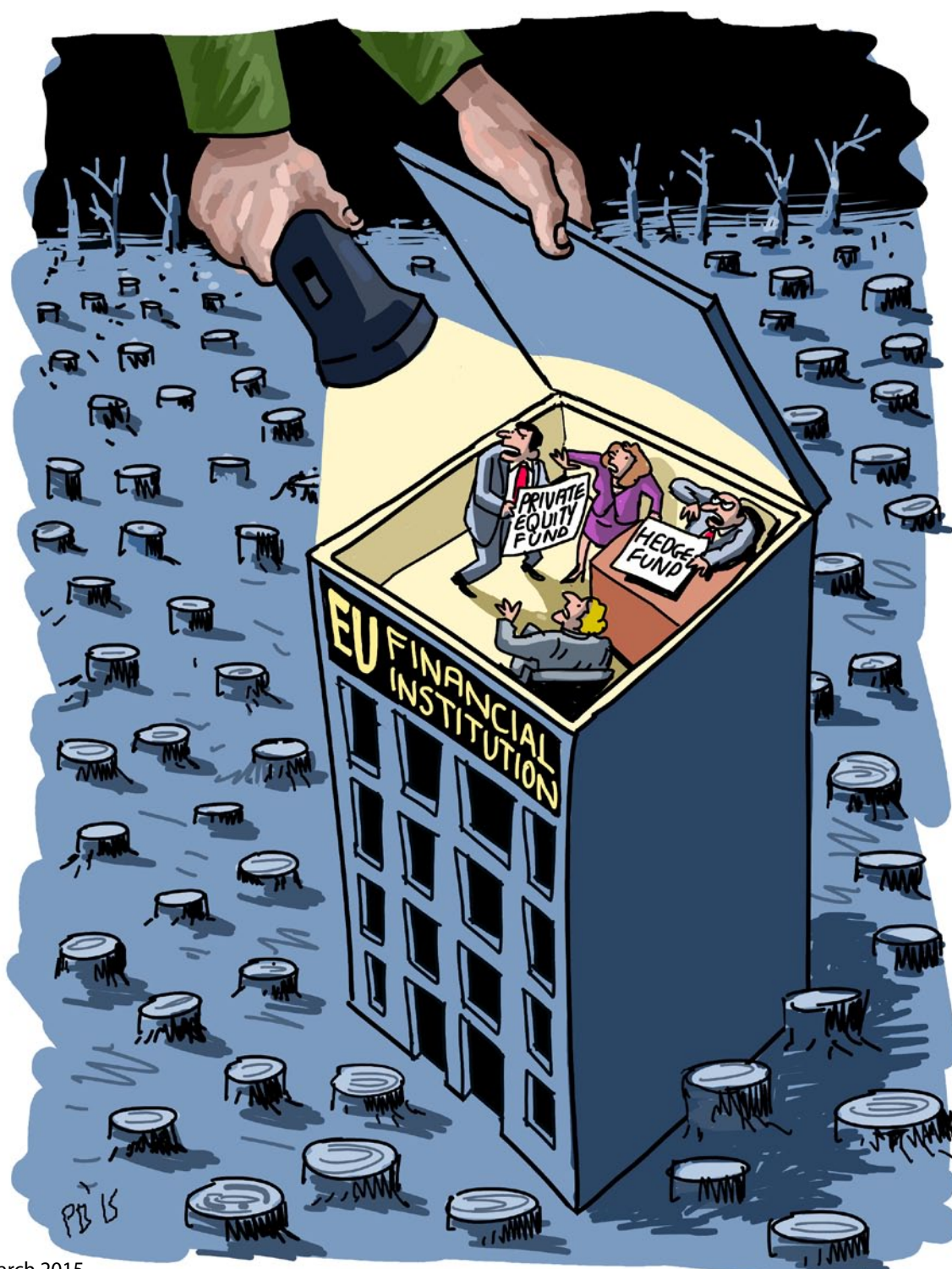


# Clear Cut

MAKING EU FINANCIAL INSTITUTIONS  
WORK FOR PEOPLE AND FORESTS





## Acknowledgements

Clear Cut: Making EU Financial Institutions Work for People and Forests

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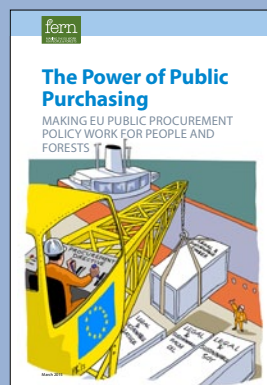
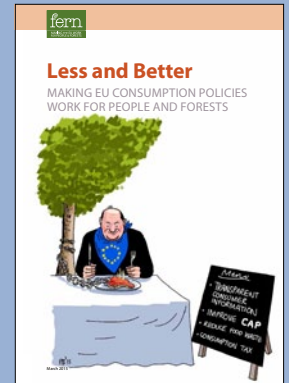
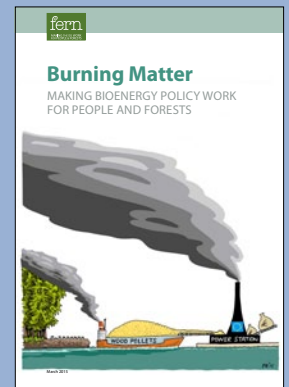
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"I do not want a Europe stuck on the sidelines of history ...  
I want a Europe at the heart of the action, a Europe which moves forward, a Europe which exists, protects, wins and serves as a model for others."

