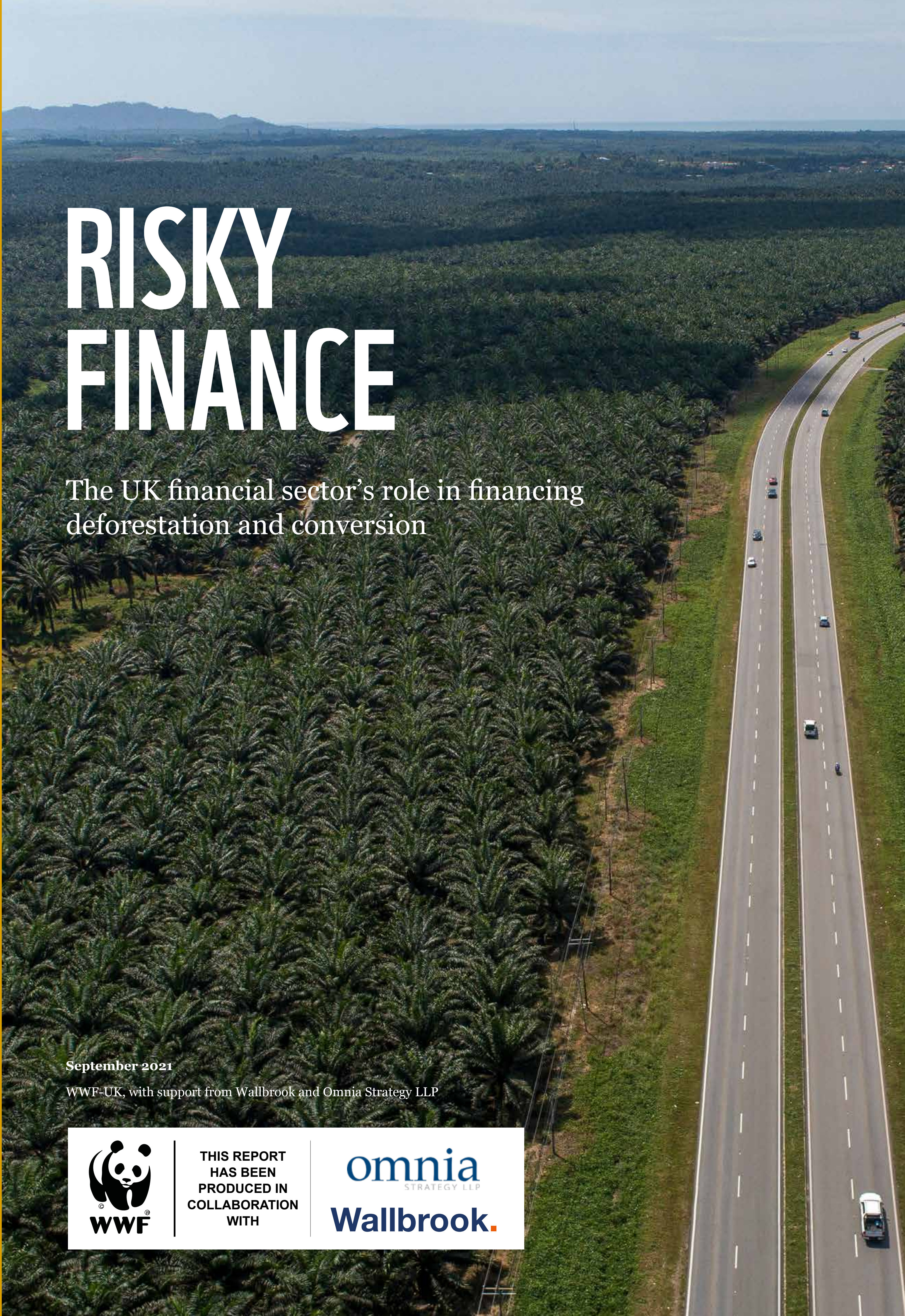

RISKY FINANCE

The UK financial sector's role in financing deforestation and conversion

September 2021

WWF-UK, with support from Wallbrook and Omnia Strategy LLP

WWF

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This report sets out research and analysis commissioned by WWF-UK with the support of the consultancy Wallbrook and the law firm Omnia Strategy LLP, specialists in ESG. This research complements the recent WWF technical report, Due Negligence: Will a due diligence regulation on illegal deforestation de-link UK supply chains from deforestation?, which lays out the implications of the due diligence amendment in the UK's proposed Environment Bill (Schedule 16) and calls for the strengthening of this regulation. This complementary study looks at the omission of the finance sector and makes the case for working towards its inclusion, presenting a path forward.

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EXECUTIVE SUMMARY

27%
OF DEFORESTATION RESULTS FROM AGRICULTURAL COMMODITIES

The recent report from the Intergovernmental Panel on Climate Change (IPCC) has given a stark warning that urgent action is needed to avoid irreversible and unprecedented destruction to the planet, people and nature. The Global Futures report (February 2020) estimates that the decline of natural assets will cost the world at least £368 billion a year, with the UK suffering annual damage to its economy of at least £16 billion by 2050. Economies need to rapidly decarbonise to achieve the target of limiting global warming to 1.5°C – and the global food and commodity sectors must play a significant role. Agriculture, forestry and land-use change generate around a quarter of the world's greenhouse gas emissions. Agriculture's outsized impact derives from the conversion of carbon sinks (like forests and natural ecosystems) to high-emission food, commodities and their waste. More than a quarter (27%) of deforestation results from agricultural commodities. At the heart of this is the production of commodities like soy, palm oil, timber, pulp and paper, beef and leather, rubber, and cocoa (so-called "forest-and-ecosystem-risk commodities", here referred to as "forest-risk commodities") in some of the most biodiverse ecoregions of the world. Forest-and-ecosystem-risk commodities are defined as those which are driving agricultural expansion into natural forests and ecosystems, often as a result of complex drivers and misaligned financial and policy incentives. In this report we focus on the commodities above, although in practice "forest-and-ecosystem risk" commodities extend well beyond these seven.

Scientific evidence suggests the world's largest rainforest, the Amazon, is already approaching a "tipping point" where the ecosystem starts to irreversibly dry and shift to savannah. Parts of the Amazon are already emitting more carbon than they absorb, mainly due to increased deforestation and deliberate forest fires. Losing the Amazon would be a catastrophic setback in managing runaway climate change. International action is urgently needed to ensure not only that such forests are conserved, but that they are restored at scale. A 2020 WWF report showed that the UK's demand for and trade in forest-risk products alone require an area overseas equivalent to 88% of the total UK land area, from 2016-2018. This is 15% higher than the value estimated for previous years (2011-2015). Such demand could impact more than 2,800 species already threatened with extinction, and comes with a carbon price tag of well over 28 million tonnes of carbon dioxide equivalent (CO_2e) per year – comparable to 7-8% of the UK's offshore carbon footprint in 2016. The UK would likely need to reduce its global footprint of consumption and production by 75% if it is to meet planetary ecological limits, highlighting the need for cohesive policy action in this space.

THE UK'S DEMAND FOR AND TRADE IN FOREST-RISK PRODUCTS ALONE REQUIRE AN AREA OVERSEAS EQUIVALENT TO 88% OF THE TOTAL UK LAND AREA FROM 2016-2018. THIS IS 15% HIGHER THAN PREVIOUS YEARS, 2011-2015

The UK financial sector plays a substantial role in facilitating the trade of such commodities, both for products bound for the UK and for foreign markets, and as this study shows, is highly exposed to nature-related risks like deforestation and conversion through its investment and lending. This report examines the exposure of the UK financial sector to such risks and sets out how this could be addressed through legislative action in the UK. We make the case that voluntary commitments are not sufficient to curb the scale of environmental loss we are experiencing today.

Halting the destruction of natural ecosystems, like forests, and addressing associated human rights issues is fundamental to limiting global warming to 1.5°C, halting and reversing biodiversity loss by 2030, and achieving global development targets. It has also been clear that it is integral to managing the emergence of new infectious diseases and preventing future pandemics like Covid-19. But this can only come with coordinated action by all those who produce, trade, buy, process, and finance global commodities.

Equally, it is imperative that all parts of the economy align with the Paris Agreement, which is key to tackling climate change and mitigating large-scale ecosystem destruction. This is a priority if the UK's financial sector seeks to remain a credible hub for green finance. Mitigating deforestation risks through enhanced due diligence should be an integral part of any strategy to align the financial sector with the UK's commitments under the Paris Climate Accord, and legal commitments to net zero. It should also form a key part of commitments to a Paris-aligned finance sector strategy and associated transition plans required of and published by the financial sector. This study calls on the UK government to develop a robust due diligence obligation that covers the majority of actors in UK forest-risk commodity supply chains, including finance. It also calls on the government to uphold the recommendations of the Global Resources Initiative and develop a pathway for mandatory due diligence for the financial sector, in the runup to the 26th Conference of the Parties (COP26) to the United Nations Framework Convention on Climate Change (UNFCCC).

Throughout this report we will refer to the definitions, guidelines and standards set by the Accountability Framework, which provides the baseline for an international set of standards for managing forest-risk commodities. A glossary is provided in Annex 2.

CONTEXT OF THIS STUDY

The policy landscape with regards to due diligence on environmental and human rights has been strengthening rapidly, both in the UK and abroad. The European Commission's Sustainable Corporate Governance Initiative has proposed a European Union (EU) directive that would introduce mandatory human rights and environmental due diligence obligations on EU companies. Following this, the European Parliament has adopted a resolution with recommendations on a legal framework to "halt and reverse" EU-driven global deforestation. Resulting due diligence requirements would apply to the financial sector and all deforestation and conversion (including "legal" deforestation as defined by national laws).

In the UK, following the 2015 Modern Slavery Act and the 2021 UK Timber Regulation, a new Environment Bill has been proposed after the country's exit from the EU. Schedule 16 of the new Environment Bill would require companies trading forest-risk commodities to implement additional due diligence to ensure that they are not exposed to illegal deforestation. An amendment was also proposed to include financiers of these supply chains, in line with the recommendations to the government set by the Taskforce of the Global Resources Initiative (GRI) whose goal was to establish how the UK government could decrease our overseas environmental footprint.

However, the true size of the UK financial sector's exposure to deforestation and conversion has not yet been examined, which has presented a barrier to defining what an effective due diligence mechanism could look like.

This paper therefore takes the first step in demonstrating what we would need for an effective state policy that could move the UK towards truly deforestation and conversion-free supply chains. It quantifies the scope of exposure of the UK's financial sector to deforestation and conversion, and it explores how a mandatory policy could address existing gaps in legislation and failings in voluntary sustainability reporting mechanisms. The current Environment Bill focuses on preventing the illegal trade of such commodities, and it is recognised that an obligation on the financial sector would need to follow the framework of existing law. But an effective due diligence obligation should be synchronised across all companies producing, trading, processing, buying and financing forest-risk commodities. Moreover, we present this paper as a model for how deforestation and conversion-free supply chains would be best achieved, and we examine what this could look like for the financial sector. We therefore emphasise that the Environment Bill would need to be strengthened for all companies in the value chain. Where a due diligence obligation is applied to the financial sector, clear and detailed sectoral guidance is needed for different financial actors and to effectively cover all types of investment and asset class. We therefore begin with a banking sector model, with the expectation that this would be extended to all financial sector actors.

THE UK'S EXPOSURE TO DEFORESTATION AND CONVERSION RISKS

Our study comprised a literature review, interviews with 22 different expert stakeholders from finance, government and civil society, and a subsequent workshop to discuss what an effective due diligence law and corporate action could feasibly look like.

