

# 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



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# 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.

# INTRODUCTION

**Ending deforestation is critical 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. Conversely, halting deforestation and allowing restoration and recovery of degraded forests can contribute up to 30% of global mitigation potential.**

Last year, the scale of the fires in the Amazon and Australia drew much needed attention to deforestation and its critical interlinkages with holistic climate management. Building on our work on climate change management within financial services and the shift towards the impacts of financing activities, CDP started working on developing forests-related indicators for the financial services sector.

This year, previous progress on climate change management has been overshadowed by the COVID-19 health crisis and its devastating effects on businesses and economies around the world. The coronavirus outbreak has upended the economy, but not deforestation. Instead, the health crisis has had negative effects on land use change through weakened enforcement of forest protection laws, and local monitoring systems, through volatile commodity prices and the lowering of standards to boost the economy and trade. Paradoxically, land-use change only increases the risk of new pandemics. Wildlife trade, habitat degradation and deforestation all mean increased contact between humans and wildlife, the spillover effect of which is an increased risk of new and potentially deadly viruses attacking human beings. Reducing pandemic risk therefore means working with nature, presenting an opportunity for the financial services sector to take a leap forward towards a sustainable economy.

Deforestation and climate change create risks to the safety and soundness of financial institutions and to the stability of the whole financial system. Environmental risks impact financial risks through two main channels, namely physical risks and transition risks. The financial impact of environmental risks and opportunities are illustrated in Appendix 1.

Physical risks arise from increasing severity and frequency of climate and weather-related events. For businesses such events are likely to impact operational costs and lead to disruptions in production capacity, including FRC output. Cost inclines can be expected from fluctuating energy availability, cost of raw materials, damage to assets and infrastructure. A reduction in production capacity can emerge from supply chain disruptions, raw material availability, constraints to labor supply and damage to operational facilities. Production disruptions will feed into rising operational costs as well. Companies can expect lower profit margins, missing revenue targets and in the long term reduced credit worthiness.

Transition risks arise from the adjustment towards a carbon-neutral economy, including halting deforestation, which will require significant structural changes to the economy. Extensive policy, legal, technology, and market changes to address mitigation and adaptation requirements may prompt a reassessment of a wide range of asset values, a change in energy prices, and a fall in income and creditworthiness of some borrowers. This entails credit losses for lenders and market losses for investors.

However, it is important to note that the transition to a carbon-neutral economy also presents business opportunities for the financial sector, such as financing investments in renewable energy and sustainable agriculture, including sustainable production of forest commodities.

This report provides preliminary findings from CDP's current project, **Increasing Transparency of Banks: The Transition to Sustainable Lending to the Forest Risk Commodity Sector**. It has three main outcomes:

- ▼ Improved adoption of publicly available forests safeguard policies to ensure sustainable lending among banks within the Southeast Asian (SEA) finance sector.
- ▼ Increased transparency among the banks financing agricultural commodities.
- ▼ Financial regulators, Nordic and European financial institutions hold SEA financial institutions to account on financing of forests related risk – ensuring that the funding is based on sustainable practices.

# SCOPING WORK AND IDENTIFICATION OF STAKEHOLDERS

The research identified a number of Southeast Asian and global banks engaged in forest risk commodities based on their lending to the FRC supply chain. Financing research was focused on palm oil, rubber and timber, as these commodities are driving deforestation in Southeast Asia<sup>1</sup>. The list formed a target group of banks to involve in the pilot.

## Identification of Lenders to the FRC Sector

In the stakeholder mapping process, CDP conducted extended research on the financing landscape of the FRC sector in Southeast Asia. The research was based on data made publicly available by Forests & Finance, a joint project of the Rainforest Action Network, Tuk Indonesia, and Profundo ([www.forestsandfinance.org](http://www.forestsandfinance.org)). The research studied total lending volumes to the FRC sectors by bank from 2010 to 2018, and the respective lending volumes per relevant commodity, namely palm oil, rubber, and timber. In doing so, we identified a select group of high impact banks based on top 20 SEA and top 23 global banks' lending volumes to the FRC sectors. The detailed findings of this research are outlined in subsequent sections.

**Figure 1 - Top 20 SEA banks and 23 global banks based on lending volumes to FRC sectors**

#	Bank	Country	Total Lending (US\$,2010-18)	% of Global Lending (2010-18)
1	Bank Rakyat Indonesia	Indonesia	3,332,572,121	5.21%
2	Bank Mandiri	Indonesia	3,073,079,832	4.81%
3	Oversea-Chinese Banking Corporation	Singapore	2,675,867,688	4.19%
4	Malayan Banking	Malaysia	2,553,463,090	4.00%
5	DBS	Singapore	2,093,421,435	3.28%
6	Bank Negara Indonesia	Indonesia	2,064,806,014	3.23%
7	Public Bank	Malaysia	1,360,392,424	2.13%
8	CIMB Group	Malaysia	1,269,391,803	1.99%
9	United Overseas Bank	Singapore	1,209,391,205	1.89%
10	RHB Banking	Malaysia	1,141,141,202	1.79%
11	Indonesia Eximbank	Indonesia	700,118,112	1.10%
12	AmBank Group	Malaysia	574,028,532	0.90%
13	Bank Pan Indonesia	Indonesia	510,178,727	0.80%
14	Bank Central Asia	Indonesia	320,284,195	0.50%
15	Bank DKI	Indonesia	241,719,685	0.38%
16	CT Corpora	Indonesia	138,817,800	0.22%
17	Bank of Philippine Islands	Philippines	135,419,660	0.21%
18	Siam Commercial Bank	Thailand	129,192,971	0.20%
19	Export-Import Bank of Malaysia	Malaysia	113,129,650	0.18%
20	Affin	Malaysia	105,419,129	0.16%
Total			23,741,835,276	37.15%

1. **Pendrill, Florence, et al.** "Deforestation displaced: trade in forest-risk commodities and the prospects for a global forest transition." *Environmental Research Letters* 14.5 (2019): 055003.

