalable financing solutions that help halt and reverse deforestation.

Financial solutions are made possible by using the shared data vault (Action 1) because it allows for the identification of:

1. Producers verified as deforestation-free or forest restorative;
2. Producers working towards becoming deforestation-free or forest restorative;
3. Buyers looking to transition to deforestation-free or forest restorative sources of supply.

Equipped with this information, banks can mobilise, structure and distribute financial benefits to qualifying producers.[xi] This would be a data-for-benefits swap, where incentives are offered for soft commodities that meet anti-deforestation standards, as proved by high-confidence data. Financial benefits could include:

1. Extending the term of debt financing to the producer so they can invest in shifting production practices to be forest restorative – investment that can take many years to yield results.
2. Reducing the cost of capital for term loans and project financing, including for innovative financing that aims to create sustainable landscapes, such as the WWF Landscape Finance Lab.[xii]
3. Improving the pricing or tenor of a producer's trade financing.
4. Facilitating the arrangement of longer commercial offtake agreements, providing guarantees to suppliers or to any finance that banks issue.[xiii]
5. Facilitating direct payment for ecosystem services or carbon credits, such as afforestation, where appropriate.

These financial benefits could be funded by a variety of sources: impact investors, philanthropic foundations, government, development banks or soft commodity buyers. As well as mobilising these funds, banks can aggregate and structure sustainable financing to open up avenues for institutional investment.[39]

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[xi] Producers here could range from SME producers linked to a local bank, to large scale operators that are financed through structured products.

[xii] This is one example of a prominent initiative aimed at scaling landscape solutions. Others include Landscale, Commonland and the IDH verified sourcing areas.

[xiii] Longer offtake agreements have emerged as a key focus of corporates. Mars Head of Sustainability and Procurement, Barry Parkin, commenting that: "The company had been hoping the whole [palm oil] industry was going to change, but it's clear that it is not going to change a vast amount. … We have to move further and faster to clean up our supply chain, and that will require radical simplification, *longer-term contracts directly with farmers*, and stronger due diligence on-the-ground." See: https://www.ethicalcorp.com/deadline-2020-we-wont-end-deforestation-through-certification-schemes-brands-admit

Over time, a bank's appetite to contribute to these financial benefits itself may also increase. For example, if a client's operational profit and resilience improves as a result of regenerative agriculture techniques, rating agencies and banks may upgrade the client's rating.[40]

As such, banks are facilitators of financial flows. Empowered by data they have gathered, they source and distribute capital, supporting the UK-based Global Resource Initiative recommendations to 'mobilise funds for nature-based solutions'.[41]

### Why this action is needed

- By mobilising, structuring and distributing sustainability incentivising finance, banks – working with clients and sustainability experts – can make deforestation-free and forest restorative soft commodity production the more commercially attractive option to producers. Producers are the focus, rather than major corporates, who instead are a source of capital through purchasing terms.
- Aligned risk management policies and enhanced traceability alone cannot transform supply chains.

  Exiting clients only shifts deforestation risk to another funding portfolio, missing the opportunity to transition and retain clients using financial solutions.[42]
- Stimulates the data-for-benefits swap between the producer and the corporate, with the bank facilitating.

  Financial solutions that distribute benefits to producers in exchange for high-confidence data about deforestation-free or forest restorative activities.

### Standardised templates will help to scale opportunities

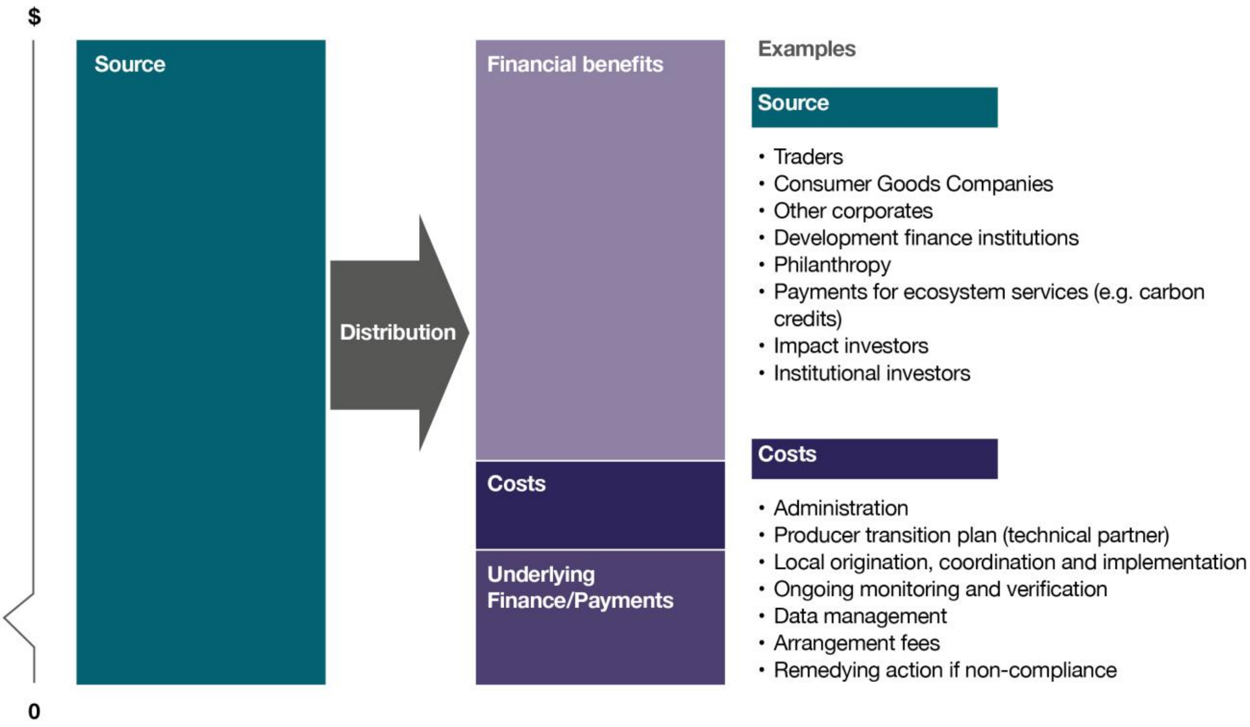
Standardised templates for providing financial benefits will be critical for scaling a pipeline of producer finance that contains anti-deforestation incentives. [xiv] Some banks may not have the capacity to design these financial structures and so global banks can lead on the creation, sharing expertise in exchange for a pipeline of producers eager to grow the supply of deforestation-free and forest restorative commodities.