*Jean-Claude Juncker, President of the European Commission, Opening Statement in European Parliament, 15 July 2014*

The European Union (EU) has set itself the goal of ending deforestation by 2030. More than 70 per cent of deforestation in the tropics is the result of land being cleared for commercial agriculture. 36 per cent of the crops and livestock products that were grown on deforested land and traded internationally, was consumed by the EU: twice as much as China and Japan combined. Even in 2015, with China's consumption increasing at a rapid rate, the EU still has a far larger footprint per person than China.

Much of this deforestation is illegal. In 2012 alone the EU imported EUR six billion of soy, beef, leather and oil palm that came from land illegally cleared of forests. Not only is our consumption destroying forests: it is undermining global governance and the rule of law.

Market pressure from consumers who do not want to be party to this trail of destruction is increasing. Far-reaching corporate commitments on zero deforestation have shown that businesses are also ready to act. But consumers and companies cannot act alone.

The EU, as one of the largest importers of forest risk commodities needs to act and serve as a model for others. It must base its policies on the fact that many of the world's forests belong to communities who depend on them. Forest protection will not work, therefore, unless it goes hand in hand with respecting and strengthening communities' tenure rights.

This report is one of a series presenting recommendations to the EU for an Action Plan to halt deforestation and respect rights, looking at EU aid, climate, consumption, financial, illegal logging, renewable energy and trade policies. Together, the series forms a comprehensive action plan for the EU, available at [www.fern.org/EUdrivers](http://www.fern.org/EUdrivers).

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# Acronyms

AIF	Alternative Investment Fund
CSR	corporate social responsibility
ESG	environmental, social and governance
EU	European Union
FPIC	free, prior and informed consent
FSC	Forest Stewardship Council
GCP	Global Canopy Programme
GHG	greenhouse gas
GRI	Global Reporting Initiative
HCV	high conservation value
NGO	non-governmental organisation
OECD	Organisation for Economic Co-operation and Development
PRIIP	packaged retail investment and insurance-based investment product
RSPO	Roundtable on Sustainable Palm Oil

# Summary

**EU-based banks and investment institutions are major funders of large-scale commercial agriculture projects in tropical regions. These projects often lead to deforestation and human rights abuses for displaced communities.**

**In some cases EU- based investor organisations may be providing finance for illegal projects that ultimately result in illegally produced goods being imported into the EU. These are issues the EU will need to address if it is to meet its target of eliminating global deforestation by 2030.<sup>1</sup>**

**Many banks and investor organisations have already signed up to voluntary codes of conduct on environmental and social issues. However, this has not stopped the abuses. Something stronger than voluntary measures is required.**

**Part of the solution lies in toughening up and extending the existing framework of EU financial regulation. But to really address the problem, policy makers will need to introduce new forms of targeted regulation that specifically address the role EU financial institutions play in funding destructive agriculture projects.**

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<sup>1</sup> <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex:32013D1386>



Frankfurt is  
the largest  
financial centre  
in continental  
Europe.  
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# Introduction

Banks and investment organisations based in the EU are a major source of finance for large-scale agriculture projects in forested, developing countries. Such projects frequently lead to forest destruction and violation of the rights of local communities. Moreover, recent research suggests that much forest land conversion to large-scale agriculture concessions is illegal.<sup>2</sup> EU-based financial institutions are rarely directly responsible for these problems, but they can play an important facilitating role. In many cases they provide the credit, investment capital or capital-raising services that allow bad projects to happen. This is not an issue that has

“Considering the fact that many forest conversion projects are illegal, there is a clear possibility that EU banks and investment organisations are funding or facilitating projects that lead to imports of illegally produced agricultural commodities into the EU.”

received much attention in the past, let alone been subject to EU regulation or legislation. However, if the EU is serious about its commitment to halt deforestation by 2030, the role that European banks and investors play in funding forest-risk agriculture projects is an issue that must be urgently addressed.

However, reducing deforestation is not the only factor in this equation. There is also a business case for encouraging financial institutions to take this issue more seriously for their own well-being and, ultimately, the well-being of the European economy. Making loans or investing capital in rogue agriculture projects that lead to deforestation and land-grabbing potentially exposes banks and investors to

serious material risks. The most obvious risk is reputational damage from being associated with projects which violate human rights and cause deforestation. Beyond that there are the losses that can result, for example, from projects being abandoned or delayed due to land conflicts with local populations.<sup>3</sup> In the past such dangers have been insufficiently recognised in the way that financial institutions evaluate risk. This is something that needs to change.

To some degree, the means to tackle these concerns may already be available. In recent years, the EU has embarked on a process of reforming the complex tangle of directives and regulations that regulate the financial sector. While for the most part these ongoing reforms are primarily intended to address issues such as the stability of the financial system, creating a single European market in financial services and giving additional protection to investors, they may also be used as a platform for curbing rogue deals in agriculture that result in forest loss and land conflicts. This paper argues that it is possible to extend the remit and practical application of key aspects of EU financial regulation to address growing concerns about the serious environmental, social and governance risks associated with European financial sector funding of agriculture projects and land-grabbing in developing countries, and to meet the EU’s commitment to halt deforestation by 2030.