#	Bank	Country	Total Lending (US\$,2010-18)	% of Global Lending (2010-18)
1	SMBC Group	Japan	5,815,439,156	9.10%
2	Mizuho Financial	Japan	4,204,885,707	6.58%
3	Mitsubishi UFJ Financial	Japan	3,131,898,999	4.90%
4	HSBC	UK	1,706,835,671	2.67%
5	Standard Chartered	UK	1,665,390,619	2.61%
6	Credit Suisse	Switzerland	1,303,394,705	2.04%
7	Rabobank	Netherlands	835,925,002	1.31%
8	ABN Amro	Netherlands	834,292,309	1.31%
9	Citigroup	USA	803,658,997	1.26%
10	JPMorgan Chase	USA	660,151,772	1.03%
11	BNP Paribas	France	592,347,941	0.93%
12	Bank of America	USA	528,114,766	0.83%
13	Cathay Financial	Taiwan	494,905,165	0.77%
14	ING Group	Netherlands	376,596,799	0.59%
15	Barclays	UK	329,676,954	0.52%
16	Credit Agricole	France	304,221,599	0.48%
17	BPCE Group	France	222,814,641	0.35%
18	Raiffeisen Bank International	Austria	172,862,391	0.27%
19	Commerzbank	Germany	161,170,815	0.25%
20	Deutsche Bank	Germany	160,536,660	0.25%
21	NatWest Group plc	UK	160,198,189	0.25%
22	Santander	Spain	158,502,034	0.25%
23	Societe Generale	France	118,099,272	0.18%
Total			24,741,920,165	38.71%
<b>Grand Total</b>			<b>48,483,755,441</b>	<b>75.86%</b>

## Preliminary findings

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.

Deal-level data was available for term loan and Revolving Credit Facility (RCF) deals, as well as bond and equity underwriting deals. It showed that companies within FRC supply chains in Southeast Asia rely primarily on bank lending for their financing needs. Term loans accounted for 41% of financing and RCFs 25%, together reaching US\$66bn over the 8 years. This shows that banks' largest exposure to risks associated with forest risk commodities will generally be within their loan book, and this would be a good place to start with any portfolio analysis. It also suggests that banks wield a great deal of influence over companies in forest risk commodity supply chains, and they could improve outcomes by making their lending conditional on sustainable practices.

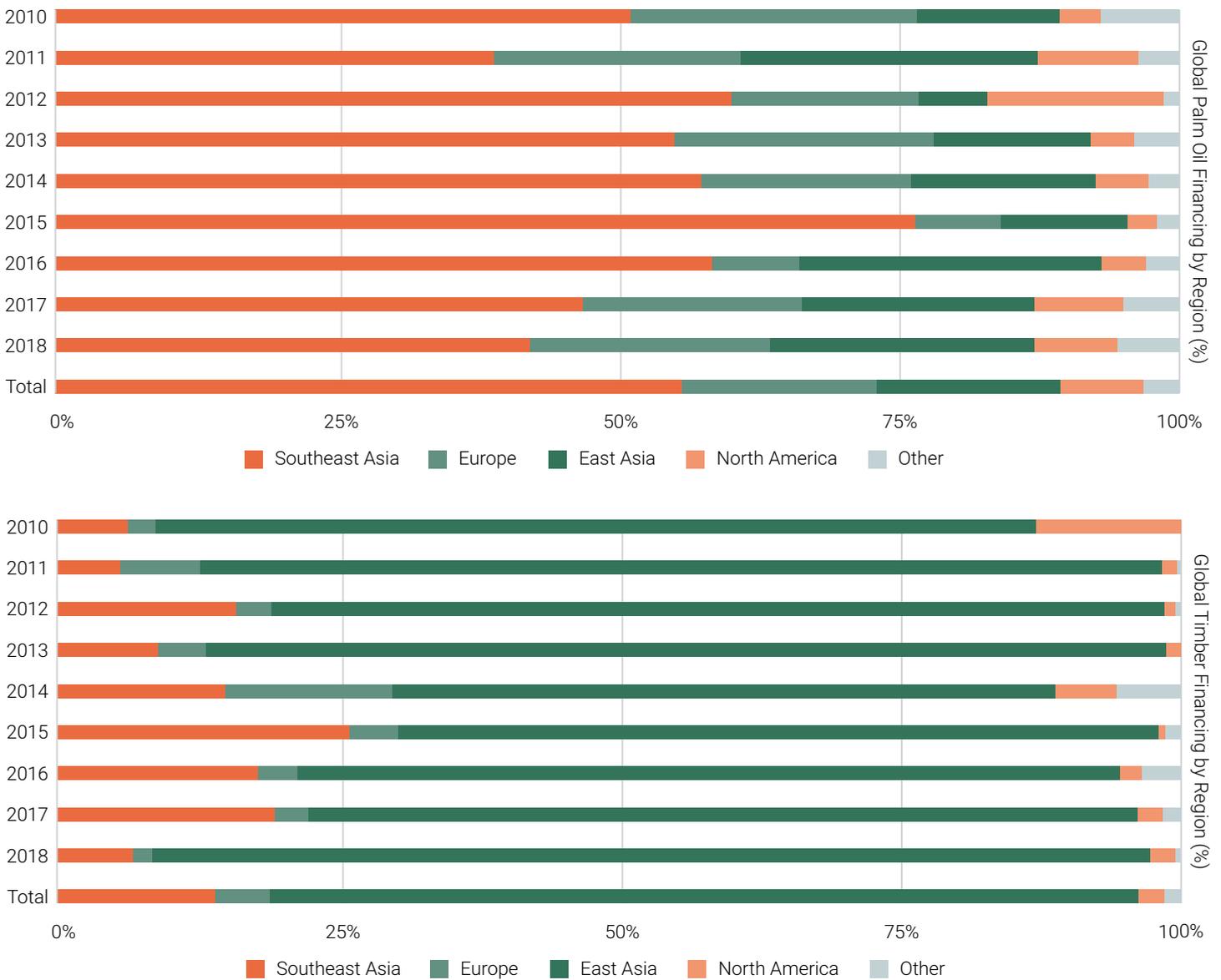
Figure 2 - Global financing to FRC sector by product type (US\$)



▼ 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 are dominated by East Asian lenders.

Companies in forest risk commodity supply chains in Southeast Asia are financed primarily by banks with closer geographic links to the region. But the picture is not identical across all commodities. Southeast Asian banks provide the most lending to palm oil companies, committing 56% of financing from 2010 to 2018, or US\$29bn. Financing of timber products is dominated by East Asian lenders who committed 77% of financing from 2010 to 2018, or US\$24bn. If a bank is exposed to one forest risk commodity over the others, as the data suggests Southeast Asian banks are with palm oil, they may be able to start with a commodity-specific policy covering that commodity.