[xiv] One initiative working in this subject area is the Chancery Lane Project.

### Source and uses of funds to incentivise sustainable soft commodity supply

Figure 6 maps suggested source and uses of funds, akin to a concessional blended finance arrangement.[43]

*Figure 6: Fund sources and uses, illustrative[44]*



## How banks can participate in Action 2 [Scaling sustainable soft commodity supply]

| Producer Finance | Global Corporate & Institutional | Developed Economies Focus |
|---|---|---|

*All banks*

1. Agree types of producer finance that could effectively transfer benefits (see the five examples above) and create legally viable standardised templates, e.g. discounted invoice financing.
2. Agree on when and how the benefit will be distributed to producers and build this into the template.
3. Agree the method for aggregating recipients of finance together, such as landscape financing, so that default risk is diversified, and minimum transaction size thresholds are passed.
4. Use the shared data vault to connect banks of producers that can receive benefits with banks looking to procure and structure financial benefits from financial markets and buyers interested in transitioning their purchasing strategy.
5. Collectively sign off technical partners in different jurisdictions that would directly support producers' transition to 'deforestation-free' or 'forest restorative' practices.[xv]

| Producer Finance | Global Corporate & Institutional | Developed Economies Focus |
|---|---|---|
| • Promote finance and benefits to producers.<br>• Work with approved technical partners (e.g. local NGOs) to provide producers with up-front support to transition practices and secure financial benefits.<br>• Support technical partners and peers to aggregate producers together into financial structures that exceed minimum transaction size (e.g. landscape financing).<br>• Distribute financial benefits to producers. | • Lead the design of the standardised templates.<br>• Mobilise financial benefits from institutional investors, corporate clients (commodity buyers and traders), government, philanthropic sources, impact investors, development finance, etc.<br>• Structure blended finance, using the standardised templates as a start point, and crowd-in institutional investors. | • Engage with clients (commodity buyers and traders) and promote the opportunity to provide financial benefits to producers in exchange for data and a sustainable soft commodity supply, e.g. offtake agreements.<br>• Mobilise financial benefits from institutional investors, clients, government, philanthropic sources, impact investors, etc. |

Based on the roles described in the above table, a local bank who works with producers could source funding opportunities, whilst a global bank mobilises and structures the financial incentives. It is also true that off-takers, such as soft commodity traders and consumer goods companies, could source these opportunities for global banks by using their existing relationships with producers.

**Steps for different roles (Action 4 contains role definitions)**

### Legal

- Lead the legal elements of standardised templates.

### IT Change and IT Operations

- Ensure financing that distributes benefits links to the shared data vault (feeding back into Action 1).

### ESG solutions

- Driving force behind the creation of standardised templates.
- Educate relationship manager community about product and templates.

### Senior coverage banker

- Promote financial benefits to producer clients.
- Present the opportunity to participate to relevant clients.

### ESG risk and policy

- Participate in the creation of standardised templates.
- Provide ongoing audit and oversight of transactions.

### Capital markets; Development finance coverage

- Mobilise funds to pay for financial benefits.
- Coordinate with senior coverage banker to source financial benefits from corporates along the supply chain, e.g. off-takers.
- Oversee structuring of finance and producer benefits.

### Credit risk

- Regularly assess if clients in receipt of such financial benefits are improving their risk profile as a result of more sustainable business models.

## Who else needs to be involved for this action to succeed?

- Commodity **buyers** (corporates and traders), **investors**, **development finance institutions** and **philanthropy** to fund financial benefits.
- **NGOs** and **technical partners** to ensure financial benefits lead to positive outcomes and deliver transition plans with producers (including smallholders).
- Where necessary, **local partners** to populate pipeline with producers – government, NGOs, cooperatives, associations, local NGOs and off-takers such as soft commodity traders.