Of specific interest are the EU Pension Funds Directive, legislation regulating credit rating agencies, regulation relating to PRIIPs (packaged retail investment and insurance-based investment products), and the proposed Shareholder Rights Directive and Capital Markets Union. Even small amendments to the text of upcoming EU financial regulation can create space that helps put financial sector responsibility for the economic and social consequences of their financial decision-making on the agenda. However, while tweaks to existing financial rules are a useful first step, there is also a need for new dedicated regulation specifically addressing

<sup>2</sup> Lawson S, Consumer Goods and Deforestation: An Analysis of the Extent and Nature of Illegality in Forest Conversion for Agriculture and Timber Plantations, report for Forest Trends, September 2014.

<sup>3</sup> See the work of the Munden Project, e.g. The Financial Risks of Insecure Land Tenure, 2012. [http://www.rightsandresources.org/documents/files/doc\\_5715.pdf](http://www.rightsandresources.org/documents/files/doc_5715.pdf)



Cane fields outside of Georgetown, Guyana

© SC Cunningham (Flickr)

the problems associated with the financing of forest-risk agriculture projects and agriculture projects that lead to land grabs.

This paper argues that more in-depth research is required to give EU policy-makers a better understanding of the role that the financial sector plays in forest loss, particularly focusing on banks and private equity. Research is also required to understand more fully the material, financial risks that financial institutions face by not taking these concerns into account.

Considering the fact that many forest conversion projects are illegal,<sup>4</sup> there is a clear possibility that EU banks and investment organisations are funding or facilitating

projects that lead to imports of illegally produced agricultural commodities into the EU. Fern's report ► *Stolen Goods: The EU's complicity in illegal tropical deforestation*<sup>5</sup> suggests that in one year alone, 2012, EUR 6 billion worth of palm oil, soya, beef and leather were brought into the EU that had been produced on illegally cleared former forest land. This is clearly another area where additional EU regulation or legislation may be required.



4 Lawson S, op. cit.

5 [www.fern.org/stolengoods](http://www.fern.org/stolengoods)

## Different types of financial institution

Private-sector financial institutions based in the EU are a diverse group. This section sets out a brief classification, and indicates how particular kinds of financial institution may be involved in forest-risk agriculture.

**Banks** fall into three categories.

- *Commercial banks* make loans using their depositors' money.
- *Investment banks* help their clients raise capital through bond or share issues. They also invest directly in companies and projects themselves.
- *Private banks* manage the wealth of rich people and may make investment decisions on their behalf.



The City of London

© Chris Wevers/FlickrCC

Large banking groups often span these three functions. Banks play an important facilitating role in providing credit or raising capital for commercial agriculture projects and agricultural companies. EU-based banks are regulated on financial matters but not on environmental or social issues relating to their loan and investment decisions.

**Institutional investors** such as pension funds, insurance companies and asset managers own or manage a portfolio of many different investments. Most of their holdings are typically in shares and bonds traded on financial markets, but they may also make direct investments in companies and projects. Additionally, they invest indirectly by buying stakes in other more specialised funds that put money into particular businesses or projects. Their main involvement in forest-risk commercial agriculture is likely to be through owning the shares or bonds of companies involved in destructive practices or through investing in private equity ventures that put money into agriculture projects. In 2013, EU-based pension funds had assets worth more than EUR 3.5 trillion,<sup>6</sup> making them one of the largest sources of private investment capital in Europe. Only a very small proportion of

this is invested in agriculture in developing countries, but in absolute terms the amounts of money involved could still be substantial. Large institutional investors in the EU are subject to relatively tough regulation on financial issues, but not on the environmental or social consequences of their investment policies.

**Alternative Investment Funds (AIFs)**, which includes hedge funds and private equity funds. AIFs are a type of institutional investor but they invest on behalf of wealthy individuals and other professional/institutional investors seeking high returns, not the general public. They are less regulated and are generally subject to much less public scrutiny than other managed funds. There is evidence that in recent years there has been a surge in developing country agricultural investments by European and US-based private equity funds, especially in Africa and Latin America.<sup>7</sup>

However, not all funding of commercial agriculture projects is

6 EOPA Financial Stability Report 2014, p 31.

7 Buxton A, Campanale M, Cotula L, Farms and Funds: Investment Funds in the Global Land Rush, International Institute for Environment and Development, January 2012.



done by banks or external investors. Agricultural companies often finance their own projects, using their own money from past profits or getting funding from wealthy individuals. EU-based financial institutions fund forest-risk agribusiness projects in developing countries through a range of different channels.<sup>8</sup> For example:

- banks provide credit to EU-based agriculture companies that then invest in non-EU agriculture firms or projects
- banks provide credit to companies outside the EU that invest in agriculture projects
- investment banks underwrite (facilitate and guarantee) issues of bonds and/or shares that raise capital for agriculture companies, either based in the EU or outside it, to fund new projects
- institutional investors (e.g. pension funds and asset managers) have holdings of bonds or shares in stock market listed companies, in the EU or outside, involved in tropical commercial agriculture
- institutional investors invest in other investment funds (inside or outside the EU) that fund agriculture ventures
- less regulated private equity and hedge funds have holdings of shares or bonds in stock market listed tropical agriculture enterprises
- private equity funds finance particular projects or buy stakes in non-listed companies involved in commercial agriculture.

Maros, Indonesia. A farmer fertilises his rice field in Rammang-rammang village, South Sulawesi, Indonesia.

