

INCREASING TRANSPARENCY OF BANKS: THE TRANSITION TO SUSTAINABLE LENDING TO THE FOREST RISK COMMODITY SECTOR

IDENTIFYING KEY METRICS FOR DISCLOSURE OF
LENDING TO THE FOREST RISK COMMODITY SECTOR



EXECUTIVE SUMMARY

Ending deforestation is crucial to addressing the climate crisis. Even with all other anthropogenic emissions phased out, 'business as usual' deforestation alone could still drive global warming above 2 degrees Celsius by year 2100.

Deforestation and climate change also create risks to the soundness of financial institutions and to the stability of the whole financial system. However, the transition to a carbon-neutral and deforestation-free economy presents opportunities for the financial sector, such as financing investments in renewable energy and sustainable agriculture, including sustainable production of forest commodities.

Deforestation and land-use change also increase the risk of pandemics. Wildlife trade, habitat degradation and deforestation all result in increased contact between humans and wildlife, the spillover effect of which is an increased risk of novel and potentially deadly viruses attacking human life. Reducing pandemic risk means working with nature, presenting an opportunity for the financial services sector to take another step towards a sustainable economy.

Building on our work on climate change management within financial services and the shift towards the impacts of financing activities, CDP set out to develop forests-related indicators for the financial services sector and started to engage with lenders to the Forest Risk Commodity (FRC) supply chains in Southeast Asia to drive financial services activities away from deforestation and towards sustainable business practices. A sample of Southeast Asian and global banks engaged in forest risk commodities was identified based on their lending to the FRC supply chains. Our research on financing was focused on palm oil, rubber and timber, as these commodities are driving deforestation in Southeast Asia, which was CDP's initial target region for the project. The highlights of the research on financing were:

- ▼ For companies in the FRC supply chains in Southeast Asia, bank lending is the most important form of financing – making up 66% of their total financing from 2010 to 2018, or US\$66bn.
- ▼ Southeast Asian and East Asian lenders commit the most financing to companies in FRC supply chains in Southeast Asia. Financing of palm oil is dominated by Southeast Asian lenders while timber products is dominated by East Asian lenders.
- ▼ Lending to companies in the FRC supply chains in Southeast Asia is very concentrated. Just 24 banks accounted for over 72% of lending from 2010 to 2018.
- ▼ Indonesian banks are the most exposed to forests-risks relative to the total size of their loan books.
- ▼ European lenders are being more selective about which companies in the FRC supply chains they lend to. Of the loans committed from 2010 to 2018 by European banks, 69% were to companies that SPOTT rank in the most sustainable band, compared to only 33% of loans committed by Southeast Asian banks.