[xv] In the BEI project, Bank 2030, 'collaborative finance' was cited as a key method for allocating more capital to the emerging low carbon economy. In this collaborative finance, the bank acts as an intermediary between capital, *technical expertise* and clients; specifically, the bank connects clients with *technical experts* to help clients develop low carbon propositions that are then capable of attracting capital, which the bank can provide itself or from government, DFIs or capital markets.

## Benefits to banks of taking Action 2 [Scaling sustainable soft commodity supply]

| Producer Finance | Global Corporate & Institutional | Developed Economies Focus |
|---|---|---|

*All banks*

- By gathering data about the character of supply and sourcing funds for producers' financial benefits, banks have the opportunity to offer additional financial services, generating new business opportunities.
- Strengthen relationships with clients along the supply chain that are looking to reduce deforestation risks.
- Interaction with technical partners grows bank capacity about how land use can be part of climate mitigation and adaptation, as well as human rights and social welfare strategies.
- Reduce climate-related financial risks through, for example, techniques that regenerate land and improve supply chain resilience.[45]
- Opportunity to help both banks and clients meet biodiversity and emissions targets.[46]
- Avoid need to draft bespoke covenants for each transaction though creation of standardised templates.

| Producer Finance | Global Corporate & Institutional | Developed Economies Focus |
|---|---|---|
| • Opportunity to offer financial benefits to producers stimulates new business with existing and potential clients.<br>• Aggregated risks o can be held off-balance sheet, with finance sourced from capital markets.<br>• Improve the resilience of clients and reduce the wider risk of local biodiversity tipping points that would impact portfolios.[47] | • Create additional highly credible green finance opportunities for investors.<br>• Opportunities to offer corporate and institutional clients (1) a mechanism to halt and reverse deforestation and (2) a range of positive SDG impacts through forest restoration and rehabilitation.[48] | • Opportunity to engage soft commodity buyers (bank clients) and offer options for moving their business to deforestation-free supply. |

## Benefits for different roles (Action 4 contains role definitions)

### C-suite sponsor

- Positions the bank as a pioneer for halting and reversing deforestation.
- Provides an additional avenue for scaling sustainable finance capabilities, creating strategic optionality to diversify revenue.

### ESG solutions

- Opportunity to create new sustainable finance solutions.
- Expertise gained during the collaborative creation of standardised templates could be used to innovate to tackle other SDG challenges

### Senior coverage banker; capital markets; development finance

- Opportunity to engage corporate and investor clients and offer mechanisms to halt and reverse deforestation, differentiating the bank from competitors and strengthening client relationships.
- Opportunity to offer financial benefits to producers that stimulate new business with existing and potential clients.

### ESG risk and policy

- Solutions with measurable positive impact will demonstrate alignment with bank policy.

# Action 3: Set time-bound targets that enable progress toward deforestation reversal, with performance measured and managed

## [MEASURABLE TARGETS]

Short time-bound targets create focus and momentum. Zero net deforestation was too broad a goal, lacking specific working-level steps to make measurable progress toward halting deforestation – steps that could be implemented over the course of months, not years. For this reason, Technical Guidance was created during the Compact with KPIs against which banks could demonstrate progress.

Building on this principle, we advise an Objectives and Key Results (OKR) approach going forward. This would involve setting Objectives – clearly defined goals – that each have three to five Key Results. These Key Results would be specific, measurable, realistic and time-bound milestones that demonstrate progress.[xvi]

For this Action, we suggest the following two Objectives:

Objective 1: Bank finance and advisory services are only associated with soft commodity supply that is deforestation-free or forest restorative.

Objective 2: Volume of deforestation-free and forest restorative soft commodities has materially increased, to the extent that the amount of deforestation connected to soft commodity production globally is in decline.

Based on Objective 1, we propose the following Key Results:

1. **Align relevant risk management policies** across banks along the supply chain (global, regional and local) to a best practice anti-deforestation standard. Securing alignment crystallises the collaborative action and triggers work on the other Key Results.
2. Establish the structure of a **shared data vault**.
3. **Gather data** along the supply chain about client exposures to deforestation and feed into shared data vault.
   Use the vault to report anonymous, aggregated information about this exposure and the extent to which it aligns with risk management policies.
4. Once data is gathered, **set time-bound targets with clients** to transition to deforestation-free or forest restorative status.

   The first phase could involve engaging clients and connecting them with technical partners to finalise a transition plan, before mobilising financial benefits for producers, where necessary,

[xvi] Key results, if achieved, will advance the objective in a useful manner to those involved. They must describe outcomes, such as end user impact, rather than activities, i.e. "consulting" or "helping". To be results they must also include evidence of completion that is credible and easily discoverable. The OKR goal-setting framework tends to be attributed to Andy Grove of Intel.