Our first assessment looked at **UK lending and investment** to hundreds of producers, traders, processors and buyers of forest-risk commodities (cocoa, rubber, timber, soy, beef, palm oil, pulp & paper) from 2013 to 2021. The total investment over this period was found to be **£8.7 billion,** primarily in revolving credit, underwriting and corporate loans. The UK banking sector had well-established and largely consistent financial relationships with commodities traders over the timeframe. The analysis also indicated sectoral concentration in a few large banks, asset managers, insurance and pension providers. Most exposure was to palm oil (£2.1 billion), beef (£1.78 billion) and soy (£1.45 billion). **The level of UK investment in the same companies trading forest-risk commodities, especially palm oil and soy has remained largely consistent between 2015-2020, since the signing of the Paris Agreement.**

Focussing on supply chain analysis, we then assessed the whole investment risk exposure for UK financial sector actors to deforestation and conversion in **Brazilian beef and soy supply chains and Indonesian palm oil supply chains,** finding 303 financiers were exposed through their investment and lending. The assessment covered a wide range of listed and private companies producing, trading, buying, processing and financing these supply chains as of August 2021.

Almost £40 billion in investment and lending went to companies that directly produce, trade and buy these products as a primary business activity by 303 different UK-domiciled financial institutions and funds. Risks were also likely to be concentrated. Over 50% of finance was provided by only 15 large banks and investors in such supply chains. Corporate loans and revolving credit are more likely to be used for consolidated global traders who have established relationships with producers, many of whom are private companies and as such may have concentrated risk exposure. Almost none of these investee or client companies can guarantee they are not exposed to deforestation and conversion risks. Therefore, these investments represent a deforestation risk for the financial institutions providing services to them.

When accounting for finance to all companies operating in the supply chain, including indirect exposure through other investors, funds and passive investment vehicles, the scale of such risk exposure is estimated to reach almost **£200 billion.**

An assessment of the companies with the highest risk exposure is out of the scope of this paper. Such numbers rather illustrate the scale of the investment and lending exposed to supply chains where inadequate transparency measures are in place. The assessment only covered countries with high rates of tropical deforestation, when significant deforestation and conversion fronts also exist elsewhere. Data gaps and scope limitations therefore mean this is likely to be a lower-bounds estimate of risk exposure. And it is clear that a wide range of companies along the value chain are exposed. For this reason, our study demonstrates that a wider range of companies should be required to assess their clients, customers, supply chains and investees for exposure to deforestation and conversion.

We recommend starting with institutions providing direct lending and investment to players most exposed to such risks, but the process should move to cover all companies who derive financial benefits from jurisdictions where there is a risk of exposure to deforestation and conversion. Such policies can be complemented by incentives that support sustainable production.

In the next section, we describe how a due diligence obligation is the primary instrument to manage deforestation and conversion risks.

POLICY SOLUTIONS TO ADDRESS FINANCED DEFORESTATION AND CONVERSION

The study shows that financing to companies with high exposure to deforestation and conversion risks is still high in the UK and may occur through a variety of instruments and actors. Although there is sectoral concentration, managing exposure through the voluntary commitments of a handful of players is unlikely to address the root of the issue.

In the UK, there are only voluntary commitments to ensure that products are not sourced from deforestation-risk areas. Many players still only have a policy on illegal deforestation risk. For timber and agricultural products there is a dependence on certification mechanisms to ensure that products are produced sustainably, like the Roundtable on Sustainable Palm Oil (RSPO) certification, Roundtable on Responsible Soy (RTRS), Forest Stewardship Council (FSC)/Programme for the Endorsement of Forest Certification (PEFC), No Deforestation, No Peat and No Exploitation (NDPE) etc. While this is a first step and may work for individual companies, certification does not reduce the rate of deforestation beyond niche markets or have the scale of impact needed to address the deforestation and conversion crisis. Evidence of certification is therefore not considered to be evidence of lack of exposure to deforestation and conversion, and additional due diligence measures should be applied by companies.

As a global centre for finance, the UK is primed for leadership in sustainable finance markets. Rising interest in environmental, social and governance (ESG) frameworks, sustainability reporting, and the growth of "green finance" markets has drawn investor attention to climate risks linked to financial portfolios. It has also accelerated the growth of voluntary sustainability reporting standards and mechanisms, many of which apply to the finance sector. However, many of these sustainability frameworks do not address the more complicated environmental and social risks associated with deforestation and conversion in supply chains, which are made more complex by inadequate supply chain data.

IN THE UK, THERE ARE ONLY VOLUNTARY COMMITMENTS TO ENSURE THAT PRODUCTS ARE NOT SOURCED FROM DEFORESTATION RISK AREAS.

Voluntary commitments to reduce deforestation and conversion have been in place for some time. The 2006 Amazon Soy Moratorium and 2017 Cerrado Manifesto both made strides in preventing deforestation from agricultural expansion in specific biomes in Brazil. In 2014, more than 200 parties endorsed the New York Declaration on Forests (NYDF) at the United Nations climate summit, with the aim to halve global forest loss by 2020. Pledges on deforestation-free supply chains have continued in recent years. Initiatives aimed at the financial sector have also bloomed, for example the Cambridge Institute of Sustainability

THE NYDF PROGRESS REPORT SHOWED THAT RATES OF FOREST LOSS HAVE INCREASED, DESPITE THE RISING STRENGTH OF CORPORATE POLICIES

Leadership's Soft Commodities Compact and subsequent Banking Environment Initiative, which also sought to align the banking industry's services with the zero net deforestation ambition by 2020.

Nevertheless, by 2020, the NYDF progress report showed that rates of forest loss have increased, despite the rising strength of corporate policies and targets. There has been evidence that these targets were not going to be met for some time.

One of the proposed ways to approach deforestation risks from an investor perspective has been through sustainability reporting frameworks. Examples include the Task Force on Climate-related Financial Disclosures (TCFD) and the pending Task Force for Nature-related Financial Disclosures (TNFD). The TNFD is promising, but still in its infancy. It is also voluntary, and it is likely that it will take some time before it is adopted broadly across industry. The TCFD focusses on climate risk and materiality associated with carbon emissions, so deforestation and conversion are not likely to be completely covered in this framework.

Deforestation is often covert, or executed over many years, which is why cut-off dates that prohibit land in a certain area from being used for production if it was cleared after a set date are vital in addressing the underlying drivers of deforestation. It has been estimated that 69% of deforestation and conversion globally has been conducted in violation of relevant national laws, the scale of which reached 31.7 million hectares (the size of Norway) between 2013 and 2019. Approximately 31% of this is to produce commodities for export. In the Brazilian Amazon, for example, forests can be cleared and used for grazing years before being sold to established producers. Assessments of annual deforestation in Brazil indicate a lack of transparency in legal compliance when it comes to permits for the clearance of vegetation: only 6% of states had permitting transparent enough to ensure compliance. In Indonesia, 81% of palm oil operations (particularly in large commercial plantations) were found to breach national laws and regulations, according to a review by Indonesia's Supreme Auditing Agency. Deforestation is therefore more likely to be an outcome of sourcing from areas with weak rule of law, unclear land rights and poor track records on labour rights, without the necessary due diligence requirements in place. This makes it far more difficult to capture in annual reporting and makes such tools unlikely to address the underlying drivers of forest loss on their own.

Standard sustainability reporting frameworks may also fail to set a standard for identification and risk assessment, making it difficult to compare progress or identify points of failure. Furthermore, they do not cover all potential risks associated with deforestation. Human rights issues are still prevalent even in the operations of large conglomerates, as evidenced by a 2019 Public Eye report focusing on agricultural trading companies supplying to European markets.

In a series of interviews and workshops conducted for this report, it was clear that the risks associated with deforestation are known to many financial sector actors; and in many cases deforestation and conversion policies have voluntarily been strengthened. However, without strong rule of law and clear, detailed sectoral guidance, there is likely to be significant leakage and a risk of leaders being undercut by players with less ambitious policies. A clear need for a standard for how to manage deforestation and conversion risks was identified in the study – not only at policy-setting level, but one that addresses implementation and action.

The current UK Environment Bill may provide an opportunity to set out such requirements for transparency and corporate action. However, it has a few key gaps to ensuring that the UK's supply chains are deforestation-free: firstly, it only pertains to deforestation occurring in breach of national laws, which could lead to a significant reporting burden on companies and in many cases may be impossible to execute due to transparency issues. Secondly, it only pertains to forest ecosystems and not broader conversion, which could leave other biologically irreplaceable ecosystems vulnerable to conversion. A recent WWF study of Brazilian supply chains providing the UK with soy estimates that 29,000-42,000 hectares of deforestation and conversion driven by UK soy supply chains between 2021 and 2030 could be legal, and would not be captured by a due diligence obligation based on producer country laws if the current scope of the Bill remains the same. Thirdly, it also only covers certain companies and commodities – which risks misaligning incentives between different actors in a supply chain, and leaves the financial sector out altogether, which means that the UK's entire footprint and risk exposure is unlikely to be addressed cohesively. In addition, it also fails to address specific Indigenous and human rights issues prevalent in these supply chains.

In order to effectively manage risks related to deforestation and conversion, we therefore need a strong, clear and detailed due diligence obligation that sets out uniform standards and definitions; that applies to all actors in the supply chain, including the UK financial sector; and that encompasses the drivers of deforestation and conversion. Conversion and associated human rights risks must be identified and monitored through robust due diligence processes mandated by law, in addition to standard sustainability reporting frameworks.

MANDATORY DUE DILIGENCE PRINCIPLES TO ADDRESS FINANCED DEFORESTATION

Building upon existing voluntary reporting frameworks and mandatory due diligence legislation, we outline policy positions and actions we propose the UK government should take as it enhances its existing positions on environmental leadership and protection. We have chosen our recommendations to be complementary to existing initiatives and feasible in the short to medium term.

Principles of a deforestation and conversion-free due diligence obligation

For effective due diligence on deforestation and conversion that truly reduces the UK's global footprint, the UK government should strengthen the existing law for all companies and financiers. An effective due diligence state policy must:

1. **Halt all deforestation and conversion.** The proposed due diligence obligation and proposed review mechanism in the UK's Environment Bill must extend coverage to all deforestation and conversion (legal and illegal) of natural ecosystems. Addressing only deforestation and conversion that is deemed illegal as a matter of local law is insufficient from an environmental perspective, incentivises deregulation in forest countries, and imposes an unnecessary burden on businesses by requiring a sometimes complex analysis of relevant local law and its application.

   The lack of a clear and consistent definition of key concepts presents an obstacle to private sector action and informed evaluations of progress. The UK government should endorse and seek to build support for standardisation based on the definitions of "forest", "deforestation" and "conversion" as set out by the Accountability Framework Initiative (AFi). For this reason, we use the AFi's definitions throughout this report (see Annex).

2. **Include all companies in mandatory due diligence obligations.** Regulating the impact of financial institutions on deforestation and conversion is a natural corollary to the UK government's legislative initiative to prohibit the importation or use of forest-risk commodities (UK Environment Bill, Schedule 16). A legal framework prohibiting importation of forest risk commodities into the UK while enabling their financing from the UK is at best incomplete and at worst incoherent and vulnerable to circumvention.

   Finance for deforestation, conversion and related adverse human rights impacts may come in many forms and be provided by a range of different types of institutions. The UK government's policy should cover all companies and financiers, and include guidance for financial sub-sectors including banks, asset managers, insurance companies and investors. The UK government should **develop and publish a roadmap for taking action** – including legislative initiatives and sectoral guidance – that starts with the banking sector and then extends to the whole financial sector.

3. **Enable sufficient information and transparency frameworks.** Reporting requirements on corporates under a due diligence mechanism must be clear, detailed and cohesive to improve transparency and information sharing across supply chains and to ensure effective verification of finance compliance and risk exposure.

4. **Include human rights.** The inclusion of Indigenous communities through free, prior and informed consent (FPIC) is needed to strengthen gaps in current human rights legislation.

5. **Establish effective dissuasive penalties for noncompliance that are clear and enforceable.** This mechanism must include sufficient transparency criteria to identify and remedy non-compliance. It should also enable progressive improvement and seek to ratchet up to all forest-risk commodities as deforestation and conversion fronts shift.

Below, we outline what a state policy framework applied to finance would look like. This builds on the more progressive policies that are already incorporated into banking sector due diligence processes, calling for them to pertain to a set of standards on all deforestation and conversion.