Figure 3 - Global palm oil and timber financing by region (%)



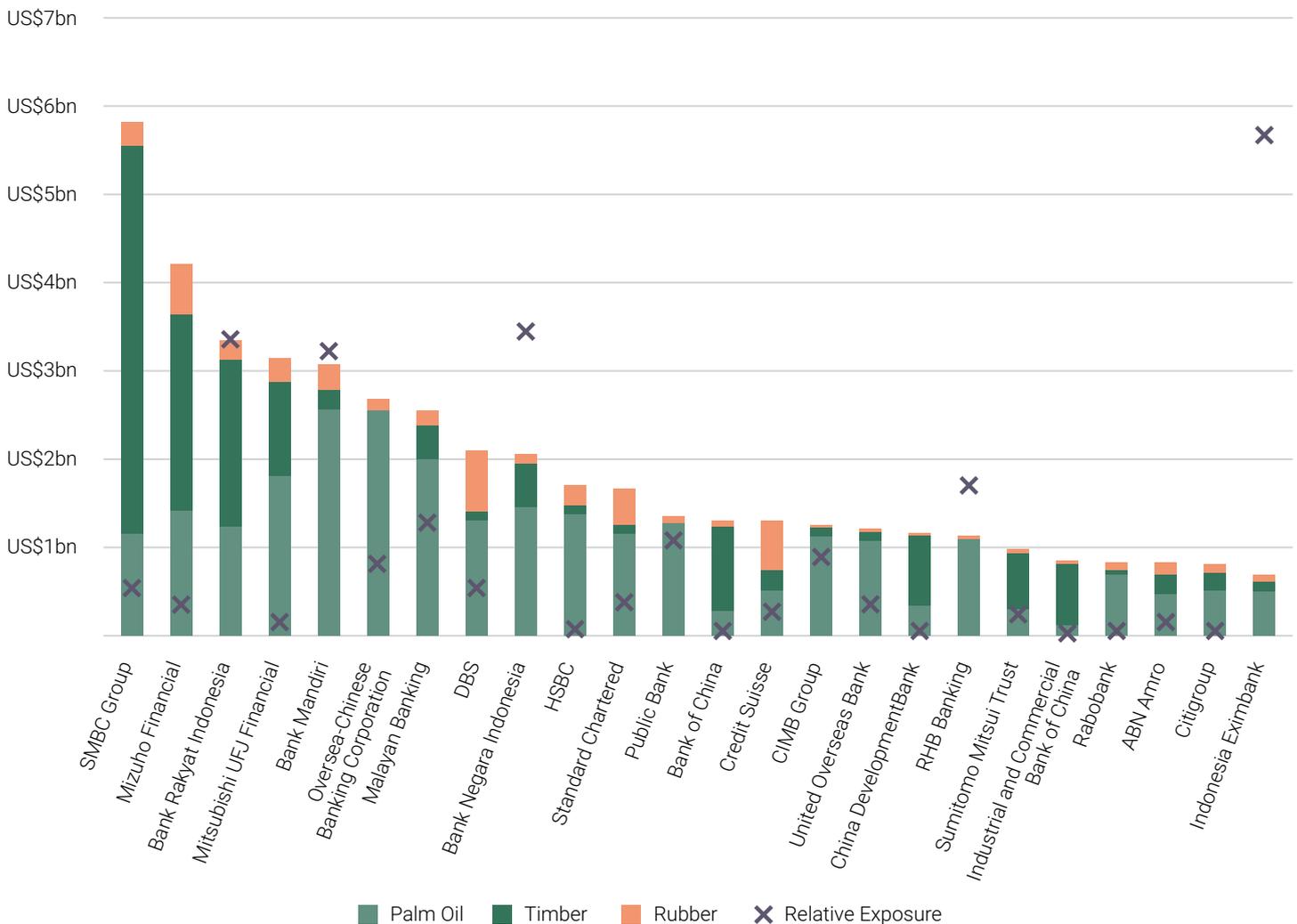
▶ **Lending to companies in the FRC supply chains in Southeast Asia is very concentrated. Just 24 banks accounted for over 72% of lending from 2010 to 2018.**

The concentrated lending suggests that action by just a small number of financial institutions could have a very significant impact in driving a shift away from lending practices that abet deforestation. If these 24 banks engaged with existing clients to ensure practices transitioned from unsustainable to sustainable, and made their lending to new clients conditional on sustainable agricultural practices, it would significantly reduce the financing options available to companies producing unsustainable forest risk commodities and not willing to change.

▶ **Indonesian banks are the most exposed to forests-risks relative to the total size of their loan books.**

Even if the amount of financing flowing into the FRC sectors seem eye-watering, banks may argue that in the context of their overall balance sheet the risks are not material. This may be true for some global banks with total assets in the US\$ trillions, but the data shows for some banks, particularly in Indonesia, lending to companies in forest risk commodity supply chains makes up a much larger and more material proportion of their portfolio. With the deal-level dataset available we were not able to calculate an accurate percentage of each banks' portfolio made up of loans to forest risk commodity companies. While we had data for new loans, we did not have data on loans that exit the portfolio, either through repayment at maturity, prepayment or loan sales. However, we were able to calculate a robust proxy for this by dividing lending to the forest risk commodity sectors from 2010 to 2018 by the total size of each banks' loan book at the end of 2018. The four banks most exposed relative to the total size of their loan books are all Indonesian. While this may be a function of the fact that the palm oil market is a substantially larger part of the Indonesian economy than in other countries, it nevertheless highlights the degree to which Indonesian banks are exposed to FRC risk.