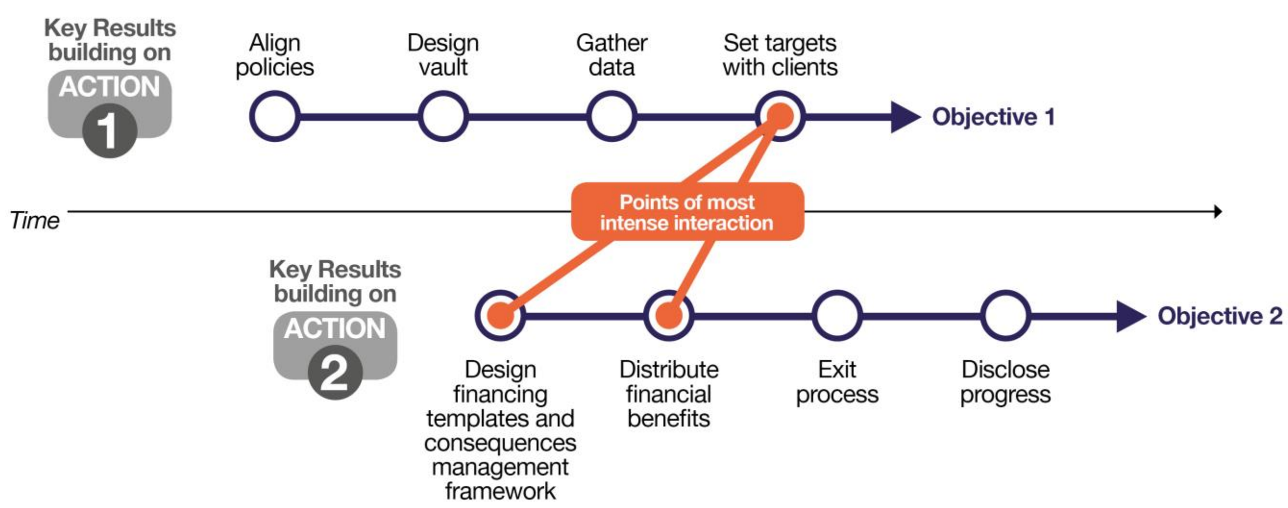
to transition the status of supply. The following phase would be about deploying capital raised to offer financial benefits, beginning the transition of supply.

Based on Objective 2, we propose:

5. Build **standardised financing templates** for the distribution of financial benefits to qualifying producers.
6. Develop a **consequences management framework** for employees and clients if progress is not made toward aligned anti-deforestation standards.
7. Once producers in line with the anti-deforestation standards, or capable of being so, are identified, engage soft commodity buyers, traders and others and offer the opportunity to provide **financial benefits** to these producers.
8. If buyers or producers do not transition toward the anti-deforestation standards or accept financial benefits for transitioning, then after communication and engagement with banks, and within the window specified, initiate an **exit process**.
9. **Disclose progress** toward anti-deforestation standards, how financial benefits were distributed and what the result has been, likely in line with annual soft commodity procurement cycles. This disclosure can raise awareness of the tangible impact of these actions, attracting more banks and sources of funding. The data tags in the shared data vault should make it possible to run this report at minimal incremental cost.

These Key Results are visualised in Figure 7 to offer an indication of when they occur relative to one another.

*Figure 7: Visual representation of the Key Results marking progress toward Objectives*




## Why this action is needed

Ambitious time-bound Key Results of between 12 and 36 months are critical for making progress in complex organisations, such as banks. As well as ensuring accountability, they can also be opportunities to incentivise staff.

The targets are especially important to drive collaboration between banks along the supply chain – to secure producers to whom financial benefits can be allocated and source capital to pay for those benefits.

## How to take Action 3 [MEASURABLE TARGETS]

1. Secure board sign-off for the Objectives and time-bound milestones (Key Results) and make them public. This generates the energy and buy-in needed to deliver a multi-year effort.
2. Secure internal budget for education, human resources, IT development costs and employee incentives needed to deliver.
3. Establish methods for internal reporting on bank and client progress, with a team and C-suite sponsor accountable for delivery (an 'Implementation Team', scoped in Action 4).
4. Design external reporting templates for disclosing progress.
5. Sign off governance and terms of engagement, to manage any situation where a bank is thought not to be contributing as would be expected (this would need to be actioned and governed by a secretariat).

### Steps for different banks

Global banks need local and regional banks at the table for this to work. New ways of collaborating will need to be established, such as sharing local/ regional/ global knowledge and systems, risk management policies, expertise and access to diverse funding sources.[xvii]

### Steps for different roles (Action 4 contains role definitions)

#### C-suite sponsor

- Bring together a team to determine and agree time-bound milestones (Key Results) with other banks.
- Secure board sign-off for the milestones, as well as the internal budget to deliver them.

#### IT Change and IT Operations

- Ensure data can be gathered for internal and external reporting from the shared data vault.

#### ESG risk / ESG policy

- Establish internal and external reporting methods about progress.

#### Communications

- Promote the success stories of collaborative action.
- Distribute and market external reporting about progress.

[xvii] Multi-stakeholder education programmes such as UNEP FI's Good Growth Partnership could represent a starting point for this conversation.

