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BANKING ON SUSTAINABILITY

What would happen if banks pushed deforestation out of their portfolios and only support companies that produce responsibly?

We urgently need new business models that support better commodity production," says Andrew Voysey. "And to enable these different business models to develop at the pace and scale required, we need to mobilize financial capital."

Andrew leads the Cambridge Institute for Sustainability Leadership's (CISL) engagement with the finance sector. In 2010, CISL established the Banking Environment Initiative (BEI), convening a group of international banks to look at how the industry can direct capital towards socially and environmentally sustainable development.

At around the same time, the Consumer Goods Forum (CGF) – which represents over 400 of the world's largest retailers, manufacturers and service providers – made a public pledge to drive deforestation out of their supply chains by 2020. CISL helped the groups spot a natural alliance.

"The BEI banks and the CGF Board formed a partnership to investigate what it would mean to align banking services with the CGF resolution," explains Andrew. "We spent eighteen months exploring these issues, with guidance from WWF."

SOFT COMMODITIES COMPACT

The result was the Soft Commodities Compact. Banks that adopt the Compact require their clients operating in the palm oil, forestry or soy sectors to adopt credible third-party certification that confirms these commodities are produced sustainably, by 2020 at the latest. At the same time, these banks work with companies and their supply chains to develop "responsible financing solutions that support the growth of markets producing palm oil, timber products, soy or beef without contributing to deforestation".

"In the same way that we're seeing commodity buyers and producers making commitments for higher sustainability standards, the Compact articulates a commitment to those same standards from the banking industry," says Andrew.

To date, ten international banks, representing around a fifth of the international financing of agricultural commodities have adopted the Compact. The BEI and WWF expect more banks to join them.

"As one of the largest companies in our region and a major banker to agribusiness, Westpac has a responsibility to use its influence to help protect the environment and the rights of the local communities in which we operate. Our commitment to the Soft Commodities Compact will help us better support our customers, many of whom are members of the Consumer Goods Forum, and their efforts towards net zero deforestation in their supply chains."

Tony Smith, Westpac Institutional Bank's Head of Consumer & Agribusiness

WWF TARGETS

2020 Banks/investors finance global soft commodities in a sustainable manner, meeting the world's growing need for food and fibre while conserving environmental resources.

PROGRESS

Convergence among global banks toward the use of credible standards as a key lending and investing threshold for soft commodities.

Increasing impact on banking policy with ten banks currently signed up to the Soft Commodities Compact, covering palm oil, soy and timber.

CONTEXT

Threats

- Higher business risk and negative outcomes among borrower companies from poor environmental and social performance.
- Unanticipated exposure to macro-risks from underlying resource scarcity and volatility.
- Reputational risks to banks from exposure to irresponsible practices.
- Loss of access to markets reducing financial performance of borrower.

Opportunities

- More profitable, lower-risk client base.
- New financial products and services based on sustainable production and trade.
- Better client relations and more repeat business for banks.
- Portfolios more resistant to macro-risks related to environmental degradation and demographic change.

SUSTAINABLE SHIPMENT LETTER OF CREDIT

The first "financing solution" has already appeared in the form of the Sustainable Shipment Letter of Credit. Letters of credit exist to resolve a basic conundrum in any transaction: the seller doesn't want to deliver the goods until they have received payment, and the buyer doesn't want to pay until they have received the goods. In such a situation, banks can step in with a guarantee that the seller will receive payment, assuming certain conditions are met. This simple instrument supports a significant proportion of international trade, especially in emerging markets.

"The finance industry plays a crucial role in joining up buyers and sellers," explains Andrew. The BEI has been looking into how letters of credit can incentivize sustainable commodity trade, starting with palm oil. The Sustainable Shipment Letter of Credit makes it possible to differentiate shipments of certified sustainable palm oil (CSPO) from uncertified shipments. Thanks to guarantees from the International Finance Corporation, banks are able to offer their clients preferential terms on CSPO shipments.

"It's an early prototype of a financial product that offers an economic incentive for sustainable commodity trade," says Andrew. "In principle a letter of credit for sustainable production is possible wherever supply chains have chain of custody processes in place."

As well as helping CGF members to meet their zero net deforestation targets, the BEI is looking into what services banks can provide to support producers on the ground – for example, to help smallholders in developing countries to intensify production while conserving landscapes. "Ultimately, what we want to do is to make it easier to raise capital for sustainable commodity production," says Andrew.

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To stop the degradation of the planet's natural environment and to build a future in which humans live in harmony with nature.

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