**Figure 4 - Exposure to FRC sectors relative to total size of loan book**

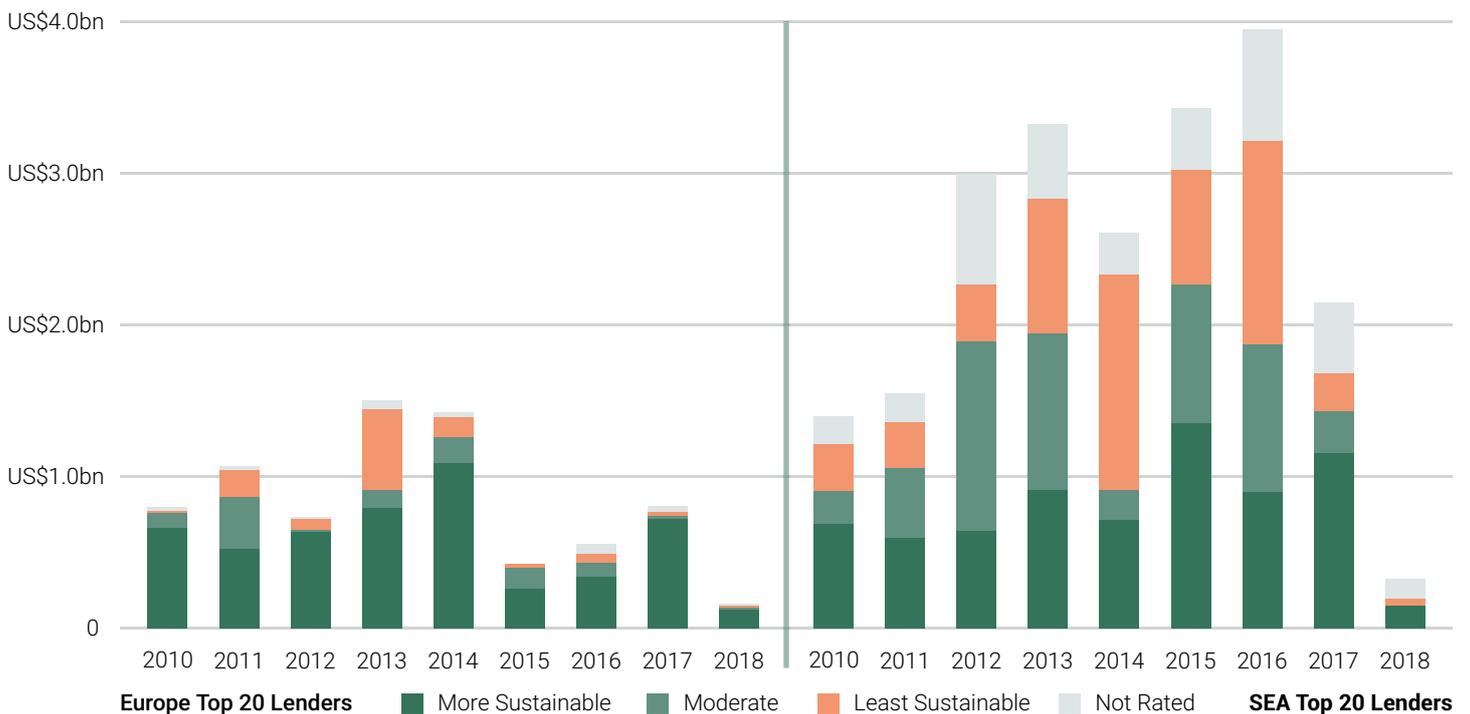


European lenders are being more selective about which companies in the FRC supply chains they lend to. Of the loans committed from 2010 to 2018 by European banks, 69% were to the most sustainable companies, compared to only 33% of loans committed by Southeast Asian banks.

In addition to understanding which banks commit the most financing to companies in forest risk commodity supply chains in Southeast Asia, we were also interested in whether banks were being selective at all and only choosing to lend to best-in-class companies employing sustainable agricultural practices. ZSL SPOTT (Sustainability Policy Transparency Toolkit) assesses commodity producers and traders on their public disclosure regarding their organization, policies, and practices related to environmental, social and governance (ESG) issues ([www.spott.org](http://www.spott.org)). Their assessment ranks companies into one of three bands: higher, moderate and lower. By combining the deal-level data on financing volumes with SPOTT assessment data (data available only for palm oil and timber at the time), CDP was able to determine how much of the financing was directed at sustainable commodity production, and how much was directed at unsustainable production and deforestation.

These results were striking. 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 lenders about which companies they lend to. This suggests that European lenders are more selective than Southeast Asian lenders about which companies they lend to. On the other hand, smaller regional companies in the FRC supply chain may be less robust in their sustainability strategies and they may simply not have access to international capital markets, so their only source of borrowing is local banks. As SEA banks commit more total lending to FRC supply chains than the European banks, they cannot necessarily be as selective about which companies they lend to. As a result, the SEA banks tend to be more exposed to FRC risk than European banks, both relative to the total size of their loan books and relative to risk from unsustainable supply chain practices.

Figure 5 - Palm oil and timber lending by SPOTT band





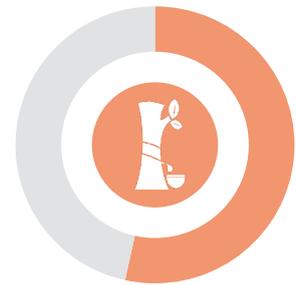
### Palm Oil

- **55%** of the financing directed at FRC sectors went to palm oil



### Timber

- **71%** of global timber financing was term loans and revolving credit facilities



### Rubber

- **53%** of global rubber financing was combined term loans and revolving credit facilities

The total financing of global palm oil peaked in 2012 at **US\$11bn**. When focusing on just bank lending, global palm oil lending peaked in 2013 at **US\$6bn**. Throughout, the banks largest exposure to the palm oil sector was through their loan book (corporate lending). Our research also showed that SEA banks provided most of the financing, the majority of which was term loans, to the palm oil sector, with other important regions being Europe and East Asia.

The banks' largest exposure to the timber sector was through their loan books. Together, term loans and revolving credit facilities make up **71%** of global timber financing (CDP's definition of the timber sector includes paper and pulp). Our research further found that timber financing was dominated by East Asian banks across different products and types of lending. This is likely because the timber companies with operations impacting deforestation in SEA are headquartered in Japan and China, e.g. Itochu.

For the rubber sector, corporate lending is the most important bank product. Term loans and revolving credit facilities combined make up **53%** of global rubber financing. Bond issuances are most often arranged by East Asian banks, while term loans are most often provided by SEA banks, and revolving credit facilities are most often provided by European banks.



# TECHNICAL DEVELOPMENT OF THE REPORTING FRAMEWORK

## Research Methodology Underpinning the Development of Indicators

When starting the development work on the pilot questionnaire, which aims to increase transparency of banks to stop financing deforestation, CDP set out to first research existing and relevant indicators for the banking industry's forest-related governance, strategy, risk management, and metrics and targets. The objective was to identify a set of indicators that describe what action CDP believes banks should be taking, and what metrics they should be tracking, to effectively manage deforestation risks and opportunities within their portfolio. This research was based on CDP's own expertise on financial services and deforestation but also on insight from other civil society organizations and coalitions. In addition, the research on key indicators was informed by relevant initiatives, frameworks and standards.

## Landscape

When developing key indicators for forest-related issues for banks, we started by identifying coalitions, initiatives, frameworks and tools relevant to the financing of FRC driven deforestation. CDP's role is to harmonize with and leverage existing initiatives rather than duplicate, which helps ensure forests-related disclosures requested of banks by investors and other stakeholders are consistent and reporting effort for banks is reduced. A number of the initiatives we drew upon when developing the indicators are listed in Figure 6.