CALL TO ACTION

Where the current Environment Bill does not cover the principles of a deforestation and conversion-free due diligence obligation, the UK government can act to mitigate unintended consequences and:

1. Uphold the UK's climate and biodiversity commitments: The UK government should, as priority, strengthen the Environment Bill as described above. It should uphold the recommendations of the Global Resources Initiative (GRI) to manage the UK's footprint of consumption and production and strengthen the UK's Environment Bill as described above and develop and publish a roadmap for action towards a due diligence obligation on all financiers and traders. As the current legislation only covers illegal deforestation and not all deforestation and conversion, a Global Footprint Target to manage the UK's consumption and production would mitigate the potential unintended consequences of gaps in the existing legislation.

2. Use its position and role as host of COP26 to demonstrate leadership on halting and reversing all deforestation and conversion, in addition to efforts focused on criminal prohibitions and law enforcement. The UK also has an opportunity to demonstrate its leadership both through the upcoming FACT Dialogues and strengthening the policy framework to incentivise sustainable production. Its leadership at COP26 is a critical opportunity for the UK to address such gaps, establishing stronger commitments to transparency.

3. Incorporate Deforestation and Conversion as Part of a Paris-Aligned Financial Sector and Net Zero Transition Plans. This a crucial element to creating a Paris-aligned financial sector that can effectively manage and mitigate its emissions associated with deforestation and conversion.

OUTLINE OF MODEL STATE POLICY

The law is framed to start with direct lending instruments, and as such is likely most relevant to the banking sector as a starting point. But the roadmap should cover all financial institutions and provide sectoral guidance and criteria. It should also recognise that although there are key areas and supply chains where deforestation and conversion risks are higher, risks may shift over time, and this means that a due diligence policy should be updated regularly in accordance with the financial institution's portfolio risks. Such a provision should require financial institutions to:

1. On an ongoing basis, **carry out effective, risk-based and proportionate due diligence** with respect to actual or potential deforestation, conversion and related adverse impacts on human rights, covering clients and clients' supply chains in forest-risk commodity sectors and jurisdictions. This includes an obligation to obtain information sufficient to assess relevant risks, to ensure adequate risk assessments to inform decision-making, to operate an effective grievance mechanism, and where necessary to provide for or cooperate in remediation. Detailed, step-by-step guidance should be set out, similar to the recommendations of the Financial Action Task Force (FATF).

2. Have and make publicly available a **corporate-level policy and action plan** that identifies and mitigates deforestation, conversion and related human rights risks, updated annually and approved by a named corporate officer or committee. The policy and action plan should, among other things, declare the commitments, objectives, targets and measures for progress for removing or reducing legal and illegal deforestation and in respect of related human rights risks.

3. Publish an **annual progress report** disclosing the steps taken by the bank to implement its deforestation and conversion policy and action plan and relevant data on performance against targets.

A competent public authority, preferably independent, should have the duty and necessary powers to supervise compliance with these requirements, with administrative, civil and criminal sanctions. The law should also provide for civil law claims.

CONCLUDING REMARKS

For cohesive global action, a diverse set of tools is needed. Our recommendations do not obviate the need for the many other initiatives on sustainability ongoing in this space. Instead, they are designed to enable the UK government to build on progress already made, take significant but feasible steps now to help reveal and reduce the UK banking sector's exposure to deforestation and conversion, and pave the way for further policy work in this area. Neither do our recommendations negate the need for leading financial institutions to go further than the legislation, and implement sustainability measures that cover all forest-risk commodities that may be exposed to deforestation. Some are already doing so.

We do not have the luxury of time to address deforestation. Policymakers and regulators must act now and in accordance with the latest science. A policy requiring all UK supply chain actors, including finance, to conduct due diligence targeted at deforestation and land conversion risks could catalyse movement towards the whole finance sector becoming deforestation and conversion free. Importantly, it would complement the new due diligence obligations on companies being introduced by the UK Environment Bill. Such a policy framework could create the incentives and transparency needed to shift the dial across the entire supply chain and tip the scales in favour of best practice. But if we overlook the importance of regulation in these value chains, the UK risks failing on global climate, biodiversity, and development commitments.

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INTRODUCTION

The global biodiversity and climate emergency necessitates cohesive global action on a scale that has not been seen before. The Covid-19 pandemic has been instrumental in demonstrating that supply-chain risks derived from degrading and converting natural ecosystems can have catastrophic repercussions. One of the major drivers of loss of natural ecosystems – and therefore the carbon sinks they provide – is their conversion through agriculture. Agriculture, land use and forestry together account for around 23% of anthropogenic emissions. The UK alone needed a land area 88% of its own size (21.3 million hectares) to supply the demand and trade of just seven agricultural commodities from 2016-2018 – palm oil, soy, beef & leather, rubber, pulp & paper, cocoa and timber. This land area increased by 15% since the previous assessment in 2011-2015. As a major global player, the UK's global footprint of production and consumption is outsized.

In recognition of such impacts, the UK government has launched a series of initiatives to manage the UK's consumption and production footprint. In 2018 the UK government outlined a 25-year plan to improve the environment, including developing goals to manage the impact of consumption on natural capital. The Global Resources Initiative (GRI) Taskforce was then commissioned to propose a policy on the mitigation of the UK's links to deforestation through imported commodities, with the aim of reducing the UK's footprint of consumption and production. It proposed a suite of actions to introduce mandatory due diligence for companies that place commodities on the market, and to ensure that similar principles are applied to the financial sector. A legally binding target to end deforestation within UK agricultural and forestry supply chains by 2030 was also recommended. The subsequent GRI Finance Working Group sought to set out what provisions finance could take to manage its footprint.

This came alongside a proposed regulation as part of the new Environment Bill that would require that large UK companies conduct additional due diligence to ensure that no illegal deforestation is contained in their agricultural and forestry supply chains for a specific subset of forest-risk commodities. The proposed law would only apply to UK-headquartered companies trading in select commodities (to be defined in the secondary legislation towards the end of 2021), where non-compliant companies may be subject to fines.

While this law presents a positive step on the road to deforestation-free supply chains, existing gaps in the legislation impede its potential effectiveness and make the UK's supply and value chains vulnerable to deforestation and conversion. Specifically, the law fails to cover all deforestation and conversion; it only pertains to a select few companies trading such commodities and excludes those financing them; and it does not address some of the impacts related to Indigenous rights issues in such supply chains. The current provision therefore risks banning the import of forest-risk commodities while enabling their financing, and at the same time puts a heightened burden on companies to report and track changes in legislation in different jurisdictions.

AS A MAJOR GLOBAL PLAYER, THE UK'S GLOBAL FOOTPRINT OF PRODUCTION AND CONSUMPTION IS OUTSIZED

While it was provisionally suggested that all companies should be included in the Bill, in line with the UK Companies Act, there has been some debate as to how much of the UK supply chain is exposed to deforestation and conversion risks through its financing, and what such a provision should look like. There has also been question as to which complementary voluntary reporting mechanisms may be a replacement for a due diligence requirement on the financial sector.

AN AREA OF 2.1 MILLION HECTARES OF NATURAL VEGETATION, EQUIVALENT TO THE SIZE OF WALES, IS OUTSIDE OF ANY FORM OF LEGAL PROTECTION IN THE BRAZILIAN MUNICIPALITIES THAT SUPPLY THE UK DIRECTLY WITH SOY

The purpose of this study is to investigate the exposure of the UK financial sector to the companies trading and directly financing forest-risk commodities. It also provides a baseline for what is actually necessary to remove financed deforestation from UK value chains alongside existing supply chain legislation, building the case for a mandatory due diligence law covering all relevant UK businesses, including the financial sector.

This study comes alongside a recently published WWF report, Due Negligence, that sets out what different due diligence frameworks could and should look like for corporate actors, and the challenges of implementing them in jurisdictions like Indonesia and Brazil, which is where the UK sources much of its palm oil and soy respectively. This report identified that an area of 2.1 million hectares of natural vegetation, equivalent to the size of Wales, is outside of any form of legal protection in the Brazilian municipalities that supply the UK directly with soy. It concluded that regulation based solely on excluding illegal deforestation would only have a limited impact on the conversion linked to UK supply chains. It would also be harder to implement and be environmentally insufficient. For example, failure to protect the biodiverse Brazilian Cerrado, which contains 5% of the world's species, could put irreplaceable biodiversity at risk and destroy a vital carbon sink. The report sets out recommendations to improve the scope of due diligence provision based on volumes of commodity imported or traded rather than company size, covering as broad a range of commodities as possible, where actors conduct supply chain due diligence before placing a product on the market; as well as to establish effective penalties.

The failure to apply the obligation to all companies financing and trading such commodities leaves the UK open to deforestation and conversion risks and circumvention of the law, while also limiting progress on cohesive transparency and reporting across all players benefitting from commodities trading. This report therefore presents the case for strengthening the proposed UK due diligence law, analysing the financial sector's exposure to soy and beef from Brazil and palm oil from Indonesia. Through extensive stakeholder engagement, we also identify key gaps to implementing deforestation-free supply and value chains for the financial sector and provide recommendations for how best to fill them.

A Glossary of terms in this report is provided in Annex 2. Throughout the report, we use the Accountability Framework initiative's definitions of "deforestation", "forest" and "conversion", which are based on those of the Food and Agriculture Organization of the United Nations (FAO).

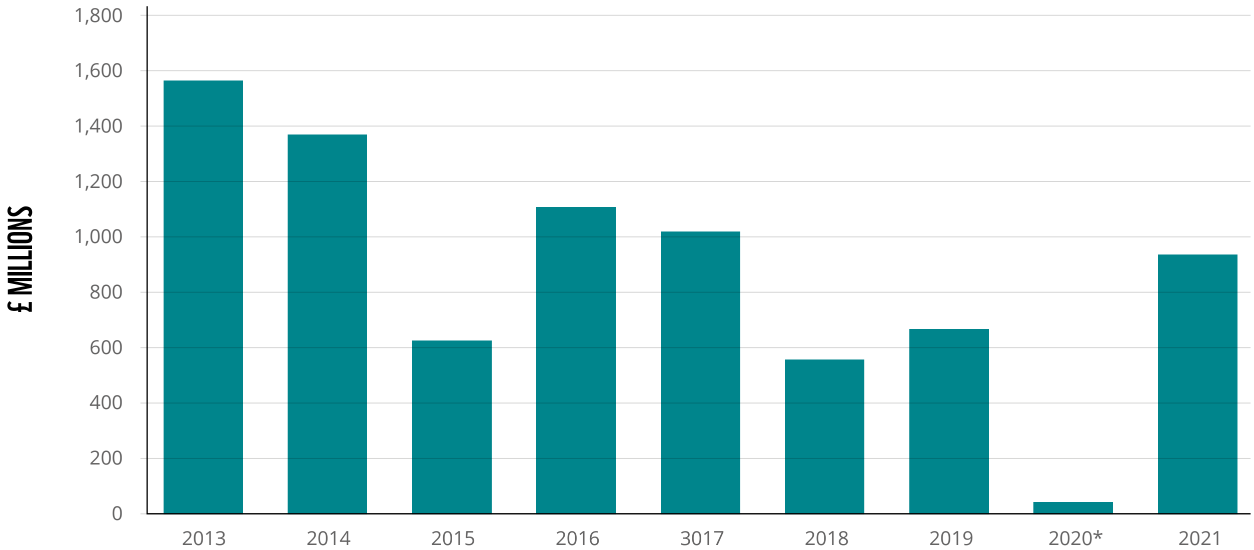
APPROACH AND FINDINGS

The UK's exposure to deforestation and conversion across seven forest-risk commodities

Our initial data analysis comprised a review of financial flows from more than 100 UK banks, insurance firms and asset managers to a representative sample of more than 300 companies producing and trading in cocoa, beef and leather, palm oil, pulp & paper, rubber, soy, and timber. The assessment was derived from publicly available datasets for rubber, soy, palm oil, timber, beef and pulp & paper. Cocoa data was provided by Profundo. The assessment was conducted from 2013-2020, covering all publicly known syndicated loans, underwriting facilities or revolving credit facilities, bond and equity holdings, in the following regions: Brazil; Cameroon, Gabon, Republic of Congo, Democratic Republic of Congo, Liberia, Ivory Coast, Ghana and Nigeria in Africa; and Cambodia, Indonesia, Laos, Malaysia, Myanmar, Papua New Guinea, Thailand and Vietnam in Southeast Asia. Underwriting, corporate loans, revolving credit and bond/share issuance was assessed from 2013 to 2021 with shareholdings and bond holdings assessed as of April 2021.