© Tri Saputra/CIFOR/FlickrCC



<sup>8</sup> This list is drawn from unpublished research carried out by the consultancy group Profundo for Fern, Global Witness and Friends of the Earth Europe, September 2014.

# Financial sector voluntary policies

There is no EU regulation of the financial sector that tackles environmental and social issues related to large-scale forest-risk agribusiness projects, not even when such ventures fail to comply with national laws and regulations. However, many European financial institutions active in this area have adopted voluntary policies covering environmental, social and governance (ESG) issues, and try to apply them when making decisions on loans and investments. In addition, many of the agribusiness ventures that European financial institutions put money into are members of voluntary schemes and industry round tables that include ESG criteria.

"...signing up to something is not the same as implementing it. The problem with these voluntary principles is that there is no way for outsiders to know how, if at all, they are being applied."

This paper uses the acronym ESG to describe policies that have an environmental and social dimension, but other terms in common use include corporate social responsibility (CSR) and Sustainability at Risk. These policies are used as the basis for due diligence on decisions about loans and investments where risks are identified.

Fern, Global Witness and Friends of the Earth Europe recently commissioned a study that examined financial institutions' voluntary commitments (in the context of a wider survey of the potential for regulatory reform on investments in agribusiness outside the EU). The remarks in this section are based on the findings of this research. It assessed the policies of 15 major EU financial institutions (including banks, insurance companies, pension funds and asset managers) active in providing credit and investment to agriculture.<sup>9</sup>

All the financial institutions studied were found to have adopted one or more of the various relevant international

voluntary standards on ESG/CSR issues, such as the UN Global Compact, the UN Principles of Responsible Investment and the Equator Principles.

But signing up to something is not the same as implementing it. The problem with these voluntary principles is that there is no way for outsiders to know how, if at all, they are being applied. In addition, most of these international voluntary standards set out broad principles but do not go into detail as to exactly what is required; nor do they set minimum standards of compliance. Only signatories to the Equator Principles are required to report on implementation.<sup>10</sup> The financial institutions covered in this research did not comment on the application of other standards, beyond saying they were committed to upholding them.

However, many financial institutions have developed their own supplementary internal policies for handling financial decisions involving ESG risks, usually linked in some way to international voluntary standards. These involve often elaborate screening processes for new loans or investments, with some element of periodic review afterwards.

The identification of potential ESG risks relies heavily on checks against information held in external databases that these financial institutions subscribe to, such as RepRisk, Transparency International's Corruption Perceptions Index, the Maplecroft Human Rights Risk Index, Reuters and NASDAQ, Sustainalytics, MSCI and ethical rating agencies. These databases get their information from many sources including government agencies, the media and NGOs. The process is akin to a Google search, only using sophisticated software tools to analyse more comprehensive datasets than anything generally available online.

An excerpt from one major EU bank's description of its ESG screening process is set out in Box 1.

A number of the EU-based banks studied had developed specific policies on environmental and human rights issues. One important yardstick for measuring such policies is the

9 Ibid.

10 The Equator Principles have been adopted by 79 financial institutions from 35 countries. They provide a framework for managing environmental and social risks in project finance, typically on large-scale projects: <http://www.equator-principles.com/>

### Box 1: Description of ESG screening process at one major EU based bank (anonymized)

'The screening establishes whether the client can be considered a "responsible operator". The bank will screen the policies and track records of companies, in media, NGO reports, and other sources of information. The vision, motivations, commitments, readiness for improvement, and management systems are checked. The management system is screened for its ability to meet the companies' own visions and commitments. Companies are screened for the level of transparency of reporting to the public. They are screened for their readiness and the manner in which they solve problems that arise.

The companies are screened for their commitments to voluntary guidelines, membership of relevant roundtables, their certification status and their commitments to work towards certification. If clients are not members of the relevant roundtables or initiatives, then the bank will not consider providing them with financial services, or will carry out its own impact assessment.

The bank has an exclusion list of companies it does not want to invest in, particularly for weapons. However, this is not made public. The bank also uses a risk categorisation scheme. This is based on the country the potential client operates in, the sector they operate, and the attitude of the entrepreneur, i.e. are they considered a "responsible operator". When a client falls in the category of high risk they are subject to more stringent screening and more frequent reviews. The most frequent is three-monthly.'

extent to which they set clearly defined minimum standards required of clients applying for loans or other financial services. Table 1 summarises minimum standards set by six major European banks involved in funding agriculture projects, based on an assessment of information publicly available on the banks' websites in March 2014. The record appears to be stronger on purely environmental concerns than issues relating to human rights and local communities.

"...the market is not delivering the demand for sustainable or responsible investments which the EU has committed to, nor have voluntary ESG policies helped remedy the problems of deforestation and land-grabbing."

Three of the six banks had an explicit commitment to no deforestation. Four of the six required their clients not to be involved in clearing of high conservation forests and not to use fire for land clearing from their clients. However, only two banks explicitly required clients to obtain the free, prior and informed consent (FPIC) of communities affected by agriculture projects. None of them had explicit stipulations

against plantation development on contested land, clients hiring armed guards or using violence in land conflicts. Banks may argue that some of these issues are covered implicitly through the terms of international standards and industry certification schemes they have signed up to or require their clients to comply with.