## Who else needs to be involved for this action to succeed?

Although progress on time-bound milestones will be a function of the resources and commitment of banks, it will also rely on:

- Capital being available from **buyers, investors, development finance, philanthropy** and others to fund financial benefits.
- **Buyers** (corporates and traders) and **suppliers** (producers) sharing information about the characteristics of their production or the commodities they handle.
- Enough opportunities to fund the transition of producers being made available from **local partners**, including **government**, **local NGOs** and local banks in commodity origin countries.[49]
- **Corporates** who directly fund producers being open to distributing financial benefits to those farmers, such as traders. In the Brazilian Cerrado, for example, banks provided less financing for soy production in 2016-2017 than corporates.[50]
- A **secretariat** to provide a neutral setting, recruit new participants and administrate the governance agreed by the banks in the collaboration, as well as to provide project management and a forum for dialogue and decision making.

## Benefits to banks of taking Action 3 [Measurable Targets]

Seniors leaders interviewed for the Banking Environment Initiative's Bank 2030 report commented that a key driver of action on sustainability challenges today is to position the bank to service the 'winning clients of tomorrow'.[51] These leaders viewed it as a strategic imperative that the bank align with these clients as they will be the ones growing as climate- and nature-related financial risks manifest and drive market adjustments. Time-bound targets support bankers to engage existing and new clients and ensure their portfolio is beginning to align with those 'winning clients of tomorrow'.

Reporting progress by using time-bound milestones would also:

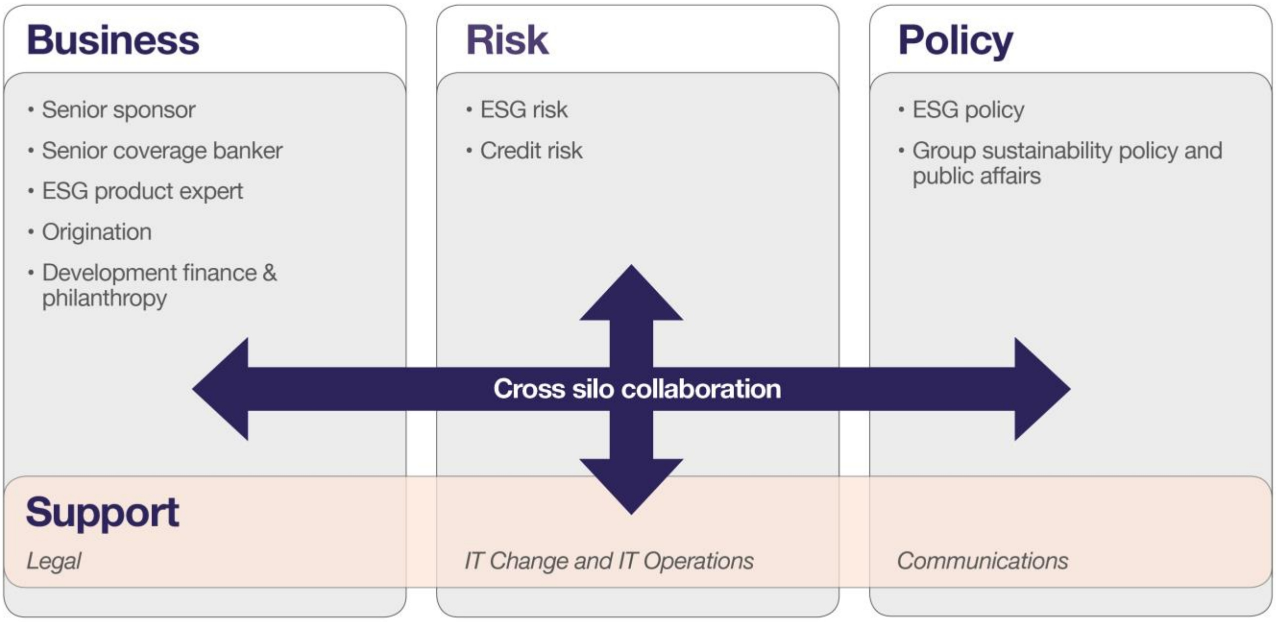
- Provide banks with evidence to demonstrate and share leadership on the deforestation challenge.
- Allow banks that service the same parts of the supply chain to see whether they are behind their peers, motivating the deployment of resources.
- Create transparency and accountability on the deforestation challenge, ensuring banks retain a societal licence to operate.

# Action 4: Identify a team responsible for delivering time-bound targets, with C-suite accountability and expertise to implement

## [ACCOUNTABILITY]

Just as a variety of banks and stakeholders are needed to take actions that reverse deforestation, so a diverse range of skills within banks is needed to implement those actions.[xviii] Based on observations during the 'Soft Commodities' Compact we suggest the following roles:

*Figure 8: Implementation Team*




### C-suite sponsor

Drawn from the Executive Management Board to ensure accountability at the highest level for making progress toward the Key Results specified in Action 3.

### Senior coverage banker

Responsible for overseeing relationship managers' engagement with clients in soft commodities supply chains, including supporting client transitions away from deforestation risk.

[xviii] The specific steps these individuals take so the bank can deliver the action points, and their motivations for doing so, are detailed under each of the other Action Point sections.