**Figure 6 - Initiatives relevant to the financing of FRC driven deforestation**

Coalitions	Initiatives	Frameworks	Tools
<ul style="list-style-type: none"> <li>▶ PRI Sustainable Palm Oil Investor Working Group</li> <li>▶ TFA2020</li> <li>▶ RSPO</li> </ul>	<ul style="list-style-type: none"> <li>▶ Soft Commodities Compact</li> <li>▶ Forests and Finance</li> <li>▶ Forest 500</li> </ul>	<ul style="list-style-type: none"> <li>▶ Principles for Responsible Banking</li> <li>▶ Principles for Responsible Investment</li> <li>▶ Equator Principles</li> </ul>	<ul style="list-style-type: none"> <li>▶ WWF SUSBA</li> <li>▶ Soft Commodity Forest Risk Assessment</li> <li>▶ SPOTT</li> </ul>

As a second step, we reviewed the individual recommendations of the identified stakeholders for banks, investors and companies. We then sorted the recommendations which were the same or similar into categories. The categories were defined as per the themes set out by the **Task Force on Climate-related Financial Disclosures** (TCFD): Governance, Strategy, Risk Management, and Metrics and Targets.

Where a category was a recommendation for a company, we converted it into an equivalent recommendation for a bank, as the third step in our approach.

Next, we decided which categories were relevant and could become indicators for banks financing FRC driven deforestation. We then ordered the categories in a sensible and logical sequence.

We finally reworded the results into the final set of key indicators listed in Appendix 2.

## Regulation

### Indonesia

The **Indonesia Stock Exchange** is supervised by **Otoritas Jasa Keuangan (OJK)** – the Financial Services Authority of Indonesia which regulates and supervises the country's financial services sector – but is self-regulatory and regulates its own market and possesses the ability to enact rules on listing and membership requirements. The Indonesia Stock Exchange has, however, not signed the UNEP FI Sustainable Stock Exchanges Commitment Letter and does not require ESG reporting as a listing rule. OJK, on the other hand, took over regulatory and supervisory duties from the Indonesian central bank in 2013. In addition to usual banking regulation architecture such as licensing, capital requirements, prudential management and examination, OJK has published a Roadmap for Sustainable Finance and are introducing regulation in line with this roadmap such as requiring financial institutions to develop a Sustainable Finance Action Plan and produce public Sustainability Reports. Consequently, we did research OJK's Regulation 51 to establish to which extent CDP's reporting framework could or should be informed by, or support, Indonesian reporting requirements.

### Malaysia

**Bursa Malaysia** is the stock exchange on which Malaysian financial institutions and palm oil companies are listed. It is supervised by the Securities Commission but is self-regulatory and stipulates the requirements that need to be met by the regulated entities as well as actively supervising the listed issuers and the participants. Bursa Malaysia has signed the UNEP FI Sustainable Stock Exchanges Commitment Letter and requires ESG reporting as a listing rule. **Bank Negara Malaysia (BNM)** – the Central Bank of Malaysia, acting as banker and adviser to the Government of Malaysia and regulating the country's financial institutions, credit system and monetary policy – is a member of the **Network of Greening the Financial System (NGFS)**, a group of central banks and supervisors willing to share best practices and contribute to the development of environment and climate risk management in the financial sector. BNM works with the industry to implement the recommendations of the FSB **Task Force on Climate-related Financial Disclosures (TCFD)** in Malaysia. As such, CDP's reporting framework will directly facilitate Malaysian reporting requirements.

### Singapore

**Singapore Exchange** is the stock exchange on which Singaporean financial institutions are listed. It is a frontline regulator itself and is only evaluated by the **Monetary Authority of Singapore (MAS)** – Singapore's central bank and financial regulatory authority, administering the various statutes pertaining to money, banking, insurance, securities and the financial sector in general. Singapore Exchange has signed the UNEP FI Sustainable Stock Exchanges Commitment Letter and requires ESG reporting as a listing rule. MAS, on the other hand, is a member of the NGFS, and is promoting sustainable financing in the financial sector, including engaging financial institutions to consider ESG criteria in decision making processes, support the adoption of industry standards and guidelines, encourage industry-led capacity building efforts and collaborate with local stakeholders and international counterparts to distil best practices. Hence, CDP's reporting framework will support Singaporean reporting requirements.



# NEXT STEPS: FROM RESEARCH TO IMPACT

The research conducted in 2019 comprised identifying key SEA financial institutions and regulators for engagement and identifying key metrics for disclosure. Following that research and entering year 2020, we set out for the next steps of the project – with the aim of going from research to impact.