The UK's financial services have provided **over £8.7 billion to 167 different major traders, processors and buyers of forest-risk commodities (cocoa, rubber, timber, soy, beef, palm oil, pulp & paper) from 2013 to 2021.** The UK's banking sector played a significant role in direct lending to these companies, and there is evidence of established and consistent financial relationships during this period. These values are in line with similar studies estimating the exposure of the UK's financial sector.

While overall bank lending via corporate loans and revolving credit slowly decreased from 2013 to 2015, lending has, since 2015, remained relatively unchanged, especially for commodities like palm and soy. There is still strong evidence of established and consistent relationships between the banking and commodities traders without adequate, timebound policies to end conversion and deforestation, despite rising alarms on deforestation and lack of progress on targets to achieve net zero deforestation by 2020. The values also hide some nuance in individual financiers. Financing from NatWest and Lloyds during this period has decreased significantly while those of other banks remained somewhat consistent. Financing still goes to a concentrated set of traders with variable policies and records on deforestation and conversion. Direct financing to such corporates from UK banks is relatively concentrated compared to share/bondholders who are less so and more likely to change.



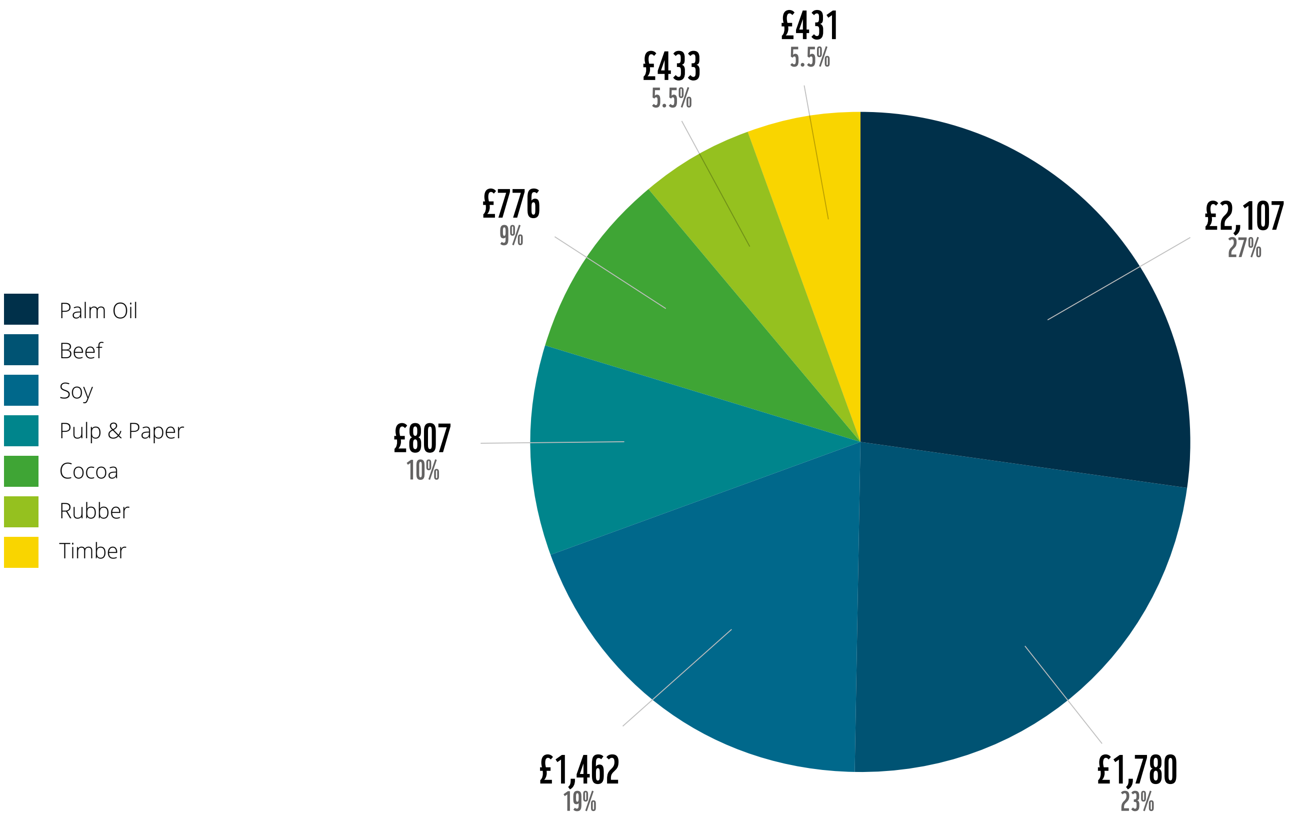
	2013	2014	2015	2016	3017	2018	2019	2020*	2021
Total/year (£Millions)	1,579	1,380	633	1,117	1,026	565	672	44	945

FINANCING PER YEAR TO SIX FOREST-RISK COMMODITIES (PALM OIL, SOY, RUBBER, TIMBER, BEEF, PULP & PAPER

* The year 2020 is likely to outlier due to the Corona-19 outbreak
** Analysis excludes cocoa

Graph 1:
Annual exposure of UK-headquartered financial institutions since 2013. Analysis includes all commodities except cocoa. Source: Rainforest Action Network

The analysis also indicated sectoral concentration in a few large banks, asset managers, insurance and pension providers. The UK's banking sector had the highest exposure to palm oil (£2.1 billion), beef (£1.78 billion) and soy (£1.45 billion).



Graph 2:
UK financial exposure by forest-risk commodities. (Note that percentages/figures have been rounded up)

ASSESSMENT OF EXPOSURE TO BRAZILIAN SOY AND BEEF AND INDONESIAN PALM OIL

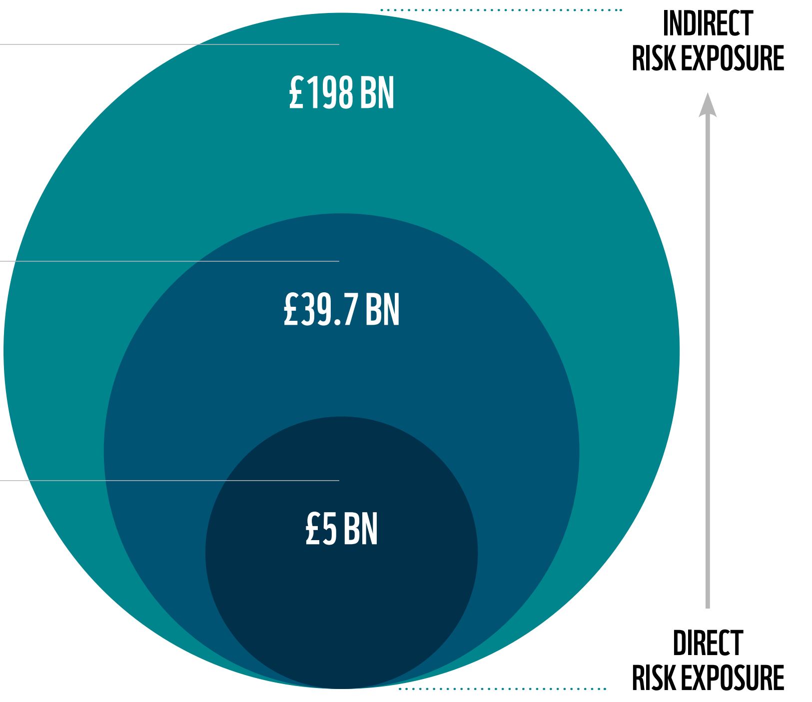
To provide a more comprehensive assessment of the exposure of the financial sector we conducted a secondary deep dive into financing to Indonesian palm oil companies and Brazilian beef and soy companies. The purpose of this assessment was threefold. Firstly, Brazilian soy/beef and Indonesian supply chains have been criticised for their difficulty in distinguishing between legal and illegal deforestation. Secondly, the UK is particularly exposed to these supply chains, as indicated by the previous analysis and that of UK supply chains. Thirdly, a deeper dive allowed a more comprehensive analysis of the breadth of financial sector exposure, through supply chains, other financiers and funds.

TRASE FINANCE, a partnership established between the founding partners Stockholm Environment Institute and Global Canopy with Neural Alpha, conducted an assessment of more than 500 UK financial institutions and 2,800 funds domiciled in the UK and therefore likely aimed at UK investors. The assessment covered financial entities with exposure to companies producing, trading, processing, buying and financing Brazilian soy/beef and Indonesian palm oil companies through their lending and investment. It included equity, bonds, loans and revolving credit facilities, as of August 2021. The methodology maps both the direct and indirect financing of companies through their ownership networks, where data is available, and provides an assessment of exposure to deforestation and conversion risk. The assessment was based on direct and indirect exposure to Brazilian soy/beef and Indonesian palm oil traders (excluding other commodities such as cocoa), and so included exposure via passive and active funds.

Indirect exposure via funds and financiers of Indonesian palm oil and Brazilian soy & beef

Exposure via all debt, equity and bonds in producers, traders, buyers, processors of Indonesian palm oil and Brazilian soy & beef

Exposure via debt instruments (loans, revolving credit) directly to commodities traders in Indonesian palm oil and Brazilian soy & beef



Graph 2:
Exposure of UK and UK-domiciled funds to forest-risk commodities in £billions as of 20 August 2021, to companies operating in Brazilian soy/beef and Indonesian palm oil.

Including indirect exposure via funds and other financiers that have forest-risk holdings, this rises to almost £200 billion. This shows that indirect exposure through the financial sector is also a cause for scrutiny. While this is only a small sample of two supply chains in two tropical regions, agricultural commodities (and other commodities, such as mining) are responsible for ecosystem conversion in many other areas of the world, including pristine savannahs, wetlands, grasslands, other forests, plains, steppes etc. This is therefore a lower bounds estimate of potential risk exposure.

Forest-risk holdings were also found in an estimated £800 million of UK-domiciled "ESG funds". The presence of forest-risk holdings in "ESG" funds indicates that many ESG funds still contain forest-risk holdings because of lack of specialised screening criteria on nature risk (some funds base their "ESG" criteria on social or climate-orientated criteria and approaches differ vastly per fund). However, where screening criteria is strong and due diligence is conducted correctly, companies that are conducting best practice can be effectively identified. Nevertheless, these risks are assessed using many different standards and criteria that continue to expose institutions to deforestation and conversion risks. The lack of standardisation to assess these risks is a key barrier to ensuring that supply and value chains are deforestation and conversion-free.

INCLUDING INDIRECT EXPOSURE VIA FUNDS AND OTHER FINANCIERS THAT HAVE FOREST-RISK HOLDINGS, THIS RISES TO ALMOST £200 BILLION

Exposure to the producer does not necessarily mean that they are deforesting and converting forests and ecosystems, but where there is low transparency it is difficult to differentiate between those that are and those that aren't. Assessments from Forest 500 show that 43% of companies and financial institutions still do not have commitments on forest-risk commodities they are exposed to. However, even when they are present, they may be incomplete. For example, extracting an indicative list of some of the more common names financed shows that many large conglomerates may have a commitment covering legal deforestation, but it may not include all ecosystems/entities in the corporate group, or may not have a clear target date by which they aim to have fully achieved the commitment. For example, many in soy supply chains do not have a clear cut-off date by 2020 for soy-driven conversion. Many will also rely on spot markets and indirect suppliers which can also expose the supply chain to leakage.