If an issue is omitted from the list of minimum standards, it does not necessarily mean that financial institutions are unaware of it. Some banks have policies that refer in detail to potential risks such as deforestation, use of fire for land clearance, threats to the rights of indigenous peoples, greenhouse gas emissions, habitat destruction and threats to species such as the orang-utan. However, these policies do not appear to set minimum standards for doing business, or at least not minimum standards for the agriculture and forestry sectors.

An additional complexity arises with banks and investor organisations that have signed up to the Equator Principles, which are a set of voluntary international guidelines for dealing with environmental and social issues in financing very large projects – generally USD 100 million or more. Organisations that have committed to the Equator Principles are required to seek the FPIC of communities potentially displaced by such projects. This obligation is built into performance standards set by the World Bank's private finance arm, the International Finance

**Table 1: Minimum standards in ESG policies of financial institutions**

Minimum standards are marked with an X. A blank space means no minimum standard is set.

ESG issue	Minimum standard	Rabobank	Swedbank	UBS	Deutsche Bank	Allianz	HSBC
Land tenure and community relations	No plantation development on contested land						
	No use of violence in land conflicts						
	Commitment not to hire armed guards, or members of military, police or other armed forces as protection						
	At least 20% of the land bank must benefit local communities						
	FPIC for indigenous peoples	X					X
	FPIC for local communities (not indigenous)	X					X
Climate change	No plantation development on peat	X					
	Policy to avoid and reduce GHG emissions						
Deforestation	No deforestation	X			X		X
	No fires for land clearing	X		X	X		X
	No plantation development without appropriate permits	X					X
Biodiversity	No clearing of HCV forests	X		X	X		X
	Protecting the habitat of endangered species						
	No killing of endangered species			X			
Certification	Time-bound plan to achieve relevant certification in a few years	X		X	X		X
Transparency	Publication of a sustainability report based on GRI standard	X	x	X	X	X	X
Tax avoidance	No base erosion and profit-shifting						
Corruption and money laundering	No corruption	X					
	No facilitation payments	X					

Corporation, upon which the Equator Principles are based. However, individual agriculture and forestry projects (unlike mining and infrastructure) rarely require very large sums of money to finance them. Most, therefore, fall well below the minimum thresholds set for the Equator Principles to apply. Furthermore, the Equator Principles are intended specifically for 'project finance'. Large loans to agribusiness companies rarely fall into this category. They are commonly described in regulatory filings as intended for 'working capital' or 'general purposes'. In some cases, these non-specific descriptions may be a way of avoiding the tougher obligations that would apply under the Equator Principles if the loans were classified as 'project finance'. However, some individual banks have adopted internal policies to go beyond what is strictly required. HSBC, for example, says it applies the Equator Principles in some circumstances to loan decisions on smaller projects involving sums less than the standard minimum threshold.

While some EU-based banks and investment organisations have clearly put significant time, effort and resources into developing procedures and policies to improve their performance on ESG loan and investment decisions in

forest-risk regions, these policies suffer from a number of weaknesses.

- Policies may look good on paper, but there is no public reporting of the monitoring and implementation of the policies. Nor is there any procedure for external monitoring or external checks. It is therefore impossible to say what is happening in practice.
- ESG policies are excessively reliant on certification schemes such as those of the Forest Stewardship Council (FSC) and the Roundtable on Sustainable Palm Oil (RSPO). Membership is seen as an indicator of compliance, which in effect outsources the financial Institutions own responsibility for these issues. The result is that membership of certification schemes becomes a proxy for effective due diligence, with the result that there are few, if any, other checks before loans are advanced or investments made.



An investigative report by Rainforest Action Network presents evidence that Cargill is operating two undisclosed palm oil plantations in West Kalimantan, Indonesia. Crude palm oil tanker truck inside Cargill's PT Harapan Sawit Lestari plantation. Borneo, 2009.

© David Gilbert/Rainforest Action Network

NGO investigations have exposed instances of where apparently comprehensive voluntary policies on ESG issues have failed to stop bad practice by major EU-based financial institutions. For example:

- HSBC was found by Global Witness<sup>11</sup> to have provided USD 130 million in finance to logging companies in Sarawak (Malaysian Borneo) in obvious breach of its own forestry policies. The companies were responsible for illegal clearance of rainforests and human rights abuses, including – in one case – hiring gangsters to intimidate communities that opposed their plans. HSBC's internal forestry lending policy required clients to be on track to having their operations FSC-certified.<sup>12</sup> However, none of them were actually FSC-certified.
- Rabobank, a leading Dutch lender to agriculture, contravened its internal sustainability policy by providing nearly EUR 50 million in loans to a controversial

Indonesian palm oil company.<sup>13</sup> The company, Bumitama, has been accused of breaking RSPO guidelines (and Rabobank's own internal procedures) by managing an illegal plantation. Rabobank's sustainability policy requires palm oil clients to be RSPO-compliant. Only after Friends of the Earth Netherlands and Friends of the Earth Europe filed a complaint with the OECD for breach of its guidelines for multinational companies did the company stop the management contract with the illegal plantation.<sup>14</sup>

There are many other similar examples. In our view, voluntary ESG policies of the sort adopted by many European financial institutions have proved insufficiently robust to be relied on, and the recent emphasis shift from voluntary to simply market-based mechanisms is even more worrying. The evidence outlined in this chapter clearly highlights that the market is not delivering the demand for sustainable or responsible investments which the EU has committed to, nor have voluntary ESG policies helped remedy the problems of deforestation and land-grabbing. Consequently, it is important that the EU explores a range of other stronger measures to tackle EU financial-sector funding and facilitating of rogue agriculture deals that lead to deforestation and social conflicts.