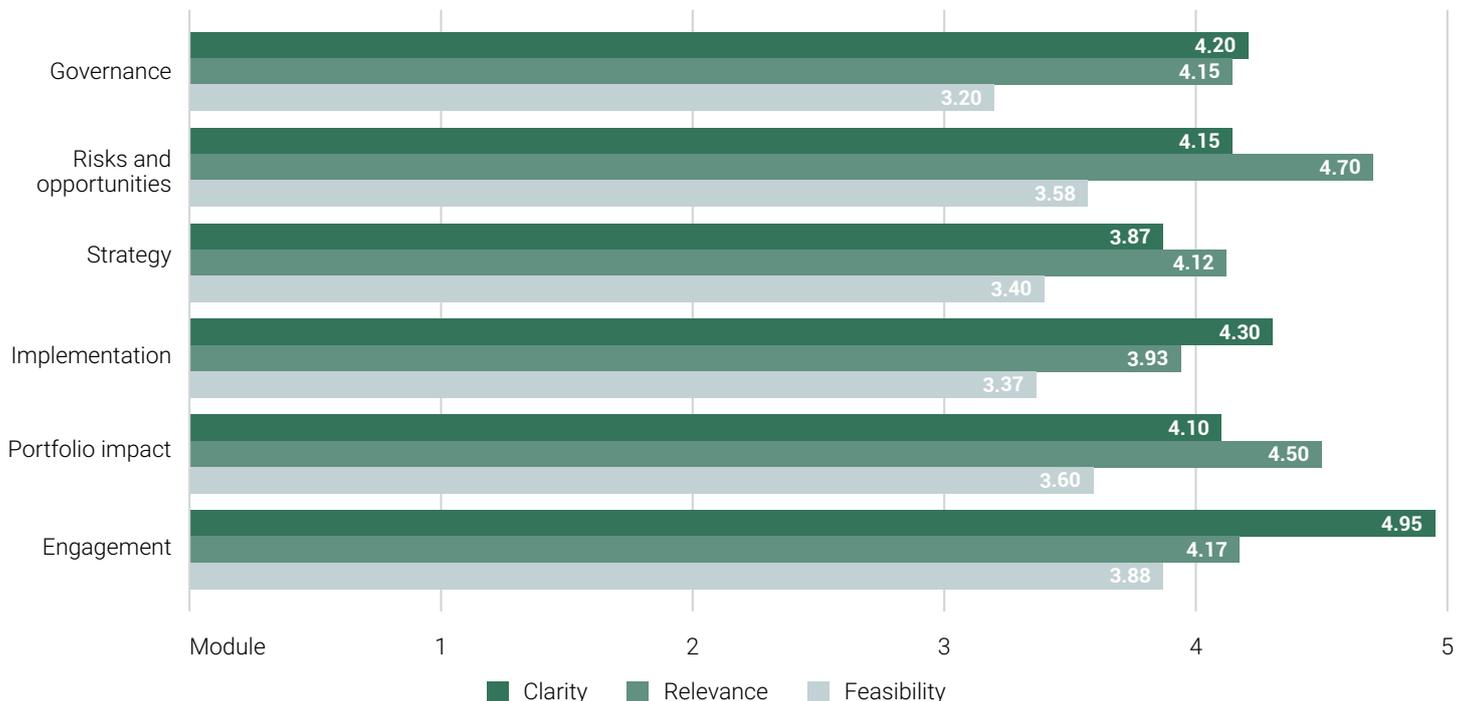
The first of those steps was to, based on the indicators developed during the research phase, draft a pilot questionnaire which aims to increase the transparency of banks to drive the transition to sustainable lending to the FRC supply chain. This underscores CDP’s belief that disclosure leads to action; “what gets measured, gets managed”.

The second step was to consult on the draft questions with a selected Technical Working Group (TWG), consisting of seven SEA banks, three global banks and two civil society members, listed in Appendix 3. This step aimed to perfect the draft questions – to ensure that the questions are clear, relevant and feasible to participating financial institutions to get them committed to disclosing their forests-related issues to CDP. The consultation work started with three workshops: one for the Malaysian banks, one for the Indonesian banks, and a third for the Singaporean banks. In the workshops we introduced the mission, work and reach of CDP, as most of the participating SEA banks currently do not disclose any data to CDP. We also described how environmental risks translate into financial risk, and we presented on the regulatory landscape, including specific regulatory aspects in the respective country. We then introduced the scope of this NICFI funded project and the function and work of the Technical Working Group. Last, we ran a consultation session on a sample of draft questions covering five topics:

- ▼ Governance
- ▼ Financing products and services
- ▼ Forest safeguard policies
- ▼ Engagement
- ▼ Smallholder financing

The workshop consultation session also served as an introduction to the three TWG calls that followed the workshops. Each of the subsequent TWG calls was conducted twice, once in English and once in Indonesian Bahasa. In the calls we presented the TWG with draft questions, and then gave the TWG members two weeks to digest those questions and give feedback, either through a survey or during discussion in the next call. We gathered quantitative and qualitative feedback on a total of 36 questions. The quantitative feedback measured clarity, relevance and feasibility of each question on a scale from 1 to 5 (one being minimum and five being maximum score). The average scores per module in the questionnaire are displayed in Figure 7.

**Figure 7 - Quantitative Feedback; Average Scores per Consulted Module**



The qualitative feedback reflected participants' narrative thoughts on the questions. The feedback was duly analyzed by CDP's project team and used to amend questions and response options. Examples of qualitative feedback are displayed in Appendix 4. One of the key outcomes was the decision to define a bank's "portfolio" in the pilot questionnaire to mean only the lending portfolio or loan book (while "portfolio" in future applications of the pilot questionnaire will cover also other parts of a bank's activities, including off-balance sheet activities such as underwriting). We believe limiting the scope to the lending portfolio in the pilot will assist banks as many methodologies for measuring environmental risk in portfolios are asset class-specific and focused on loan portfolios. Another key outcome was the need for a clear definition of "climate-related" and "forests-related" risks and opportunities. CDP recognizes that any company action that reduces deforestation will also benefit the climate due to the crucial role of forests in addressing the climate crisis. However, we ask that if an action only benefits or harms the climate through a reduction or increase in deforestation, disclosing banks report this as a forests-related issue. The feedback gained from the TWG was also used to inform the project team when writing the guidance for the questionnaire. A key learning from the process was to include different types of stakeholders in the consultation, do that early enough and tailor the format of the consultation to the convenience of the various stakeholders (some TWG members preferred to provide feedback through our survey, others preferred to do it verbally in the calls).

The third step of going from research to impact is the ongoing engagement with the selected banks and investors along with regulators. Through engagement, CDP strives to support the stakeholders in their journey towards sustainability. We recognize that there is global demand for forest commodities such as palm oil, rubber and timber, all of which drive deforestation. We also recognize that the livelihoods of countries such as Indonesia and Malaysia to a large extent are dependent on the production of forest commodities. Financing these activities presents both a business opportunity and a responsibility for SEA banks and beyond. We therefore recognize that putting demand on these banks to stop financing the FRC sector would be detrimental to both social and certain economic aspects of society. Further, this could lead to 'sustainability leakage', whereby other lenders with little or no concern for climate change or deforestation would take advantage and start financing the gap. CDP is therefore committed to engagement with banks in their transition to sustainability, driving their lending away from unsustainable agricultural practices and towards sustainable agricultural practices. CDP's aim is to support the banks in building the capacity required to capture, measure and manage their forests-related risk and opportunities, and to ensure that they fully appreciate the financial impact of their environmental risk management. CDP also aims to ensure that the regulators enforce proper environmental risk management on financial institutions, including transparent disclosure of their environmental risks and impact. Further, CDP strives to get investors to put more pressure on their investees with regards to their forests-related risks and ensure that their business practices are environmentally sustainable.

Last, by asking the targeted SEA banks and global banks to respond to the new pilot questionnaire, CDP will be able to collect important information on forests-related risk exposures and management thereof. The output from the pilot questionnaire will also inform CDP on how to develop and implement the questionnaire as part of CDP's publicly available questionnaire suite in the future.

These next steps are designed to map and measure financial institutions' forests-related risks and opportunities, and thereby guide stakeholders' actions towards impact – to ultimately decouple the financing of forest commodities from deforestation.