To tackle the challenge of transitioning carbon intensive sectors, some leading banks have a senior coverage banker overseeing those responsible for client engagement. Such a role and responsibilities could also be created to support client transitions in soft commodity supply chains.

### ESG solutions

Some banks have begun to develop ESG solution teams.[52] These groups are empowered to scale financing to support sustainability objectives, such as those suggested in this paper. Product area expertise could include:

1. Trade finance
2. Revolving credit facilities
3. Term loans
4. Project financing
5. Microfinance or small project securitisation, to enable aggregation of producer financing to the landscape level so it can be marketed to capital markets
6. Bond or fund structuring, e.g. sustainability bonds (covered, senior unsecured, etc.)
7. Blended finance

### ESG risk and policy

An individual with responsibility for the design, update and implementation of the soft commodities sector and anti-deforestation policies across the bank.

### IT Change and IT Operations

Individuals capable of ensuring the shared data vault connects to existing data architecture and visa-versa.

### Legal

Member of the legal team capable of ensuring that the collaborative action complies with applicable laws. Empowered to sign off positions without introducing referral delays.

### Credit risk

Drawn from the team responsible for TCFD implementation or climate risk modelling and placed within the credit risk team, this individual ensures that the data gathered in the shared data vault becomes useful over time in the credit risk framework. The hypothesis is that the risk profile of clients aligned with anti-deforestation standards improves.[53]

### Group sustainability policy

Member from this team ensures that group policy positions, and the global alliances that the bank is a part of, make the Key Results in Action 3 easier to achieve.

#### Communications

Individual responsible for promoting the successes of the collaborative action internally and externally.

#### Origination / Capital markets

Someone with visibility of institutional clients interested in green finance opportunities. Sitting in-between the coverage bankers and product/structuring team, the individual will make sure the financing proposition is attractive to enough investors.

#### Development finance and philanthropy

An individual with a working level relationship with development finance institutions and philanthropic foundations so they can be plugged into any blended, concessional producer financing structures distributing financial benefits.

### Entrepreneurialism is a desired character trait

Supporting client transitions away from deforestation risk commodities and, in turn, increasing the volumes of deforestation-free and forest restorative commodities is first and foremost a business development challenge. It means engaging clients and connecting capital with producer financing opportunities so that financial benefits can scale sustainable soft commodity supply. It also requires patience and persistence, relying on external entities to supply feasible projects and external sources of capital to fund financial benefits (corporates, DFIs, governments, philanthropy). Entrepreneurialism is therefore a valuable trait for those in the Implementation Team to execute a task that can be "tortuous".[54]

The suggestion of standardised templates for distribution of financial benefits aims to mitigate this; yet momentum is likely to be a challenge until templates are used, data flows back and builds trust, and the producer finance pipeline is strong.

## How to take Action 4 [ACCOUNTABILITY]

For this Implementation Team to succeed they need to be supplied with knowledge, time and tools. The BEI Bank 2030 project notes employee empowerment as a key foundational step for the bank becoming an agent of change in a transition to net zero. As a part of this empowerment, employees are provided with the subject matter education they need to support clients and the time to collaboratively deliver against targets – so that these targets are not side of desk.

Together with education, time also empowers individuals to communicate progress toward the Key Results and the benefits of taking action. Such internal communication can drive additional effort, collaboration and impact across the bank.

## Who else needs to be involved for this action to succeed?

- External education providers to empower individuals with the subject matter expertise needed to succeed.
- Secretariat function to ensure learnings are shared across banks in the collaboration.

## Benefits to banks of taking Action 4 [ACCOUNTABILITY]

Upskilling catalyses conversations with clients about the risks and opportunities associated with deforestation and forest restoration.  This client engagement process, which is a separate project and focus of the Banking Environment Initiative, has the potential to create new demand for sustainability-linked financial solutions, such as those discussed in Action 2.

Those in the Implementation Team would also be better able to analyse:

- The strategic positioning of producers, traders and buyers. Such positioning will be increasingly important as supply chains simplify and food systems evolve. COVID-19 has demonstrated sensitivities in supply chain length and future sources of systemic risk referenced annually by the World Economic Forum, such as climate change, could pose similar threats to resilience.[55]
- How land use change contributes to climate- and nature-related financial risks,[56] as well as how other demographic and consumer trends could impact land use change.
- Potential risks of greenwashing by companies seeking financial benefits without taking meaningful action.
- Credit and business risks, as well as commercial opportunities, of financing certain businesses along the supply chain.

# Action 5: Advocate for government action that makes deforestation commercially unattractive or illegal [SYSTEMIC SUPPORT]

By setting public anti-deforestation commitments, embedding nature- and climate-related risks caused by deforestation and setting targets to scale sustainable soft commodity supply, it becomes in the interest of banks to advocate for policy and regulation favourable to a transition. Doing so enhances the value of leading banks' evolving expertise, financial solutions and transitioning client base.

