

The banks and investors exposed to deforestation risks in Southeast Asia

See the  
impacts

Photo: Ulet Ifansasti / Wildlife Asia / RAN / Racing Extinction

**forestsandfinance.org** reveals the finance flowing into forest-risk commodity sectors in Southeast Asia.

- » a searchable database on financier-client deals from 2010 onwards
- » scorecards on bank policies as relevant to forest-sector environmental, social and governance (ESG) risks
- » case studies on clients linked to deforestation and human rights abuses

Search the database to discover the links between banks, investors and deforestation-risk companies. Run searches using different filter options including finance type, bank or investor, bank or investor region, forest-risk client or group, year and forest-risk sector. Results can be exported for further analysis.

Search total (USD million) 1838.32

## MATERIALITY OF ESG RISKS IN TROPICAL FOREST-RISK COMMODITY SECTORS

Protecting the world's tropical forests in Southeast Asia, the Amazon and the Congo Basin is critical for achieving the Sustainable Development Goals and maintaining a habitable planet, but they are rapidly being destroyed. Tropical forests regulate global rainfall patterns; sequester and store carbon; enable over 1 billion people to meet their basic needs for food, water, shelter and medicines; and safeguard the majority of the Earth's remaining terrestrial biodiversity.

However, **tropical tree cover loss has nearly doubled over the past 10 years**. In 2017 alone, 15.8 million hectares of tropical forests were lost, an area the size of Bangladesh. The primary cause is the clearance of land for agriculture, often done illegally. In Southeast Asia, palm oil, pulp and paper, and the expansion of industrial rubber and logging operations are the main drivers of deforestation and forest degradation.

**Tropical deforestation and degradation is a major cause of climate change, estimated to contribute up to one fifth of annual global greenhouse gas emissions, and is associated with serious human rights violations as a result of land conflicts with Indigenous and local communities and exploitative labor practices.** Banks and investors that finance deforestation-risk companies are therefore exposed to significant environmental, social and governance (ESG) risks that could ultimately have a financially material effect (see below).

### ESG ISSUES

### FINANCIALLY MATERIAL SUPPLY CHAIN RISKS

### RISKS TO INVESTORS AND BANKS

#### ENVIRONMENTAL

- » GHG emissions from forest and peat loss
- » Biodiversity loss
- » Land and ecosystem degradation
- » Water, air, and soil disruption

#### SOCIAL

- » Community conflict and violence
- » Land rights violations
- » Displacement
- » Child labor, forced labor, and human trafficking
- » Health hazards from haze and chemical exposure

#### GOVERNANCE

- » Bribery
- » Illegal activity
- » Economic/financial crime: tax evasion, money laundering, transfer pricing

#### OPERATIONAL RISK

Loss of productivity, work stoppages, property damage, increased staff costs to deal with conflicts, etc.

#### REGULATORY RISK

Inability to adapt to changes in and/or breach of regulations related to GHG emissions, forests, peat, labor, land tenure and governance, etc.

#### REPUTATIONAL RISK

Damage to brand value and loss of social license to operate due to NGO campaigns or media exposés

#### LEGAL RISK

Litigation for failure to manage ESG risks, resulting in retraction of operating permits, fines, compensation costs, or confiscation of land, etc.

#### MARKET RISK

Cancelled contracts or decrease in consumer demand from failure to meet buyer standards, i.e. No Deforestation, No Peat, No Exploitation (NDPE) Policy

#### FINANCIAL RISK

##### (INVESTORS)

- » Loss of capital due to i.e. stranded assets.
- » Negative return on investment (ROI)

##### (BANKS)

- » Nonperforming loans / increased default risk
- » Loss of revenue

#### REGULATORY RISK

- » Inability to meet new requirements on the inclusion of ESG risk criteria in due diligence and risk weighting
- » Failure to disclose ESG risks in portfolio

#### LEGAL RISK

- » (INVESTORS) potential breach of fiduciary duty from failure to integrate ESG
- » Accountability for ESG impacts under OECD Guidelines

#### REPUTATIONAL RISK

- » Damage to brand value due to NGO campaigns or media exposés
- » Breach of ESG commitments / policies (i.e. UN PRI, Equator Principles)
- » Loss of credibility as a responsible investor/bank