11 'In the future, there will be no forests left', Global Witness press release, November 2012, <http://www.globalwitness.org/sites/default/files/HSBC-logging-briefing-FINAL-WEB.pdf>

12 For a fuller description see: <http://www.globalwitness.org/library/hsbc-rakes-us130-million-bankrolling-rainforest-destruction-and-human-rights-abuses-malaysia>. This is how Global Witness described the FSC non-compliance: 'The report shows how four of HSBC's current clients in Sarawak systematically violated the bank's 2004 forestry policies. These required the bank to drop clients that did not have a credible likelihood of having 70 per cent of their operations certified to the Forest Stewardship Council (FSC) or equivalent standard by 2009. None of HSBC's Sarawak forestry clients investigated by Global Witness hold a single FSC certificate. This represents a 100 per cent compliance failure. Furthermore, Global Witness uncovered multiple instances of unsustainable and illegal operations by the companies.'

13 <https://milieudefensie.nl/publicaties/bezwaren-uitspraken/oeso-complaint-against-rabobank-concerning-financial-services-to-bumitama/view>

14 For more information see: <http://foeeurope.org/bumitama-cuts-ties-illegal-palm-oil>

## Box 2: 'Forest 500'

'Forest 500'\* is a new initiative by the Global Canopy Programme (GCP). It identifies, ranks and tracks the 'powerbrokers of zero deforestation'. These players include governments, companies and financial institutions at risk of being associated with deforestation through significant involvement in, or exposure to, the complex global supply chains bringing forest risk commodities to consumer countries. These supply chains relate to six agricultural commodity products most commonly associated with deforestation: palm oil, soya, beef, leather, timber and pulp and paper. GCP say that 'rigorous methods have been developed to identify and rank these actors based on their public policies and potential impacts on tropical forests'. The first results were published in February 2015. The exercise will be repeated annually until 2020.

The list includes 150 financial institutions that between them hold USD 1.7 trillion\*\* worth of shares in publicly listed companies included in the Forest 500. GCP claims that 'the financial sector holds a unique position in its potential to contribute to a zero deforestation economy'. Investor organisations were rated according to the extent and quality of their policies on issues linked to deforestation. Each organisation was scored on a scale of nought to 100. For the purposes of comparison the scores were then placed within five broad bands of nought to five points, with five points representing the most forest friendly investor policies.

HSBC was the only financial institution to score the maximum five points. Two other European institutions Rabobank and Societe Generale, along with Bank of America scored four points. All of these banks had scored more than 75 out of a possible 100 in the initial calibration on which the broad four- or five-point ranking was based. GCP say these individually high scores 'demonstrate that progress is possible'.

However, they also point out that the average score achieved by financial institutions was just 18 points (out of a possible 100) – indicating that 'much still needs to be done' for the financial sector to achieve its full potential in tackling deforestation. Many of the organisations surveyed had made little or no effort to take account of deforestation risks in their lending or investment policies.

Scores were found to vary according to location, with investors based in the EU tending to have more developed sustainable investment policies than those with headquarters in North America and the Asia-Pacific region. Scores were also found to vary according to the type of financial institution, with banks generally scoring higher than other categories of investor organisation.

It is important to note that the evaluations were based purely on the content of individual organisations' policy documents, not an assessment of how these policies have been implemented in practice.

\* <http://www.globalcanopy.org/forest500>

\*\* At March 2015 exchange rate, USD 2.8 billion would be EURO 1.6 trillion.

# Do EU financial institutions fund projects that cause deforestation?

To inform EU policies, it is important to have figures indicating the scale of global financial-sector funding of developing country agriculture/land projects, and data indicating the significance of EU-based financial institutions, as well as a good understanding of how these organisations operate. However, comprehensive and reliable data do not exist, as there is no central record-keeping. Therefore Fern and other NGOs are putting together a picture of what is happening, based on verbal accounts, reports, specialised publications and so forth. Much can also be learned from analysis of information on financial databases such as Thomson ONE and Bloomberg, although one needs to have an expensive subscription to access these databases.

From the limited information we have, it is clear that EU-based financial institutions do put a lot of money into large-scale agricultural projects in various ways.

Our analysis suggests that the top 20 EU-based financial institutions (including banks, institutional investors and alternative investment funds) have provided nearly USD 18 billion<sup>15</sup> of outstanding loans and recent underwriting services to foreign agriculture companies based in

`"...many of the loans and investments made by EU financial institutions go to highly forested countries where forests are under threat from the expansion of agribusiness."`

developing countries.<sup>16</sup> The largest providers are HSBC (UK), Standard Chartered (UK), Deutsche Bank (Germany), Rabobank (Netherlands), Royal Bank of Scotland (UK), ING Group (Netherlands), Groups BPCE (France), Barclays (UK) and, Credit Agricole (France).<sup>17</sup> This information is drawn from recent regulatory filings, but the picture is not complete.