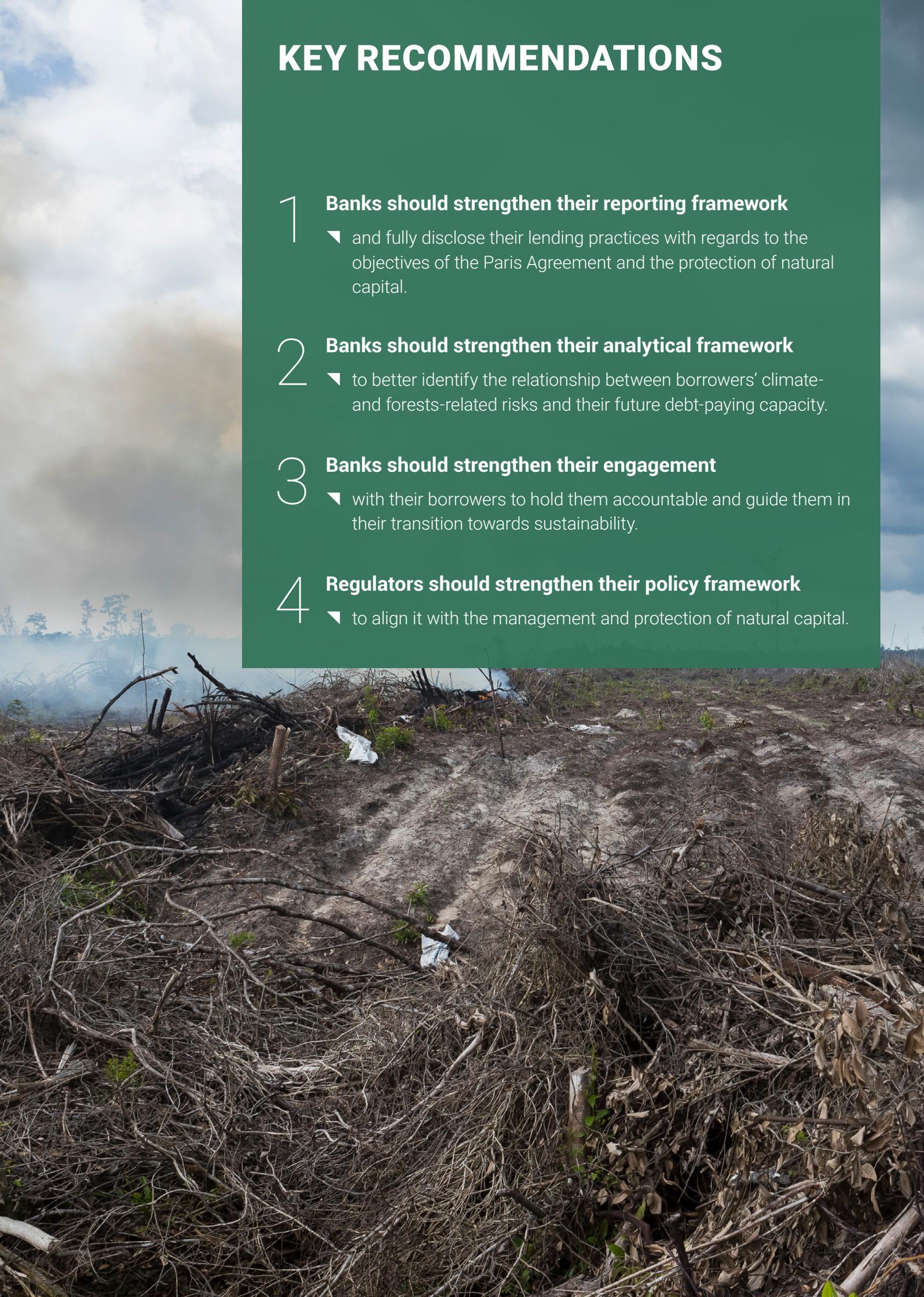
When starting the development work on the pilot questionnaire aiming to increase transparency of banks, CDP first conducted research on indicators for the banking industry's forest-related risks and opportunities. We drew upon existing work from organizations, coalitions and initiatives, including frameworks and tools relevant to the financing of FRC driven deforestation.

We also undertook research on the regulatory landscape in the relevant countries, namely Indonesia, Malaysia and Singapore to establish to which extent CDP's reporting framework could or should be informed by, or support, the local reporting requirements. As a conclusion, CDP's reporting framework will directly facilitate Malaysian and Singaporean reporting requirements, but it will also support the banks' regulatory reporting in Indonesia.

Disclosure is the essential first step to drive environmental action. By creating a robust reporting framework including forests-related indicators for the financial services sector and by engaging with lenders to the FRC supply chain and their investors and the financial regulators, CDP believes that this project will strongly contribute to driving banks from unsustainable lending practices to sustainable lending practices and thereby contribute to eliminating deforestation.

KEY RECOMMENDATIONS

- 1 Banks should strengthen their reporting framework**
 - ▼ and fully disclose their lending practices with regards to the objectives of the Paris Agreement and the protection of natural capital.
- 2 Banks should strengthen their analytical framework**
 - ▼ to better identify the relationship between borrowers' climate- and forests-related risks and their future debt-paying capacity.
- 3 Banks should strengthen their engagement**
 - ▼ with their borrowers to hold them accountable and guide them in their transition towards sustainability.
- 4 Regulators should strengthen their policy framework**
 - ▼ to align it with the management and protection of natural capital.



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Sponsor

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About CDP

CDP is a global non-profit that drives companies and governments to reduce their greenhouse gas emissions, safeguard water resources and protect forests. Voted number one climate research provider by investors and working with institutional investors with assets of over US\$106 trillion, we leverage investor and buyer power to motivate companies to disclose and manage their environmental impacts. Over 8,400 companies with over 50% of global market capitalization disclosed environmental data through CDP in 2019. This is in addition to the over 920 cities, states and regions who disclosed, making CDP's platform one of the richest sources of information globally on how companies and governments are driving environmental change. CDP is a founding member of the We Mean Business Coalition.

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