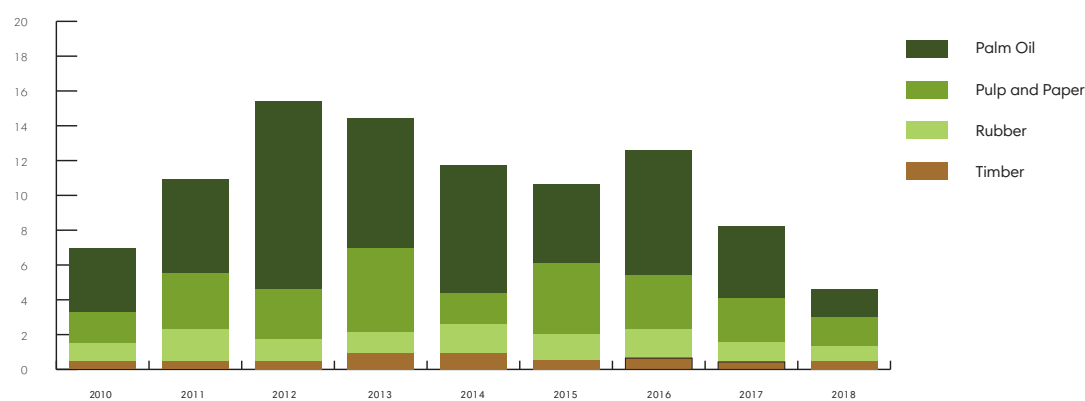
## FOREST-RISK SECTOR FINANCING IN SOUTHEAST ASIA

Forestsandfinance.org identifies the financial flows supporting 103 forest-risk sector companies whose operations impact natural tropical forests in Southeast Asia. The research seeks to segregate and present the investment that can be reasonably attributed to the production, primary processing, trading and manufacturing operations of these companies that are active in palm oil, pulp and paper, rubber or tropical timber.

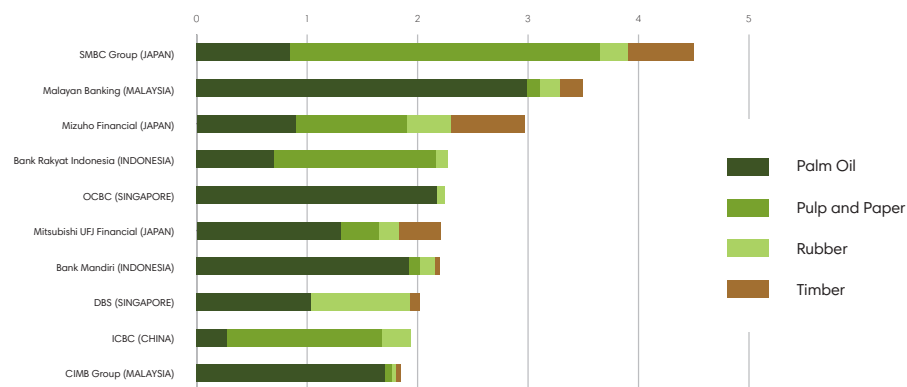
The research found that between 2013 and 2018 (June) at least USD 62.2 billion worth of loans and underwriting facilities were provided to the forest-risk sector operations of the 103 companies in the study. The banks most exposed include: SMBC Group, Malayan Banking, Mizuho Financial Group, CIMB Group, ICBC, Mitsubishi UFJ Financial Group, OCBC, Bank Mandiri, Bank Rakyat Indonesia, and DBS.

The forest operations of the 103 forest-risk sector companies were supported by an additional USD 30.8 billion worth of bond and shareholdings as of the start of 2018. The major investment funds identified include Malaysia's Permodalan Nasional Berhad, Employees Provident Fund, and KWAP Retirement Fund; US-based Vanguard and Blackrock; Japan-based Government Pension Investment Fund (GPIF) and Sumitomo Mitsui Trust Holdings; and UK-based Standard Life Aberdeen.