Steps that governments globally can take to support the five-part Action Plan include:

- Adopting 'no-deforestation'[57] policies.
- Mandatory due diligence obligations on companies along the supply chain, to improve the availability and quality of information about deforestation risk.[58]
- Support adequate protection of forests and local communities who act as stewards, based on the rule of law.[59]
- Price externalities of deforestation (e.g. carbon, biodiversity loss).
- Support sustainable supply chain scaling through trade policy or incentive mechanisms, e.g. the work of the Green Finance Institute on Sustainable Import Guarantees.
- Public procurement criteria that only permit the purchase of deforestation-free goods.
- Introduce a taxonomy that supports investment in forest restoration by local communities, such as landscape financing definitions linked to forest stewardship.
- Provide financial support for producers restoring forests, supporting financial benefits discussed by Action 2.[xix]
- Enhance cooperation between soft commodity producer and consumer countries on the issue of deforestation.

The above is far from an exhaustive list of how governments can support anti-deforestation efforts by finance and business. For further detail on this subject see the recent Global Resource Initiative taskforce recommendations to the UK government on supply chain sustainability.[60]

## Deforestation as a financial crime

If action taken by governments makes deforestation illegal, proceeds resulting from the practice could also come under the purview of banks' financial crime team. Precedents exist from illegal logging, with US incorporated companies connected to the deforestation tried under the Lacey Act.[61] The additional data gathered for the shared data vault (see Action 1) could also help flag reporting discrepancies that trigger litigation under the Foreign Corrupt Practices Act (FCPA) or become evidence in other bribery, money-laundering or corruption litigation.[62]

[xix] This could also be by financially supporting the work of development finance institutions, such as the IFC, who can de-risk the financing structures that deliver financial benefits.

## How to take Action 5 [Systemic Support]

Banks can join forces with other stakeholders to advocate for progressive government action. Policy and public affairs teams at banks can use existing industry alliances, the collective voice of those committed to halting and reversing deforestation, and use evidence gathered from traceability efforts to call for government action.[xx] This could include raising the profile of three potential developments:

1. Sovereign bond risk

   Evidence is emerging that the risk to sovereign bonds is increasing for countries reliant on soft commodity exports. It has been estimated that:

   - US$ 1.7 billion of Argentine government revenues are at risk from anti-deforestation policies.[63]
   - 34 per cent of Brazilian sovereign bonds are exposed to external action on climate and deforestation.[64]

   Banks are well placed to work with governments to determine forward-looking scenarios for sovereign bond appetite and risk profiles.

2. Tipping points in nature

   The planet is approaching dangerous tipping points in nature that will impact political stability and government revenues. Amazon deforestation is dangerously close to causing the local rainfall cycle to degrade to such an extent that parts of the region cannot support tropical rainforest and, by extension, the enterprises, supply chains and communities that rely on this land. 17 per cent of the Amazon has already been deforested; if another 3-8 per cent is deforested then it is estimated that a tipping point will be passed beyond which remaining rainforest can no longer support itself.[65] The effect, including financial effects, of such tipping points will be felt globally. As financial institutions recognise these risks as part of anti-deforestation efforts, they are well placed to share insights with governments.

3. Market awareness of need to halt and reverse deforestation

   In June 2020, investors with US$ 2 trillion assets under management threatened to divest Brazilian government bonds if the escalating destruction of the Amazon was not halted.[66] Demand for banks' financial solutions that meet anti-deforestation standards could become a bellwether for corporate and capital market commitment to halt and reverse deforestation.

[xx] Alliances such as We Mean Business, which includes the CISL CLG Europe group, is an example of business coalition encouraging the development of policies that promote sustainable land use: https://www.wemeanbusinesscoalition.org/about/

## Who else needs to be involved for this action to succeed?

- Commodity **buyers** (corporates and traders), **suppliers** (producers), **investors** and **other stakeholders in soft commodity supply chains** to support advocacy efforts.
- **Industry alliances** to provide a platform for calls to action and position statements.
- An **external research and analysis function** to pool insight gained from bank collaborative action, translated into analysis to highlight any learnings relevant to government, e.g. risks of biodiversity loss. This could constructively complement pre-existing work by NGOs to build transparency around the deforestation challenge, such as that by Global Witness, Rainforest Action Network (Forests and Finance) and BankTrack.

## Benefits to banks of taking Action 5 [SYSTEMIC SUPPORT]

Changes to global policy that make deforestation less commercially attractive or illegal will make it easier to incentivise producers to become deforestation-free or invest in forest restoration. These are tailwinds for banks and others to make progress toward the time-bound targets specified within Action 3.