			Type of deforestation policy	Scope of policy on deforestation and conversion				
Company Financed	**£ Amount**	**Global timebound commitment**	**Aim/policy Present but not timebound**	**a) Aim/policy covers all ecosystems & conversion**	**b) Aim/policy covers natural forest conversion**	**c) Aim/policy covers no clearance of a category of forest** *(usually)*	**d) Aim/policy covers no net deforestation**	**No public commitment**
CARGILL	400,709,611		X		X			
SIME DARBY	308,743,444		X		X			
COFCO	242,916,003		X			X		
BUNGE	45,240,613	X		X				
LOUIS DREYFUS	21,039,650							
TOTAL	**1,018,649,320**							

Table 1:
Figures show the total deforestation and conversion coverage of some recipients of UK credit and investment in Indonesian palm oil and Brazilian soy as of August 2020

The deep dive incorporated a wider range and more granular detail on risk exposure channels – and a much higher estimate of risk exposure than the previous analysis. Nonetheless, data gaps in many of these supply chains are significant, and a high-level assessment focussing on a few financial institutions and instruments is likely to grossly underestimate potential risk exposure.

DATA LIMITATIONS

Data gaps and transparency issues are some of the more pressing issues in identifying deforestation risks, and are a significant barrier to positive change. It is therefore likely that this only presents part of the full picture. While it was possible to assess exposure at regional level, exposure at farm level or biome level cannot be assessed through publicly available financial databases.

The empirical analysis faces a number of limitations owing to data availability and transparency around financial and company-related data. Most notably, while public syndicated loan data is available, the non-public corporate loan portfolio of banks is not; only a fraction of the overall loan portfolio of banks can be identified. The results of this analysis should therefore be seen as lower-bound estimates. The limitations of this data further stress the need for more consistent financial disclosures and increased efforts to harmonise existing information.

More detail is provided in the Annex, along with detailed methodology.

CONCLUDING REMARKS

THE LACK OF TRANSPARENCY IN SUCH SUPPLY CHAINS AS WELL AS THE LACK OF CONSISTENT REGULATORY STANDARDS SETTING CRITERIA ON BEST PRACTICE IS A BARRIER TO IDENTIFYING THE REAL RISKS UNDERLYING THESE OPERATIONS

Companies operating in these areas and supply chains are not necessarily complicit in deforestation and conversion, and they may operate without contravening national laws. However, the lack of transparency in such supply chains as well as the lack of consistent regulatory standards setting criteria on best practice is a barrier to identifying the real risks underlying these operations. Moreover, the scale of potential exposure indicates a need to go beyond existing voluntary initiatives and standards. The investment landscape is fast-moving, indicating the need for swift action, with concrete guidelines and standards to ensure that financiers of new and existing clients are asking the right questions to determine the risk of exposure.

The rising tide of passive investment vehicles also present a challenge to incorporating assessments on potential environmental harms. About 50% of non-ESG funds were passive in this assessment, amounting to about £8.155 billion in total. Passive investment funds and tracker funds seek to mimic the market, and as such do not incorporate standards of due diligence as would usually be the case in active funds, making it more difficult to monitor and manage as environmental and social governance expectations change.

Providers of debt instruments like revolving credit are more likely than other financiers to be financing operational activities, and this is the primary reason that those with direct financial relationships are best placed to implement stronger due diligence to an acceptable standard. Interviews with several banks have indicated an advanced understanding of issues with regards to risk in these regions and supply chains. But enhanced due diligence needs to go beyond high-level policy assessment to determine a company's risk exposure and should incorporate third-party verification.

In the next section, we present an overview of the regulatory landscape and assess the gaps in existing frameworks that have been in play for many years. We show that a due diligence framework on deforestation and conversion must complement, but not be replaced by, existing voluntary frameworks and initiatives, and present our model policy on deforestation and conversion for the financial sector.

MODEL STATE POLICY

In this section, we present a model state policy that would be most likely to transition the supply chain towards zero deforestation and conversion. Ideally this must fit with the existing pending UK legislation on corporations to provide a cohesive policy framework. However, as there are gaps in the current policy landscape, we start with showing why the existing legislation should be strengthened rather than conceding to a model that would still lend UK supply and value chains to deforestation risk.

To inform our recommendations, a comprehensive review of existing legislative, voluntary and regulatory frameworks was conducted, as were 22 in-depth interviews with financial and civil society stakeholders. Our proposed state policy framework recommends foundational principles and objectives as well as meaningful and feasible legislative and non-legislative interventions that would enable the UK government to promote progress on deforestation and sustainable finance, primarily through the introduction of mandatory minimum standards of strategic policy-making, due diligence and transparency.

LEGISLATIVE AND POLICY LANDSCAPE

The legislative landscape on environmental and human rights due diligence is strengthening in the UK and abroad, as is that of sustainable finance. As envisaged by the 2011 UN Guiding Principles on Business and Human Rights (UNGPs), endorsed by the UK government, legislation is being adopted to crystallise the corporate responsibility to respect human rights (including by protecting the environment) into binding legal obligations on banks and other businesses, with Europe taking the lead.

Some examples can be seen in national legislation featuring corporate due diligence obligations based on the UNGPs. Such measures include the French Duty of Vigilance Law, the Dutch Child Labour Due Diligence Law, the German Supply Chain Law and the Norwegian Transparency Act. Further initiatives are well advanced in Switzerland and the Netherlands and similar laws have already been proposed in Australia, Austria, Belgium, Denmark, Finland, Luxembourg and Sweden.

The European Commission's Sustainable Corporate Governance Initiative proposes a directive that would, among other things, introduce cross-sector human rights and environmental due diligence obligations on companies operating in the EU. Recognising the need for a supplementary focus on forests, on 22 October 2020 the European Parliament published a draft directive on an EU legal framework to "halt and reverse" EU-driven global deforestation. The proposed law, which is intended to tackle all deforestation and conversion irrespective of legality, would comprise corporate duties of due diligence, consultation, information and documentation, and would explicitly apply to financial institutions.

Among various other EU initiatives, and interrelated with the EU's Taxonomy Regulation that adopts the FAO definition of "forest", the EU Sustainable Finance Disclosure Regulation came into force on 10 March 2021. It lays down harmonised rules for financial market participants and financial advisors on transparency regarding the integration of sustainability risks. Banks and other financial market participants will also need to provide a description of the principal adverse sustainability impacts and relevant actions they have taken or plan to take in response. By the end of this year, funds will have to decide whether to classify themselves as "fully focused on sustainable objectives", "fully or partly focused on environmental, social or sustainability issues", or "not focused on sustainability". The European Supervisory Authorities are developing the applicable regulatory technical standards, which will introduce more granular specifications for the content, methodology and presentation of certain disclosures.

It is yet to be confirmed whether, to what extent and how these regulations will influence legislative changes in the UK, although the post-Brexit requirement to maintain regulatory equivalence and commercial pressures for a uniform regime are factors in favour of close alignment. Irrespective of this, in light of the EU's proactivity around sustainability reporting requirements for the financial sector, our recommendations in this report would not expose UK banks or investors to competitive disadvantage. On the contrary, they would help to equip them with the policies, procedures and information necessary to be competitive in a regional and global economy increasingly focused on demonstrable sustainability performance.

THE UK AND EU REGULATORY LANDSCAPE ON ENVIRONMENTAL AND HUMAN RIGHTS DUE DILIGENCE IS CHANGING RAPIDLY

In the UK, the 2019 Global Resources Initiative recommended to the UK government that "the financial sector should also be covered by a similar mandatory due diligence obligation, requiring them to exercise due diligence in order to avoid their lending and investments funding deforestation". More broadly, in April 2017, the UK Joint Committee on Human Rights proposed that a failure to prevent mechanism, modelled on section 7 of the UK Bribery Act, may be "an appropriate one to apply to business and human rights". In February 2020, the British Institute of International and Comparative Law published a study concluding that this proposal would be feasible, provided that it is adapted to align with the framework of the UNGPs. Calls for the UK to introduce corporate accountability laws requiring enterprises to undertake human rights and environmental due diligence continue.

GAPS IN THE UK LEGISLATURE

Following Brexit, the UK passed a new Environment Bill which is now entering its third reading. Schedule 16 of this Bill includes a due diligence obligation on large businesses operating in the UK in respect of the trade and use of forest-risk commodities and derived products, focused on deforestation deemed illegal as a matter of local law. However, several significant gaps exist in this provision that leave the law vulnerable to circumvention, allowing deforestation-risk commodities to enter the UK supply and value chains.

- A law based on illegal deforestation of natural forests only would therefore have limited impact on the UK's conversion footprint. Defining "illegal deforestation" by producer country national laws leaves a significant proportion of deforestation out of scope, and fails to protect non-forest ecosystems, some of which are irreplaceable hotspots for biodiversity and established carbon sinks. Under the current law, some 29,000-42,000 hectares of land could still be converted solely to supply UK demand for Brazilian soy in the next 10 years (2021-2030). In practical terms, this means that the UK risks continuing to import its carbon emissions through manufactured goods. The law should extend to all deforestation and conversion.

- A law based on illegal deforestation only would be extremely difficult to enforce and implement due to gaps in supply chain transparency. A WWF-Brazil study on illegal deforestation showed that the transparency and quality of publicly available permit data meant it was extremely challenging to distinguish between legal and illegal land clearance, to the point where only 5% of the deforestation detected could actually be corroborated against legal permitting. Moreover, forest laws differ substantially between countries and are often numerous and complex. For example, 22 regulations cover forest conversion in Sumatra, one of the main palm oil producing areas within Indonesia. Full traceability is difficult to achieve without disclosure, which is challenging for buyers who, for example, may trace a certain proportion of their product to farm level, but may still buy a significant proportion on the spot market. Even the British Retail Consortium – which represents more than 170 businesses – has called for Defra to make the proposed due diligence regulation in the Environment Bill more comprehensive and include other natural ecosystems as well as forests. The practical implementation of the law would be improved by setting clear standards and definitions on all deforestation and conversion.

THE CURRENT ENVIRONMENT BILL REPRESENTS GOOD PROGRESS, BUT HAS A NUMBER OF GAPS THAT MUST BE ADDRESSED

- A law that only considers traders, and not all companies operating in these supply and value chains (including finance), is insufficient environmentally and risks creating misaligned incentives in value chains. As this study shows, the financial sector has significant exposure to deforestation and conversion risks through the companies it invests in and lends to, but also through other financial sector actors. In accordance with recommendations set out in multiple guidelines on responsible business conduct, including the OECD Guidelines for Multinational Enterprises, incentives should be aligned for all players in the value chain, including finance. Risks of deforestation and conversion can be a reputational risk for UK financiers, especially as the UK sets itself up to be a green financial hub.

- The law does not adequately include provisions on Indigenous and human rights including provisions of free, prior and informed consent (FPIC) for Indigenous people. Where supply chain transparency is limited, issues of land grabbing, labour issues and other human rights issues persist.

There is still room to strengthen these policies, but replacing a clear, detailed due diligence law with voluntary measures is not sufficient.

VOLUNTARY AND REPORTING FRAMEWORKS ARE NOT ENOUGH

EVERYONE LIKES THE IDEA OF CONSOLIDATING AROUND A SINGLE SET OF STANDARDS, SO LONG AS IT IS THEIR SET OF STANDARDS

Corporate executive responsible for human rights

There is a wealth of guidance on deforestation and conversion in existing collaborative voluntary frameworks like the Carbon Disclosure Project (CDP), the Cambridge Institute of Sustainability Leadership (CISL), Climate Related Financial Disclosures (TCFD) and Global Reporting Initiative (GRI) among others. Guidance on human rights and environmental due diligence has also been set out by the UN Guiding Principles on Business and Human Rights (UNGP) and complementary Organisation for Economic Co-operation and Development (OECD) Guidelines for Multinational Enterprises. The still-embryonic Task-Force for Nature Related Financial Disclosures (TNFD) also promises to bridge the larger gaps in nature risk and impact reporting necessary to start to identify risks and impacts associated with the destruction of nature.

However, these reporting frameworks are not a replacement for the rule of law on due diligence. Firstly, they are largely not zero deforestation/zero conversion frameworks. The sheer volume of choice can be a barrier to comparability between organisations, and limit the chance of meeting the dire need for consensus around specific definitions and standards. Or otherwise, many are focussed on climate or material risk and so may not capture deforestation and conversion.

To provide more detail, despite the depth and breadth of this knowledge library, and some more recent initiatives to standardise measures of progress and other financial disclosures, our research and stakeholder engagement identified that the different and conflicting definitions, metrics and voluntary reporting frameworks to choose from was a major obstacle to informed dialogue as well as reliable evaluations and comparisons of the effectiveness and progress of deforestation and conversion strategies.