**As we take tangible steps to align our lending practices with the objectives of the Paris Agreement, disclosure of our impact and progress is key towards achieving our sustainability commitments and being accountable towards our stakeholders. As a leading bank with presence across ASEAN, we understand the urgency of aligning business growth with sustainable outcomes, such as managing risks across multiple industries including forest-risk sectors. Disclosure through CDP is valuable in helping us to measure, mitigate and monitor our environmental impact in a comprehensive manner.**

**- Luanne Sieh** Head of Group Sustainability, CIMB Group



# CONCLUSION

**The financial services sector is the missing link to the sustainable economies of the future. Most financial services companies' environmental risks come from the activities they enable within the wider economy, rather than their direct operations. Because financial services companies have influence far beyond their immediate operations, they will play a unique and pivotal role in tackling climate change and other pressing environmental issues, such as deforestation and water security.**

Many of these environmental issues have huge health impacts too. For example, deforestation and land-use change increase the risk of novel and potentially deadly pandemics. Reducing pandemic risk therefore means working with nature. Hence, this presents a timely opportunity for the financial services sector to trigger a huge leap forward to sustainable economies. Standardized, tailored disclosure of their impacts is the key first step.

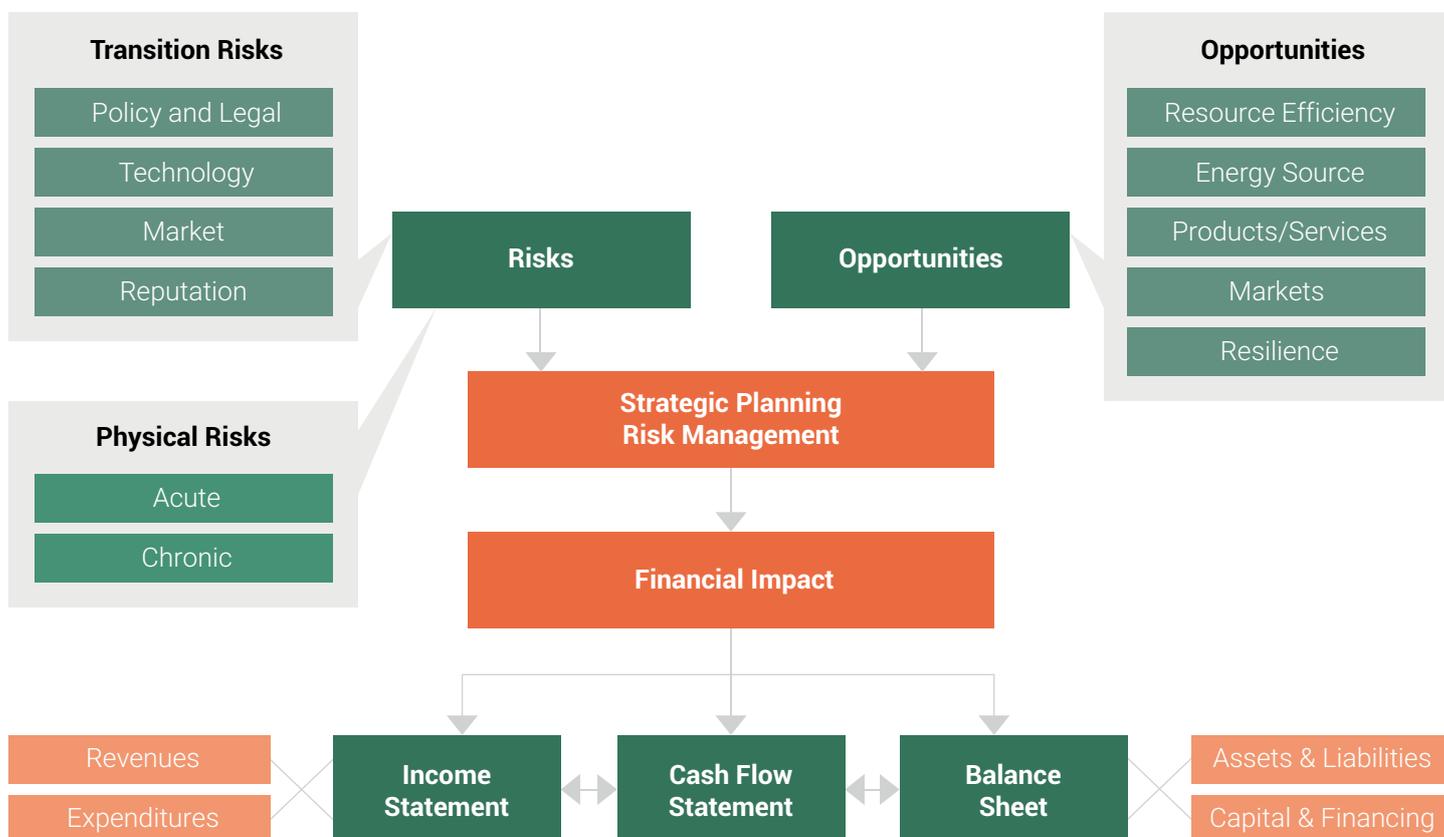
CDP's new questionnaire on financial services, launched in 2020, fills a critical data gap, as identified by the international Task Force on Climate-related Financial Disclosures (TCFD). With a focus on financed emissions, the questionnaire offers a platform to shift the focus beyond operational impacts. It is now evolving to include a wider range of related environmental impacts. For instance, the NICFI-funded pilot project on additional deforestation metrics is a step towards the future of financial sector disclosure.

By creating a robust reporting framework including forests-related metrics for the financial services sector and by engaging with lenders to the forest risk commodity supply chain in Southeast Asia, as well as these lenders' investors and the relevant financial regulators, CDP believes that this project will strongly contribute to stopping banks from financing deforestation.

## **Our key recommendations are:**

- ▼ 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.
- ▼ Banks should strengthen their analytical framework to better identify the relationship between borrowers' climate- and forests-related risks and their future debt-paying capacity.
- ▼ Banks should strengthen their engagement with their borrowers to hold them accountable and guide them in their transition towards sustainability.
- ▼ Regulators should strengthen their policy framework to align it with the management and protection of natural capital.