# 6. Bank action will fail if taken alone: other stakeholders are needed

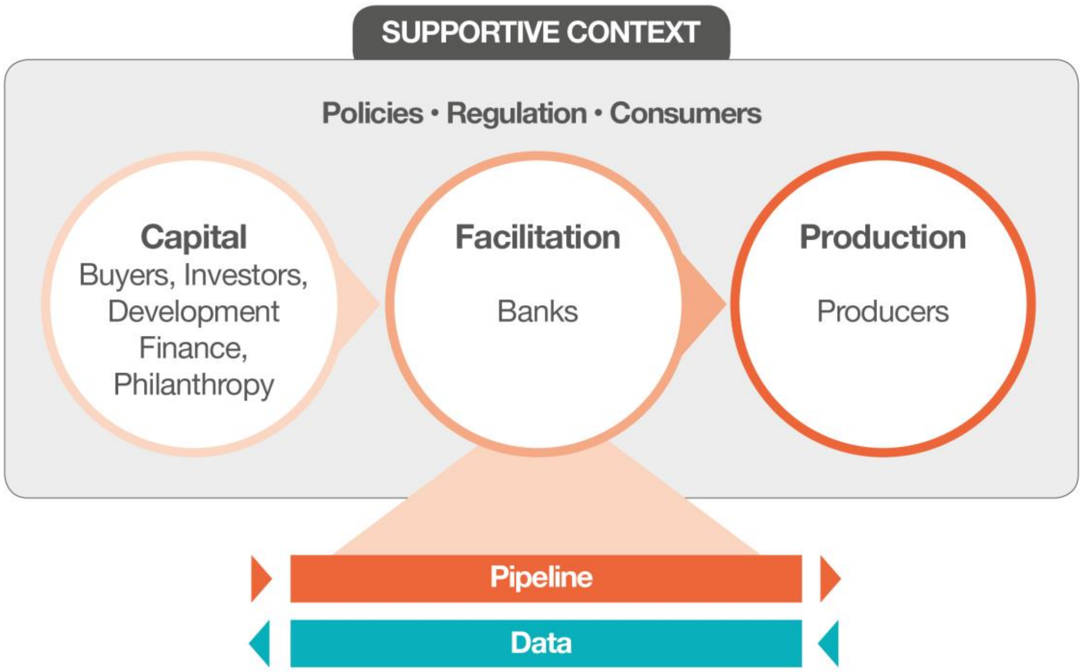
This Action Plan casts banks in the role of facilitator, mobilising the flow of capital to grow deforestation-free and forest restorative production, and supporting client transitions away from deforestation risk commodities. As a facilitator, banks rely on the support and commitment of other parties. Consequently, the Action Plan proposed by this paper requires that:

- Suppliers, buyers and technical experts agree that best practice standards banks put in place in Action 1 are ambitious and attainable.
- Access to data to demonstrate progress toward anti-deforestations standards will be granted by buyers and suppliers.
- Banks' clients engage with their supply chain and banking group in support of the Action Plan.
- Capital is made available by corporate buyers, investors, development finance, philanthropy and others to fund financial benefits Action 2.
- Producers and landscapes to scale sustainable soft commodity supply are accessible.

Further support from governments and regulators can help, setting expectations about soft commodities that make the flow of capital toward verifiable deforestation-free and forest restorative behaviour more attractive (Action 5). As can individuals, by changing purchasing choices and calling on their representatives to support system change.

Without this support, banks cannot create a pipeline of finance for deforestation-free activities (per the below Figure 9).

*Figure 9: Mapping the different stakeholder roles in scaling deforestation-free and forest restorative soft commodity supply*



# 7. Conclusion

Systemic change cannot be achieved by banks alone. However, as a result of the voluntary commitment by 12 banks to adopt the 'Soft Commodities' Compact, it became clear that banks can make a valuable contribution to the reversal of deforestation.

By taking the five actions proposed in this report, a diverse group of local, regional and global banks can:

- Become part of creating the solution to deforestation, rather than waiting for others to define standards.
- Construct a pipeline for capital capable of scaling sustainable soft commodity production.
- Provide corporates, philanthropic foundations, governments and other stakeholders with additional opportunities to support producers transition, improve livelihoods and reverse deforestation.
- Help prove the origin and sustainability characteristics of soft commodity supply and the impact of deforestation-free financing to a higher degree of confidence.
- Encourage higher standards and expectations across soft commodity sectors in halting and reversing deforestation.

## Next steps

Focused global collaboration from all parts of the value chain will be needed to succeed in halting and reversing deforestation.

The diverse group of banks and other stakeholders needed to deliver the Action Plan has yet to be formed. This Plan aims to catalyse banks and stakeholders toward action.

During 2021, CISL will seek expressions of interest from the wider financial sector, corporates, NGOs, policymakers and funders to together develop and implement the Action Plan.

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[59] One stewardship and sustainable forest management programme with government support of note is the PCI programme in Mato Grosso in Brazil. See: The Sustainable Trade Initiative. Mato Grosso, Brazil. Retrieved from: https://www.idhsustainabletrade.com/landscapes/mato-grosso-brazil/ and https://pcimonitor.org/

[60] For the GRI report see endnote: 36

[61] Thoumi, G., Mansell, A. (2018, June). Forest Crimes: Are investors aware of related financial risks?. CFA Institute. Retrieved from: https://blogs.cfainstitute.org/investor/2018/06/21/forest-crimes-are-investors-aware-of-related-financial-risks/

[62] For example see: Human Rights First. (2019, April). The global Magnitsky Act: Frequently asked questions. https://www.humanrightsfirst.org/sites/default/files/hrf-global-magnitsky-faq.pdf

[63] For Grantham Institute, see endnote: 33

[64] ibid

[65] See endnote: 33

[66] See endnote: 16