### LOANS AND UNDERWRITING BY YEAR AND SECTOR, 2010-18 June (USD billion)

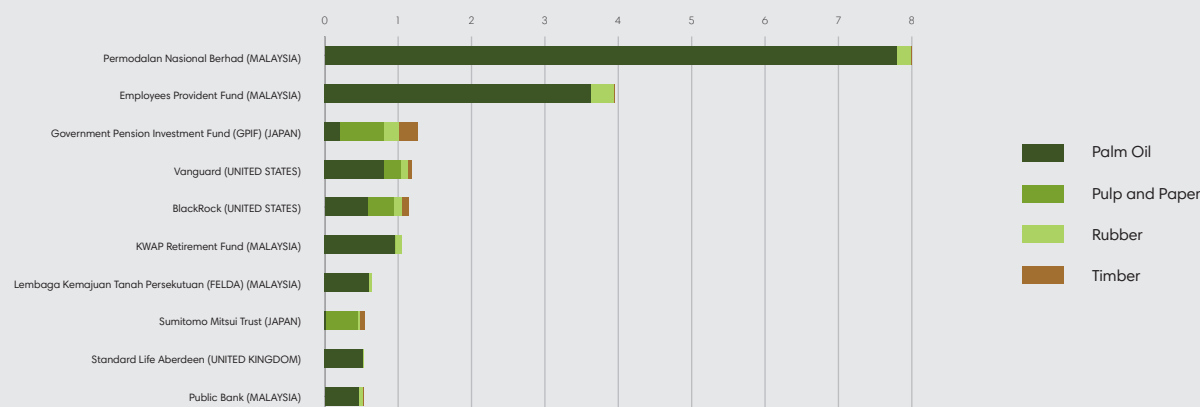


### LOANS AND UNDERWRITING BY TOP 10 BANKS BY SECTOR, 2013-18 June (USD billion)



Banks from Malaysia, China, Japan, Indonesia, and Singapore are the biggest financiers of 103 selected forest-risk sector companies in Southeast Asia.

### BOND AND SHAREHOLDINGS IN FOREST-RISK SECTOR COMPANIES BY INVESTOR AND SECTOR, (USD billion, July 2018 most recent filing date)



## WHY FINANCE MATTERS

The financial sector has a unique role to play in supporting the global transition towards a sustainable, responsible and stable economy. A sustainable financial system must respect the rights of all people and the planet's ecological limits, while fulfilling the economic needs of present and future generations. However, this research demonstrates that the financial system continues to work against bold but essential public policy agendas at the national, regional and global level, which seek to end tropical deforestation, protect vulnerable communities, promote sustainable development and combat global climate change.

## RECOMMENDATIONS

Robust ESG standards and due diligence processes by banks and investors are needed to turn the tide on the devastating social and environmental impacts endemic to the forest-risk commodity sectors in Southeast Asia. However, financial institutions will need to move faster, in larger numbers, across more regions, and adopt uniformly higher ESG standards than has occurred to date. Financial sector regulation has a critical role to play in accelerating and shaping this agenda, in order to ensure the economy serves public policy objectives.

### Financial sector regulators in all major financial centres should:

- » Develop stronger financial sector regulatory oversight and compliance mechanisms in support of environmental and social public policy objectives;
- » Require financial institutions to report annually against the Global Reporting Initiative (GRI) G4 Financial Services Sector Disclosure Framework;
- » Require financial institutions to adopt and disclose robust ESG safeguard policies and enhanced due diligence procedures, with detailed guidance for specific sectors with high ESG risks, such as forest-risk sector commodities;
- » Strengthen requirements on financial institutions to proactively identify and notify regulators of any financial transactions suspected of being associated with forest-risk sector corruption;
- » Implement a credible and transparent monitoring and investigation mechanism on ESG compliance issues for complaints against financial institutions.
- » Introduce penalties and fines for financial institutions and their board members for non-compliance with the above regulations and requirements.

### Banks and investors should:

- » Report annually against the GRI G4 Financial Services Sector Disclosure Framework;
- » Elaborate and disclose ESG policies and standards for any financial services provided to producers and associated supply chain actors in forest-risk commodity sectors, covering relevant risk factors and exclusions, including: no deforestation, protections of biological diversity and High Conservation Value areas (HCVs), prohibitions on plantation expansion on peatlands and use of fire for land clearing, legality in operations and sourcing, Free Prior and Informed Consent (FPIC) procedures for activities impacting Indigenous and customary land rights of local communities, conformance with international ILO and Human Rights conventions and norms, anti-bribery and anti-tax evasion, and monitoring, verification and dispute resolution mechanisms;
- » Ensure environmental and social impact due diligence procedures and requirements are integrated across all business lines, competently staffed and supported, and implementation incentivized;
- » Include environmental and social safeguard requirements as covenants in financing agreements;
- » Engage with companies across forest-risk commodity value chains to support improved transparency, independent monitoring, supply chain traceability, adoption of sustainable production practices, and remedy for social and environmental harms arising from their activities;
- » Support the establishment of harmonised financial sector regulations that seek to address forest-risk sector financing harms, as described above.

## ABOUT THIS PROJECT

**Forestsandfinance.org** is the result of research and investigations by a coalition of campaign and research organisations including Rainforest Action Network, TuK-Indonesia, and Profundo. Collectively, they seek to achieve improved financial sector transparency, policies and systems that ultimately prevent financial institutions from supporting the kind of environmental and social abuses that are all too common in the operations of many forest-risk sector clients. The content of the website is updated on a regular basis. Details on the project, data sources and methodology can be viewed at **forestsandfinance.org**.

**PUBLICATION DATE:** APRIL, 2019