Many of these initiatives have been proposed to replace a due diligence obligation on the entire supply chain, including finance. However, the rate and uptake of these various measures leaves gaps in ensuring that those that are most exposed are reporting their risk effectively and not simply getting credit because they are voluntarily reporting. Effective supply chain due diligence should be mandatory for all companies, not a "nice to have".

Mandatory standards and guidance would go a long way in ensuring that there is a level playing field and acceptable and comparable standards across the board. Although the Accountability Framework Initiative is helping to build consensus around a single definition of forest, for example, there are over 800 definitions of "forest" worldwide, and this leaves room for actors to circumvent rules around natural habitat conversion. Different definitions are used in the UK Environment Bill and the European Parliament resolution of 22 October 2020 with recommendations to the Commission on an EU legal framework to halt and reverse EU-driven global deforestation, too. Banking stakeholders in particular have advised us that in practice usage of foundational terms such as "deforestation", "zero-deforestation" and "net zero deforestation" vary materially, often necessitating basic "first principles" conversations rather than strategic solutions-orientated discussions and collaboration. As a result, there is a lack of clear standardisation in such frameworks as they address deforestation and conversion, as well as a lack of consensus in any given approach. A set standard would help to circumvent such complexities.

The lack of attention devoted to nature-related financial disclosures compared to climate-related disclosures is a barrier to managing forest risk in reporting frameworks like the TCFD, for example. Climate-oriented frameworks lack granularity on matters of biodiversity generally and deforestation and conversion particularly. This is a result of the political prioritisation of climate-change measures and the breadth of nature and biodiversity analysis, despite deforestation's links to climate change.

For example, while deforestation is a major contributor to greenhouse gas (GHG) emissions, the full damages of deforestation would not be recorded in the TCFD. Most deforestation emissions may be from land-use change or from felled trees being burned or left to decompose. TCFD does not necessarily cover (i) deforestation and conversion where felled trees are converted into products, such as timber, pulp and paper; (ii) the loss of the carbon sink; (iii) unplanned or undocumented deforestation; or (iv) the many other severe environmental harms caused by deforestation and conversion, such as loss of biodiversity.

An additional barrier to reporting on deforestation is that much of the actual land clearance may happen well before the land is used for production, and this is often done illegally. It has been estimated that 69% of deforestation and conversion has been in violation of relevant national laws. In Indonesia, for example, 81% of palm oil operations (particularly in large commercial plantations) were found to breach national laws and regulations, according to Indonesia's Supreme Auditing Agency. In the Brazilian Amazon, meanwhile, forests can be cleared and used for grazing years before being sold to established producers. Assessments of annual deforestation in Brazil indicate a lack of transparency in legal compliance when it comes to permits for the clearance of vegetation: only 6% of states had adequately transparent permitting to ensure compliance. The high risk of exposure to legal activity is complicated by the lack of transparency in supply chains, making it both burdensome for corporations to monitor and report on different countries' legal thresholds for deforestation and conduct effective due diligence, and making it less likely to be captured in annual reporting as a material risk.

Recent guidance on environmental crime set out by the Financial Action Task Force (FATF) notes that "the proceeds from environmental crimes are in the same order of magnitude as other financial crimes generating US$110 to 281 billion per year", and that forest crime, illegal land clearance, mining and waste trafficking account for 66% of this.

FATF expressed its concern over the "lack of proportionate government action" to detect and disrupt associated financial flows, calling on countries to review their risk exposure to such crimes. It also noted that the formal financial system is used to launder proceeds from such crimes, indicating that there are gaps in effective mitigation of these environmental risks. A high burden therefore rests on producing country governments to police companies and producers that are often operating in remote areas, while gaps in due diligence may unintentionally exist for environmental crime assessment for companies and financiers operating in these areas.

While the groundbreaking TCFD initiative and the UK government's leadership in making TCFD-aligned disclosures mandatory are commendable and vital for managing broader carbon emissions and environmental impacts, they are not "no deforestation/no conversion" frameworks as recommended in this report. The TNFD is an exciting development which is essential for the wider management of sustainability-related issues. But it is also not expected to launch until 2023 – and will then need to be mainstreamed, while all the while primary landscapes are being destroyed at a record pace. Our recommendations in this report are intended to be aligned with the mission and likely output of the TNFD, enabling action to be taken now and built upon in the future.

GAPS LEFT BY DEPENDENCE ON COMMODITY CERTIFICATIONS

In order for such mechanisms to work effectively, corporate and financial policies must be aligned, as should their commodity risk management frameworks. Currently, most assessments by finance to ensure that products are produced lawfully are voluntary, and there is a dependence on commodity certification schemes which often present different methodologies and standards. A review by Profundo in 2019 outlined 17 existing certification frameworks for soy products alone, 10 of which only cover compliance with local deforestation laws. The most commonly applied frameworks include the Roundtable on Sustainable Palm Oil (RSPO) certification, Roundtable on Responsible Soy (RTRS), Forest Stewardship Council (FSC)/Programme for the Endorsement of Forest Certification (PEFC), No Deforestation, No Peat and No Exploitation (NDPE) etc. However, certification is not enough to drive industry-wide progress on conversion-free products.

Our interviews with deforestation experts revealed that although certifications allow for better production practices, they cannot claim to have a direct impact on large-scale deforestation. Niche markets produced by certification are insufficient to exert any significant influence on the overall rate of deforestation and conversion. This is because certified production units are not in areas of high deforestation risk, and the certification may allow indirect offsetting of certain volumes by promoting better practice in equivalent production elsewhere. These are also commonly used in agribusiness companies because they don't demand significant change in sourcing policies or the business model. Buyers must therefore go further than just sourcing deforestation and conversion-free supplies, they must also adopt robust requirements for suppliers to take action across their operations, including supplier performance management systems to operationalize this action. Any certification requirements in place would need to be physical (rather than credit-based or "book and claim"), segregated certifications and to be complemented by a time-bound plan to implement deforestation and conversion-free supply chains beyond certification by 2023, as aligned with the Accountability Framework Initiative. A benchmark of such a monitoring system has been successfully implemented for 15 years in the Amazon Soy Moratorium. Otherwise, focusing on certification alone exposes the entire market to risks that uncertified products will enter mainstream markets.

Aside from dependence on certification for commodities, financial institutions often also set such certifications as a basic requirement for their clients. But this may apply only to certain parts of the company, to actors of a specific size threshold, or investments of a specific size. For example, the Equator Principles of the International Finance Corporation (IFC) are widely used for environmental due diligence but are largely applied to project finance.

In addition, UK banks (although other financial institutions may be slightly more varied) generally already have some form of no-deforestation commitment but are not obliged to enforce it, and may do so using a variety of standards and guidelines, incorporating different thresholds. As noted above, as it is difficult to assess the legality of deforestation, covert activities spaced over long periods of time in areas where the rule of law is weak become more difficult to monitor. Unlike many areas of nature-related impacts, discussion and awareness of forests-related issues among banks are far more advanced and, unlike other areas of environmental risk assessment, also relate to the supply chain measures being introduced by the Environment Bill. Our recommendations therefore serve to enforce the financial sector's ability to conduct effective due diligence in its supply chains in a coordinated and cohesive manner.

As our study shows, the banking sector is a dominant player in the financing of all soft commodities. Most UK banks have shown to have a good understanding of deforestation risks through their policy documents. Due diligence processes already fit with existing Know your Customer and enhanced due diligence processes conducted by banks, although the level of standardisation and comprehensiveness needed to be deforestation-free is lacking. On the other hand, the degree of understanding about exposure to deforestation among shareholders is likely to be varied, as shareholders have different levels of influence over and exposure to companies operating in these regions. As such we propose a framework that fits best into banking lending instruments and client onboarding, but with a caveat that a roadmap from the government needs to extend to the entire financial sector.

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TOWARDS A ROBUST NO DEFORESTATION AND CONVERSION POLICY

Against this backdrop, our proposed state policy framework recommends foundational principles and objectives as well as significant legislative and non-legislative interventions that, while moderate, would be important first steps and a catalyst for transformative change. These would enable the UK government to promote progress on deforestation and conversion, and to nurture the sustainable finance of the future, primarily through the introduction of mandatory minimum standards of strategic policy-making, due diligence and transparency. This model state policy framework is designed for maximum impact through striking the appropriate balance between ambition and feasibility of implementation in the short term and complements existing initiatives in the UK and beyond.

POLICY PRINCIPLES AND OBJECTIVES

Policy action should be grounded in clear, coherent, and strategic principles and objectives. We suggest the following fundamentals should guide the UK government's planning and action in respect of the UK finance sector:

- **Focus on deforestation and conversion.** The severe social and environmental damage caused by deforestation and conversion, and the urgent need to take action, requires a dedicated policy focus. General corporate responsibility and accountability frameworks and rules provide an important governance context, but businesses are failing to grasp the scale and urgency of the problem and to prioritise corrective action. Policy intervention is required to make deforestation and conversion unambiguously a material issue for individual businesses.

- **Halt all deforestation and conversion.** UK government policy should aim to halt all deforestation and conversion. Addressing only deforestation and conversion that is deemed illegal as a matter of local law is insufficient from an environmental perspective, incentivises deregulation in forest countries, and imposes an unnecessary burden on businesses by requiring a sometimes complex analysis of local law and its application. Including restorative incentives is also a primary goal and the UK government, financial players and companies all have a role to play in incentivising such activities.

- **Assess where existing mechanisms are inadequate.** Voluntary mechanisms are insufficient to drive change and empower financial institutions to prioritise social and environmental considerations over short-term financial relationships. Only the rule of law can do this. If deforestation and conversion are to be tackled effectively, the UK's policy framework can encompass but must go beyond existing mandatory and voluntary reporting frameworks.

- **Take immediate action towards global standards.** There are various ongoing initiatives to standardise measures of progress and other financial disclosures, many of which WWF supports. However, these do not sufficiently address deforestation, conversion and related human rights risks and will have no impact in the short term. Targeted and immediate action is required and should be pursued in parallel with longer-term projects.

- **Ensure policy coherence.** Regulating the impact of financial institutions on deforestation and conversion is a natural corollary to the UK government's legislative initiative to prohibit the import or use of forest-risk commodities (UK Environment Bill, Schedule 16). A legal framework prohibiting the import of forest-risk commodities into the UK while enabling their financing from the UK is at best incomplete and at worst incoherent and vulnerable to circumvention.

- **UK finance sector.** The UK government should explicitly recognise the UK finance sector has a substantial role to play in halting and reversing deforestation and conversion globally, both through its own impacts and through its contribution to innovation and standard-setting.

- **Develop a roadmap to regulate the UK finance sector.** Financing for deforestation, conversion and related adverse human rights impacts may come in many forms and be provided by a range of types of financial institutions. The UK government's policy should cover all financial sub-sectors, including banks, asset managers, insurance companies and investors. The UK government should develop and publish a roadmap for taking action – including legislative initiatives and sectoral guidance – across the whole financial sector.

- **Start with the banking sector, build towards the rest.** The UK government's first financial sector policy interventions should focus on the banking sector, particularly lending instruments, before addressing the guidance needed to cover other financial sector actors and investment instruments. This is based on the sector's financial relationship with companies at risk of deforestation and conversion, actual and potential impacts on deforestation and conversion, and its relatively advanced understanding, policies, procedures and practices relating to environmental risks. This is also in line with the need, identified in interviews, to establish a set of standards and criteria through regulation. Banks with significant state shareholders should not only be covered by UK policy and interventions but should be leading on matters of deforestation and conversion and related human rights issues. The UK government may deem it necessary to consider certain dispensations for micro, small and medium-sized banks, for example phasing the introduction of obligations.

- **Define and clarify: what is deforestation?** The lack of clear and consistent definition of key concepts presents an obstacle to private sector action and informed evaluations of progress. The UK government should endorse and seek to build support for standardisation based on the definitions of "forest", "deforestation" and "conversion" in the Accountability Framework initiative, which in turn is based on the FAO definition of forest and covers broader definitions of ecosystems for better understanding "conversion".