© Chris Goldberg/FlickrCC

EU financial institutions are also major holders of shares in stock market-listed agriculture companies based in developing countries. Our analysis indicates a figure of USD 2.8 billion<sup>18</sup> worth of such shareholdings owned by the top 20 EU-based institutional investors, at the most recent regulatory filing. The largest EU-based players include Aberdeen Asset Management (UK), Prudential (UK), HSBC (UK), Deutsche Bank (Germany) and ABP (Netherlands).<sup>19</sup> Again this picture is based on incomplete information. It takes no account of EU financial-sector investment in EU-based agriculture companies that have operations in developing countries.

One thing that does emerge from this limited data is that many of the loans and investments made by EU financial institutions go to highly forested countries where forests are under threat from the expansion of agribusiness. For example, Malaysia, Brazil and Indonesia are among the top five countries where European financial institutions have shareholdings in local agriculture companies.<sup>20</sup> Satellite mapping data compiled by the University of Maryland<sup>21</sup> suggest that Indonesia and Malaysia saw the biggest increases in annual rates of forest cover loss of any nations between 2000 and 2013. By contrast, the rate of annual deforestation in Brazil halved over the same period, although in absolute terms the amount of forest cover loss is still among the highest in the world, roughly on a par with Indonesia.

15 At March 2015 exchange rate, USD 18 billion would be EURO 16.9 billion.

16 Data drawn from Thomson ONE. Compiled for FERN by Profundo from most recent regulatory filings up to January 2015.

17 Ibid.

18 At March 2015 exchange rate, USD 2.8 billion would be EURO 2.63 billion.

19 Ibid.

20 Ibid.

21 [http://earthenginepartners.appspot.com/science-2013-global-forest/download\\_v1.1.html](http://earthenginepartners.appspot.com/science-2013-global-forest/download_v1.1.html)



Gunung Lumut, Kalimantan Timur, Indonesia, November 2005.

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EU-based financial institutions are, additionally, funding commercial agriculture in highly forested countries in ways that do not show up in the data quoted above. For example, EU financial institutions invest in European agriculture companies that make investments in tropical forest countries. EU-based financial institutions also put money into private equity ventures in agriculture. It is hard to know precisely how important the European financial sector is as a source of finance relative to financial institutions from other parts of the world. It is reasonable to suppose that European financial institutions are highly significant but far from dominant; US financial institutions, along with local players in Asia and Latin America, are also important in financing commercial agriculture. However, the role played by EU-based financial institutions is substantial enough to give EU policy-makers some leverage.

Analysis of who has been acquiring land in developing countries provides another way of assessing the significance of European finance in commercial agriculture. The debate about deforestation is closely linked to the controversy over social conflicts caused by large-scale land acquisitions (often referred to as 'land grabs'). Not all large-scale agribusiness projects are land grabs, nor do all of these projects cause deforestation, but the extent of land deals and who is funding them are metrics worth examining.

There are no comprehensive or fully reliable figures on land acquisition for agriculture in developing countries. Probably the best information available comes from the Land Matrix, a database compiled by a consortium of organisations led by the International Land Coalition, which has tracked land acquisition worldwide since the year 2000.

The latest Land Matrix data (January 2014)<sup>22</sup> cross-checked records of 31 million hectares of land acquisitions worldwide since 2000 – an area almost the size of Germany. Investors from two EU countries – the UK and the Netherlands – feature in the top ten acquirers of land, another indication that EU players have significant influence that potentially can be leveraged.

Most land acquisitions (in terms of area) have taken place in highly forested countries. The list of where land has been transferred is headed by Papua New Guinea, followed by Indonesia. Brazil, Democratic Republic of Congo, Republic of Congo and Liberia are also in the top ten.

22 <http://landmatrix.org/en/get-the-idea/global-map-investments/>



## Falling agricultural commodity prices

Before looking at regulatory options it is important to look at the context and, specifically, the trends. Rising agricultural commodity prices helped fuel a major expansion in the area devoted to tropical commercial agriculture in the late 2000s. Additional factors such as the EU Renewable Energy Directive (which encouraged the use of biofuels) and increased financial speculation over land in developing countries have only added to the pressures.

Among the impacts were increased rates of deforestation and a rise in the incidence of land conflicts, as new plantations and farms have encroached on the subsistence livelihoods of local populations. European financial institutions played a role in financing what has been described as an 'agricultural gold rush'. But it is important to recognise that the current investment context for commercial agriculture is rather different. Since 2010–11, the prices of many agricultural commodity prices have fallen dramatically, which – temporarily at least – may have undermined the business case for investing heavily in types of farming that threaten tropical forests and peoples' land.

Palm oil is a good example. The price of crude palm oil reached a record high in early 2011, but has subsequently fallen more than 40 per cent.<sup>23</sup> Current price levels are the same as 15–20 years ago; big gains made in the agricultural commodity price boom of the late 2000s have been erased.

The drop in commodity prices is likely to have made investors cautious. European investors in some Asian agribusiness companies are certainly feeling the pain. For example, the share price of Wilmar International, the largest palm oil trader, listed in Singapore, has dropped 50 per cent in the last five years.<sup>24</sup> Western investors who bought into Wilmar during the agricultural commodities boom period will have suffered massive losses.