# APPENDIX I - ILLUSTRATION OF THE FINANCIAL IMPACT OF ENVIRONMENTAL RISKS AND OPPORTUNITIES



Source: Task Force on Climate-related Financial Disclosures

# APPENDIX II - FINANCING ACTIVITY INDICATORS: BEST PRACTICE APPROACH TO MANAGING FOREST-RELATED RISKS



## Governance

1	Assign clear roles and responsibilities at board and senior management levels for oversight of forests-related risks and opportunities impacting the bank's financing activities
2	Incorporate performance with regards to sustainability into incentive structures and performance assessment frameworks across the organization, including forests-related KPIs where relevant
3	Participate in and actively engage with industry schemes and external initiatives relevant to industries and activities it finances (e.g. RSPO)
4	Engage in peer-to-peer learning, taking a leadership role and sharing best practice where appropriate, or developing their own response to forests-related risks with reference to best practice policies of more advanced banks
5	Make the bank's forest risk commodity policy, or policy (or policies) that specifically covers the financing of forest risk commodities, publicly available
6	Have a clearly defined process for regularly reviewing and amending its forest risk commodity policy
7	Report in a transparent way using recognized disclosure standards and frameworks e.g. TCFD, GRI and integrates disclosures into existing reporting, including forests-related disclosures where relevant
8	Disclose credit exposure to each forest risk commodity sector
9	Disclose processes used to establish and monitor if clients are in compliance with the bank's policy and their own targets
10	Disclose the percentage of clients in each forest risk commodity supply chain that are compliant with the bank's policy and their own targets
11	Disclose processes used for engaging with clients in the case of non-compliance with the bank's policy or their own targets
12	Disclose details of new financial products deployed intended to support the transition by clients to deforestation/conversion-free production or consumption
13	Work transparently with regulators and advocate for and support regulatory developments which enable the transition to deforestation/conversion-free financing



## Strategy

1	Have a policy that includes forests-related issues, or a policy (or policies) that specifically covers the financing of forest risk commodities
2	Require clients to make commitments:
2.1	▼ Require clients to commit to no deforestation/conversion
2.2	▼ Require clients to have a commitment to protect HCV/HCS

2.3	▼ Require clients to have a commitment to not adversely impact protected areas
2.4	▼ Require clients to have a zero-burning policy
2.5	▼ Require clients to protect peatlands regardless of depth
2.6	▼ Require clients to ensure the Free Prior Informed Consent (FPIC) of indigenous and local communities
2.7	▼ Require clients to have a policy that protects legal and customary land rights
2.8	▼ Require clients to have a policy that protects human rights including labor rights
2.9	▼ Require clients to conduct a Social and Environmental Impact Assessment on all new developments
2.10	▼ Require clients to not trade in or harvest IUCN Red List or CITES species
2.11	▼ Require clients to address gender equality issues
3	Encourage clients to have board oversight of forest risks
4	Require clients to publicly disclose on relevant forest related information about their business practices, such as volumes produced/used, and information on landbank, processing facilities, and identity of suppliers
5	Require clients to be engaged in multi-stakeholder initiatives and industry schemes
6	Require clients to comply with all applicable local, national, and international laws and regulations
7	Require clients to have a policy that prohibits all forms of bribery and corruption
8	Require clients to have grievance mechanisms in place to identify and remedy adverse social and environmental impacts linked to their operations and/or supply chain
9	The bank's forest risk commodity policy covers all products, regions, deals regardless of size, clients and stages of the supply chain
10	Require clients to set quantifiable targets towards achievement of commitments:
10.1	▼ Require clients to set a target for producing or sourcing forest risk commodities through a credible certification scheme
10.2	▼ Require clients to set a target for the traceability of forest risk commodities they source
11	Require clients to disclose forest risk commodity volumes compliant with commitments (certification/traceability)
12	Require clients to have systems in place to monitor compliance in their supply chain and to engage/support with their suppliers to help achieve compliance with their commitments
13	Encourage clients to commit to a landscape level/jurisdictional approach
14	Encourage clients to promote smallholder participation in forest risk commodity supply chains
15	Encourage clients to have projects focused on ecosystem restoration and protection
16	Include covenants which reflect the bank's forest risk commodity policy requirements in legal financing agreements
17	Have systems in place to support and build capacity with clients to help them comply with the bank's policies
18	Provide innovative financing solutions to support the transition towards sustainable forest risk commodity supply chains. e.g. through financing individual clients who are producing or consuming commodities sustainably, offering preferential loan rates, facilitating products such as zero-deforestation bonds, credit schemes for smallholders, or supporting jurisdictional certification approaches



## Risk management

1	Conduct portfolio analysis to assess overall exposure to forests-related risks, identify parts of the portfolio most exposed and identify priority clients for engagement
2	Conduct scenario analysis to understand potential changes to the bank's portfolio and exposure to forests-related risks under different scenarios including changing regulation, changing consumer tastes and different climate scenarios
3	An assessment of forests-related risks and opportunities is embedded in the bank's transaction level processes and procedures (e.g. risk assessments, approval processes) and outcomes influence decision making
4	Embed forest-risk considerations into due diligence processes at on-boarding and throughout the client lifecycle, both by checking certification levels and more in-depth company- and site- level due diligence where appropriate
5	Require that clients in forest risk commodity supply chains are independently verified to check compliance with the bank's policy and agreed targets
6	Use existing specialist tools to monitor forests-related risks and impacts amongst portfolio clients (e.g. SPOTT)
7	Engage portfolio companies found to be non-compliant with the bank's policy to agree quantifiable targets and support the transition towards compliance
8	Carefully consider at what point to divest from a client if repeated engagement does not bring about a transition towards compliance
9	Staff are educated and trained on sustainability issues, including on the bank's forest risk commodity policy and on forests-related risks at a more technical level where relevant



## Metrics and targets

1	Total value of banking services provided to forest risk commodity sectors
2	Loans qualified under schemes aimed at giving smallholders access to long term credit
3	Proportion of loans to the forest risk commodity sectors for which ESG risk assessment was performed
4	Percentage of clients compliant:
4.1	▼ Percentage of clients compliant with bank's forest risk commodity policy
4.2	▼ Percentage of clients that have set quantifiable targets and are compliant with those targets
4.3	▼ Percentage of credit exposure to forest risk commodity sectors to clients compliant with the bank's policy
4.4	▼ Percentage of credit exposure to forest risk commodity sectors to clients that have set quantifiable targets and are compliant with those targets
5	Timebound target with milestones towards full achievement of the bank's commitments
6	Number of employees that have been trained on the bank's forest risk commodity policies in order to monitor and support clients towards compliance

# APPENDIX III - TECHNICAL WORKING GROUP MEMBERS



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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.

Visit <https://cdp.net/en> or follow us @CDP to find out more.