- **Overcome the barriers caused by insufficient transparency.** A lack of reliable information available to external stakeholders regarding banks' exposures and approaches to deforestation and conversion is frustrating efforts to identify and assess risks, monitor progress and compare corporate practices. Banks choosing to look the other way and ignore deforestation and conversion risks should not be tolerated. While it should not be solely banks' responsibility to obtain and disclose such information, banks are well placed to require relevant data from their clients and prospective clients, and to obtain it from other sources. This information should be disclosed to the maximum extent possible.

- **The UK must show global leadership.** The UK government is well placed to demonstrate global leadership on environmental matters generally and on deforestation and conversion. For this reason the FACT Dialogues may be instrumental in establishing relationships for sustainable supply chains between exporting countries and the UK.

PROPOSED MANDATORY DUE DILIGENCE ON DEFORESTATION

The centrepiece of our model state policy is proposed legislation mandating action on deforestation, conversion, and related human rights risks; the basis for guidance is provided below. The framework below is designed to impose a set of minimum requirements while enabling leading actors to go further. The proposition introduces due diligence and reporting requirements, all backed by provisions on enforcement and sanctions. This would complement existing UK government policy and other initiatives and normative frameworks and should be informed by existing due diligence systems in respect of financial crimes. Increasingly, banks' clients are themselves becoming subject to human rights and environmental due diligence obligations. While this provides important and helpful context for the proposed law, the new duties on UK banks outlined below should not be dependent on or subordinate to any such obligations on their clients.

It would be preferable for such a measure to build upon existing general corporate due diligence legislation – of the type envisaged by the EU Sustainable Corporate Governance initiative and called for by a civil society coalition in the UK – but our risk exposure findings and stakeholder input have shown the pressing need for sector-specific action. By ensuring alignment with the UN Guiding Principles on Business and Human Rights, which the UK has endorsed, a new law can be compatible with similar legislation abroad and a key part of the UK's "smart mix" of measures to ensure responsible business conduct. Further, the EU's legislative work on both a general due diligence directive and also a specific deforestation-focused framework shows that these twin approaches are compatible conceptually and needed in practice (see Annex).

DUE DILIGENCE SHOULD EXTEND TO ALL DEFORESTATION AND CONVERSION FOR PRACTICAL, BUSINESS RELATED AND ENVIRONMENTAL REASONS

The UK Environment Bill contains due diligence requirements in respect of forest-risk commodities driving illegal deforestation or conversion, but a similar obligation should be extended to all deforestation and conversion. The primary objective of the law and adopted policies would be to ensure action on all forms of deforestation and conversion, regardless of legality as a matter of local law in the forest country. The rationale is threefold: first, it encourages banks to recognise all deforestation as harmful environmentally and undesirable commercially; second, it empowers banks to make exclusionary decisions without having to assess legal compliance in the forest country, which can be arduous and impractical; and third, it removes demand and deregulatory pressures in forest states.

While we reiterate this proposal and suggest it should cover the UK financial sector, we recognise this has not been taken up by the UK government. Accordingly, alongside this model due diligence policy, we offer a set of "strengthening" recommendations on minimum criteria for UK banks to manage deforestation exposure, including setting out a corporate policy and action plan and annual progress reporting for transparency, along with areas where the UK government needs to set out guidance.

The key aspects of the proposed law are described below.

FRAMEWORK TO CARRY OUT DUE DILIGENCE

The proposed law would require banks based or operating in the UK to, on an ongoing basis, carry out effective due diligence to identify, prevent and mitigate actual or potential deforestation, conversion and related adverse impacts on human rights, covering the bank's clients and clients' supply chains in line with the existing provisions of the supply chain due diligence law laid out by the Environment Bill. Detailed due diligence guidance by the UK government should set out (in the same way that financial criminal law articulates due diligence requirements) the criteria for compliance. Existing frameworks of anti-money laundering and anti-bribery obligations provide an effective starting point. For example, the FATF standards set out a framework to begin identifying environmental risks and the financial and non-financial information needed to trigger enhanced due diligence to detect forest-related crimes. Guidance should explain what actions are expected and effective, what constitutes compliance and what constitutes failure to comply.

CORE OBLIGATION

On an ongoing basis, carry out effective due diligence to identify, prevent and mitigate actual or potential deforestation, conversion and related human rights risks, including but not limited to violation of the rights of workers and local communities, such as the right of Indigenous peoples to free, prior and informed consent (FPIC).

The due diligence system must:

- Identify and ensure enhanced due diligence in respect of all countries, sectors and activities where there is a risk that the bank might cause, contribute to or be directly linked to deforestation, conversion or related human rights risks.
- Apply the precautionary principle to both the business and activities of the bank's clients as well as its clients' supply chains.
- Ensure the bank has sufficient information to assess relevant risks related to clients and prospective clients. If the bank lacks adequate information to assess such risks: (i) in respect of new clients and projects, it shall not provide financing or services; and (ii) in respect of existing clients and projects, it shall put in place time-bound measures to ensure the client achieves compliance with the bank's policy within a specified period, failing which the bank should cease to provide financing and services until such a time as the client achieves compliance.
- Include adequate risk assessment and mitigation procedures for incorporating evaluation of information relating to actual or potential deforestation, conversion and related adverse risks and impacts on human rights in their decision-making.

Guidance from the UK government will ensure that the due diligence system meets expectations. This guidance should clarify that:

- The due diligence should be risk-based and proportionate.
- he bank should ensure its clients put in place and carry out deforestation policies in line with the bank's own deforestation policy and action plan, for instance by using framework agreements, contractual clauses, codes of conduct, and certified and independent audits.
- he bank should gather information from a range of stakeholders, as required by the circumstances, including prospective clients, existing clients, affected communities, specialist consultants, other private sector resources and tools, and academic and civil society experts.
- Robust monitoring and verification schemes to ensure deforestation and conversion-free supply chains are being implemented.

The information to be obtained from clients and prospective clients, where enhanced due diligence is mandated, should include the client's policies and procedures on deforestation, conversion and related adverse human rights impacts; traceability data; data on physical, segregated certifications and audits, including time-bound plans to implement deforestation and conversion-free supply chains beyond certification by 2023 (as aligned to the AFi); supply chain maps and risk assessments; confirmation regarding excluded activities, such as the use of fire to clear land and development within previously defined high conservation value (HCV) and high carbon stock (HCS) areas, legally protected areas and UNESCO World Heritage sites; FPIC policy, reports and audits; and information gaps highlighted by the bank's due diligence alongside financial information recommended for review by FATF guidance on detecting forest-related crimes.

GRIEVANCE MECHANISM

UK banks should establish and operate an effective grievance mechanism addressing complaints of actual or potential deforestation, conversion and related adverse impacts on human rights and meet the effectiveness criteria set out in the UN Guiding Principles for Business and Human Rights.

Rights are futile unless they can be defended in practice. States bear the primary duty to ensure that those affected by business-related human rights abuses have access to effective remedy, but in many cases this is not always tenable where activities are located in remote areas of the world with weak rule of law. Businesses operating in such areas are expected to establish or participate in effective operational-level grievance mechanisms so that individuals' and communities' grievances can be addressed early and remediated directly and swiftly. Banks should be required to ensure access to such mechanisms and remedies.

REMEDY

Where the bank identifies that it has caused or contributed to adverse impacts on human rights related to deforestation or conversion, it should provide for or cooperate in their remediation.

REMEDIATION FOR COMPANIES ADVERSELY AFFECTED BY DEFORESTATION SHOULD BE AT THE HEART OF DUE DILIGENCE SYSTEMS

Remediation for individuals and communities adversely affected by deforestation, conversion and related human rights impacts should be at the heart of banks' due diligence systems. **The UK government guidance** should emphasise that this is not an abstract proposition and that provision of a remedy in such circumstances is not unprecedented. For example, in 2020 ANZ bank agreed to compensate Cambodian families who had been forcibly displaced by a sugar company that the bank financed in 2011. Following a process conducted by the Australian National Contact Point for the OECD Guidelines for Multinational Enterprises, ANZ "acknowledge[d] that its due diligence on the project funded by its loan was inadequate and recognize[d] the hardships faced by the affected communities". The bank paid the gross profit from the loan to the victims.

Based on our research and stakeholder conversations, banks' commitments and processes in respect of ensuring access to remediation are currently underdeveloped and an area requiring particular attention.

Strengthening corporate policies to this law are described below.

CORPORATE POLICY AND ACTION PLAN

The bank must have and make publicly available a corporate-level policy and action plan on deforestation conversion and related human rights risks aligned with its exposure to countries with deforestation risks.

In recognition that a mandatory due diligence obligation has not yet been applied to the financial sector, we set out some minimum corporate policy and reporting requirements to demonstrate that deforestation and conversion risks are being identified and mitigated. Enhanced due diligence on deforestation should be a part of any public, corporate-level policy or Paris-aligned transition plan, where action focuses on mitigating deforestation and conversion exposure, and includes related human rights risks. Policies and plans should be updated annually and approved by a named corporate officer or committee.

The policy and action plan must:

- Be updated and published online at least annually.
- Identify a corporate officer or committee with responsibility for maintaining and implementing the policy, and outline the relevant governance structures and resources in place to ensure successful implementation of the policy.
- Cover all sectors and financing and investment activities.
- Identify countries, sectors and/or activities where there is a high risk that the bank might cause, contribute to or be directly linked to deforestation, conversion or related adverse human rights impacts but not be limited by this – as deforestation and conversion fronts are likely to shift over time.

The policy and action plan should, among other things, declare the bank's commitments, objectives, time-bound targets, exclusions and other measures for progress for removing or reducing all deforestation and conversion and in respect of related human rights risks. While this would not by itself reduce banks' exposure to deforestation risks, it would be a significant first step and enable more informed engagement with – and review and comparison of – banks and their performance in respect of deforestation. Many banks already have such a policy, although their quality and level of depth varies.

Our research and conversations with stakeholders indicate that requiring banks to commit to and report on medium-term objectives as well as short-term time-bound targets is an important tool for focusing banks on strategically useful action that can be taken now and in the immediate future.

A statutory deforestation target would require companies to ensure their supply chains are deforestation and conversion-free by 2023 at the latest, or to be built around the suggested cut-off dates as per the recommendations of the Accountability Framework, which set the date at 31 December 2020.

RELATED HUMAN RIGHTS RISKS

The policy and action plan should state and explain the bank's commitments in respect of related human rights risks, and in particular commitments to withhold financing and other services from clients linked to the violation of the rights of workers and local communities, including the right of Indigenous peoples to free, prior and informed consent. Banks should show the measures in place and taken to identify, assess and address existing areas of risk, and to identify and resolve grievances.

Deforestation and conversion are often interconnected with adverse impacts on human rights. Evidence of deforestation or conversion will often mean a higher risk of related human rights abuses, and vice versa. These should be tackled holistically in government policy and banks' due diligence and supported by accompanying government guidance. The requirements and criteria for compliance should be set out explicitly and build off gaps in existing laws.

THE UK GOVERNMENT GUIDANCE SHOULD SET OUT HOW TO DEVELOP AND IMPLEMENT EXCLUSION AND RESTRICTIONS LISTS

EXCLUSIONS, RESTRICTIONS AND LOW-RISK FINANCING TRANSACTIONS

A common feature of risk policies in the banking sector is the identification of behaviours that are subject to exclusions, restrictions (subject to enhanced due diligence) and no restrictions (subject to general due diligence). This empowers banks to identify problematic practices with which they do not wish to be associated. Such exclusions and restrictions lists should expand over time as banks adopt more robust anti-deforestation stances of their own volition or in response to stricter regulation.

The policy and action plan must:

- Identify and publish any excluded activities (or "no-go areas") and excluded companies, explain the reasoning, and commit not to provide finance or other services to clients involved in excluded activities.
- Identify any restricted activities and commit not to provide finance or other services to clients involved in such activities without first satisfying enhanced due diligence.
- State the bank's strategy for assessing risks of deforestation, conversion and related adverse impacts on human rights in respect of clients not involved in excluded or restricted activities

The UK government guidance should set out how to **develop and implement exclusion and restrictions lists.** Various stakeholders have suggested that a government-maintained list of forest and conversion-risk countries, sectors, corporations and activities would be helpful and also limit confidentiality issues that may arise.