The price of crude palm oil reached a record high in early 2011, but has subsequently fallen more than 40 per cent.  
© Rainforest Action Network / FlickrCC

The impact of falling agricultural commodity prices on investment in new forest-risk large-scale agriculture projects is unclear. There does not appear to have been any research done on this topic. We simply do not know if there has been a slackening-off of EU financial sector involvement in funding such projects since the undoubted high point reached in the period 2009–11. However, if there has it will be temporary. What can be said with some certainty is that in a resource-scarce world, commercial pressures to convert forest lands to large-scale agriculture will only increase over the long term. The drivers for forest destruction (and the dispossession of communities from land they need to live on) remain in place while banks and investors retain their role as funders of potentially bad agriculture projects. Therefore the need for the EU to take action to address the part played by EU-based financiers remains as urgent as ever.

23 Information from the REA Holdings website: <http://www.rea.co.uk/rea/en/markets/cpoprices>

24 Drawn from data on Yahoo Finance: <https://uk.finance.yahoo.com/q/is?s=F34.SI&annual>

## Options for change

Effective action can only be based on a detailed understanding of how EU-based financial institutions are involved in funding large-scale agribusiness projects. The patterns may vary between different parts of the world, different crops (e.g. palm oil, sugar, rubber and so forth), and the various types of financial institution (e.g. the significance of bank finance vs investments by pension funds or private equity). Currently this understanding simply does not exist, and further research is needed.

"Between 2000 and 2012, an area of forest the size of a football pitch was illegally felled every two minutes, in order to supply the EU with soy, beef, leather and oil palm."

Particular attention should be paid to the issue of European financial institution funding of agriculture projects on illegally acquired land. Research suggests that in 2012 alone the EU imported EUR 6 billion of soy, beef, leather and oil palm – almost a quarter of the total world trade in these goods – that had been grown or reared on land illegally cleared of forests (see Fern's report ► *Stolen Goods: The EU's Complicity in Illegal Tropical Deforestation*).<sup>25</sup> Between 2000 and 2012, an area of forest the size of a football pitch was illegally felled every two minutes, in order to supply the EU with these commodities. An obvious next step is to look at the extent to which EU banks and investors may have been financing illegal agriculture projects.

It also makes sense to be aware of how different types of financial institution may vary in how they react to pressure to take issues like land-grabbing and forest loss more seriously. There are reasons for thinking that pension funds and insurance companies, for example, could be persuaded to respond positively. They are already highly regulated in terms of financial performance, and they are subject to tough financial disclosure requirements, which provides something to build on. Additionally, they may be more likely to take

a very long-term view of their investments and so could be more attuned to ESG risks than some other investors. They may also be more than usually concerned to avoid reputational damage.

Private equity investors, on the other hand, are notoriously difficult to reach. They are lightly regulated, they operate away from the public eye with few disclosure requirements, and they may have less need to worry about their public image. They answer to small numbers of professional investors who may be primarily concerned about financial returns.

There is currently no EU regulation addressing financial institutions and land-grabbing, and no regulation that is tailored to enforce ESG standards. Current EU regulations are aimed at creating a healthy and safe financial system, rather than protecting people and/or the environment against the adverse impact of certain types of investment.

The EU plays an important role in setting the rules that EU-based financial institutions must follow in making loan and investment decisions. This framework of financial regulation has gone through a process of reform in recent years. It is aimed principally at protecting investors and ensuring a healthy financial system. Forest conversion and land-tenure risks should be included in the framework of reference for assessing the impact and value of intended new financial regulation.

Fern, Global Witness and Friends of the Earth Europe have identified reforms to proposed EU legislation on pension funds (IORP II), packaged retail investments (PRIIPs) and shareholder rights that could make a difference.<sup>26</sup> Similarly, existing financial regulation should be reviewed in the light of concern about forest conversion and land tenure to see how risks can be minimised. However, while amendments to existing proposals have a useful role to play, further action in the form of regulation specifically dedicated to dealing with deforestation and land-grabbing will also be needed to fully address the issues.

25 [www.fern.org/stolengoods](http://www.fern.org/stolengoods)

26 Details available on request.

## Recommendations to the EU

- **The European Commission and the European Parliament should develop a good understanding of the role that EU-based financial institutions play in financing and facilitating agricultural projects that lead to deforestation and violations of local peoples' tenure rights. Research should be commissioned looking specifically at private equity, pension funds and banks. A key focus of this research should be identifying and understanding the nature of the risks associated with such projects, with a particular emphasis on the previously under-recognised financial and reputational risks that banks and investor organisations place on their own businesses through exposure to projects that cause deforestation or lead to land grabs.**
- **EU banking and investment regulation should be reviewed with a view to identifying where changes can be made, to help financial institutions avoid the risk of being complicit in deforestation and land grabs. One aspect of this would be to ensure that any new financial regulation addresses social and environmental risks as well purely financial issues.**
- **The European Commission and Parliament should take steps to ensure that investors are more aware of the risk that they are financing projects that lead to illegal imports of forest-risk commodities into the EU. Stronger due-diligence processes at banks and investor organisations are part of the solution. However, these processes will need to be reinforced, supported and shaped by enhanced regulation at the EU level and at the level of individual Member States.**
- **The European Commission and the Parliament should develop a new regulation that specifically addresses the funding of projects leading to deforestation and human rights violations by EU-based financial institutions with a view to stopping this happening.**

“EU-based banks and investment institutions are major funders of large-scale commercial agriculture projects in tropical regions. These projects often lead to deforestation and human rights abuses. These are issues the EU will need to address if it is to meet its target of eliminating global deforestation by 2030.”



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