GRIEVANCE MECHANISM AND REMEDY

- The bank must state its policy on recording and resolving grievances from stakeholders related to deforestation, conversion and related adverse impacts on human rights, and provide details of its grievance mechanism and how it can be accessed.

- It must state its policy in respect of providing for or cooperating in remediation where the bank has caused, contributed to or is directly linked to deforestation, conversion or related adverse impacts on human rights.

- anks must have a live reporting framework for grievances or complaints filed by third parties regarding their due diligence on deforestation .

Businesses are expected to establish or participate in effective operational-level grievance mechanisms so that individuals' and communities' grievances can be addressed early and remediated directly. Banks' clients will often also be obliged to maintain their own effective grievance mechanisms, for example under the Equator Principles or the International Finance Corporation (IFC) Performance Standards. We appreciate that banks may be concerned that complaints arising out of their clients' conduct will be directed to them (the banks) as a first resort. Banks have an interest in ensuring their clients' complaints processes are accessible and credible, and banks may cooperate with clients or other third parties to ensure grievance mechanisms are available and adequate. Ultimately, however, each bank has its own responsibility to provide for or cooperate in the remediation of adverse impacts, and this should not be abdicated on the basis that another business is involved.

In practice, banks' clients' procedures are often inadequate, especially in remote areas. In cases where a bank's own policies are breached, with or without its knowledge, there are rarely channels for such information to be reported to alert decision-makers to the risk. Recourse to the bank (in respect of activities through which the bank is making a profit) is essential for disempowered individuals and groups to raise the alarm, and seek assistance and redress.

In line with the requirement for time-bound targets proposed above, we suggest the action plan should cover a period of two to three years.

GOVERNMENT GUIDANCE

The UK government should, in its due diligence law, provide clear, detailed criteria demonstrating an appropriate target and measure of progress in line with the existing reporting provisions laid out in the Environment Bill for corporate actors in the secondary legislation. It should lay out what is required in respect of the action plans and expected reporting. This guidance could usefully be converted into a statutory requirement. We propose the action plan should include criteria on:

- the bank's approach to prioritisation
- client engagement strategies
- intended enhancements to the bank's due diligence processes
- particular challenges for which the bank has identified and will implement solutions
- challenges known to the bank for which solutions have not yet been identified
- technology and tools to be used by the bank
- contractual rights and their enforcement by the bank
- collaborations to be pursued by the bank.

The UK government should provide guidance suggesting appropriate targets and measures of progress and consider making some or all categories mandatory in the future. These could include measures of traceability of clients' supply chains; certifications held by clients, specifically those that are physical and segregated; and no-deforestation or time-bound targets agreed by existing and new clients. Time-bound targets for the upcoming 12, 24 and 36 months should include, for example, progress on traceability; progress on certifications; number of clients meeting the bank's FPIC requirements; number of client action plans issued and completed; total exposure to deforestation and conversion; and the date by which the bank will become deforestation and conversion-free.

PROGRESS REPORTING AND TRANSPARENCY

The bank must make publicly available an **annual progress report** disclosing the steps taken in the preceding year to implement its deforestation and conversion policy and action plan, supported by relevant data.

Mandatory disclosures do not automatically result in useful information and rising standards, but without mandating such disclosures it is unlikely that the level of systemic change needed to manage climate and environmental impacts will be achieved. However, there is a risk that reporting requirements lead to "tick-box" compliance approaches that distract from more strategic, impactful and solutions-oriented work. We have also heard in our banking stakeholder conversations that banks prefer clarity and certainty of new legal requirements over flexibility and ambiguity. Reporting on progress, when done meaningfully, can reveal banks' successes and remaining challenges as they work to operationalise their policies and to meet their objectives, and can inform further target- and standard-setting and public policy-making.

The bank must:

- Include in its annual financial report an explicit confirmation that the bank has complied with its obligations under this mandatory deforestation due diligence law.
- Include in its annual financial statement information specifying where the disclosures required by this mandatory deforestation due diligence law can be found, including precise locations within the bank's relevant corporate publications.

The progress report must link directly to the bank's targets and commitments, and:

- Include data (which may be aggregated and anonymised) regarding the bank's deforestation and conversion exposure, including:
  - The number of clients and projects assessed under the deforestation policy.
  - The number of clients and/or projects declined under the deforestation policy.
  - The number of clients classified as exposed to risk under the deforestation policy, with a risk mitigation hierarchy described.
  - Geographies or regions in which the bank has exposure to deforestation, conversion and/or related adverse human rights impacts.
  - Te value to the bank of its financing exposure to forest-risk commodities in a given jurisdiction.
  - The number of clients who have (1) a time-bound plan to achieve full sustainability certification by a physical, segregated supplier; and (2) a time-bound plan to achieve no deforestation and conversion beyond certification.
- Disclose the proportion of clients operating in high-risk commodity sectors with and without relevant certifications, such as FSC or RSPO.
- Disclose the bank's performance against the objectives and key results, targets and measures of progress set out in its policy and action plan.
- Disclose details of the bank's grievance mechanism, how the bank is making communities and other relevant stakeholders aware of the grievance mechanism, and data regarding complaints received and outcomes.
- Report on steps taken to engage with clients and halt and reverse deforestation, including through collaborative initiatives, enforcement of contractual rights, and agreeing more ambitious targets.

COMPETENT PUBLIC AUTHORITY

Regulatory action is a major driver of improved policies and practices and associated organisational development within banks. To be effective, the proposed due diligence law must have teeth. We recommend the enforcement and sanctions provisions of the proposed law should be based on the following elements:

- The UK government should maintain a public portal online enabling free and ready access to banks' disclosures under the mandatory deforestation due diligence law.
- The UK government should publish and maintain a "red list" of banks that have failed to comply with the mandatory deforestation due diligence law. Debarment from public procurement should be considered as a future sanction.
- A competent public authority, preferably independent, should receive the duty and necessary powers to supervise compliance with the law and issue substantial fines for non-compliance. Repeat non-compliance should lead to civil liability and, in especially serious cases, criminal sanctions. Breaches of the law would include failures to make the mandatory disclosures, and inadequate due diligence systems and actions to identify, prevent and mitigate relevant risks. The law should provide for civil law claims, allowing time for UK banks to put in place adequate resources, ensure effective and compliant due diligence, policies and reporting, and act on stakeholder feedback on their initial disclosures.
- Individuals and groups should have a right to contact the competent authority and file complaints, request information, and petition for enforcement action. The authority should be required to respond reasonably promptly to such requests and to report publicly on its enforcement activities.
- The law should include a right for affected individuals, communities and organisations to bring civil claims to court for serious breaches of the policy and action plan, due diligence and transparency reporting obligations. This should come into force after a period of two years for large banks.

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TACKLING CLIMATE CHANGE EFFECTIVELY WILL NOT BE POSSIBLE WITHOUT TACKLING DEFORESTATION

CONCLUSION

The clearing of land for the production of various commodities is the main driver of deforestation globally. Our analysis shows that UK banks and other financial institutions have been heavily involved in financing companies active in these commodities over a long period of time, representing significant deforestation risk exposure, and considerable potential leverage to engage with those client companies to improve their practices.

However, the reliance to date on voluntary policies by financial institutions to address these risks has failed. We now need to see legislation creating a due diligence obligation on financial institutions – in addition to other corporate clients as envisaged under the current Environment Bill – to drive the necessary action down supply chains globally. We have set out detailed recommendations about how this could be implemented to best effect.

While the current Environment Bill focuses on illegality, this leads to significant limitations – not in the least leaving out key members of the value chain, such as finance. Ambitious policy frameworks and incentives to decrease fossil fuels have already driven exemplary growth in renewable energy markets. And strong, cohesive and inclusive due diligence on the commodities trade can help to "green" our food systems. Such a policy framework could also incentivise the transparency needed to transform the entire supply chain.

Tackling climate change effectively will not be possible without tackling deforestation. And limiting global warming to 1.5°C, halting and reversing biodiversity loss by 2030, and managing human rights issues in supply chains is a priority if we are to achieve global targets. We have a moment in time to set the bar in the UK, in a way that allocates responsibility and accountability for environmental impacts to all those that benefit from these products. Government has a chance to demonstrate its leadership in this area through the Environment Bill and also at COP26, credibly demonstrating its commitment to make the UK a leading centre of green finance on the world stage.

ANNEX 1: METHODOLOGICAL DETAILS

The analysis comprised three sections:

1. **Broad Assessment:** analysis of UK financial sector exposure to all seven forest and ecosystem-risk commodities (palm oil, cocoa, soy, rubber, timber, beef, pulp & paper)
2. **Detailed Assessment:** analysis of UK financial sector exposure to Indonesian palm oil and Brazilian soy/beef
3. **Policy Assessment:** analysis of the leading policies on deforestation and corresponding interviews

BROAD ASSESSMENT ON SEVEN FOREST-RISK COMMODITIES

In this assessment, we analysed the UK financial sector's exposure to seven forest and ecosystem-risk commodities (palm oil, cocoa, soy, rubber, timber, beef, pulp & paper) from 2013 to 2021.

The Forests & Finance dataset provides information on 300 companies involved in the upstream segment of the beef, palm oil, pulp & paper, palm oil, rubber, soy or timber supply chains in Southeast Asia, Central and West Africa and Brazil. This selection of companies is intended to be a representative sample of companies impacting tropical forests, and is not an exhaustive list of all companies impacting or having the potential to contribute to deforestation. This data was extended with relevant information on companies trading cocoa, made available by Profundo and TRASE. The relevant financing to these companies was further adjusted to reflect the operating segment. For instance, a company with operations in different segments such as log trading, manufacturing, palm oil and others, was attributed the estimated share of financing that each operation received based on capital expenditure per segment. Further, the financing volumes to the forest-risk commodity companies were adjusted by the commodity segments in case a company is active in trading more than one forest-risk commodity. For instance, the company Cargill is, among others, active in the cocoa and palm oil business – the total loan amount given to this company by the five UK banks is hence split among the respective commodities based on the respective trading volumes in these commodities.

These datasets are derived from financial databases like Bloomberg, Refinitiv, TradeFinanceAnalytics and IJGlobal, and company reports. They focus on companies that are trading risk-commodities in tropical countries, whereas a large share of the local producers of these commodities cannot be identified and hence are not included in this analysis unless the companies are large enough to have significant vertical integration. Investments in bonds and shares of the selected companies were identified through Refinitiv, Thomson EMAXX and Bloomberg at the most recently available filing date in April 2021.

The relevant outstanding financial exposure covers the following financial instruments: first, between 2013 and 2020 all publicly known syndicated loans, underwriting facilities or revolving credit facilities are identified. Assumptions were made on the per investor share that each bank has contributed to the outstanding amount. Further, for the risk-commodity exposure all bond and equity holdings were identified based on the filing date of April 2021. Where possible, the financing exposures of individual sub-branches of the five banking groups were attributed to the ultimate parent group. For the equity exposure, all relevant investment branches and asset management subsidiaries of banks were considered.

The database covers the following countries: Brazil; Cameroon, Gabon, Republic of Congo, Democratic Republic of Congo, Liberia, Ivory Coast, Ghana and Nigeria in Africa; and Cambodia, Indonesia, Laos, Malaysia, Myanmar, Papua New Guinea, Thailand and Vietnam in Southeast Asia.

Forests & Finance is an initiative by a coalition of campaign and research organisations including Rainforest Action Network, TuK Indonesia, Profundo, Amazon Watch, Repórter Brasil, BankTrack, Sahabat Alam Malaysia and Friends of the Earth US who collectively work to achieve improved financial sector transparency, policies, systems and regulations.

Profundo is an independent not-for-profit which provides independent research analytics on financial flows, commodity supply chain analysis, and helps clients understand financial and trade risks and opportunities.

DETAILED ASSESSMENT: INDONESIAN PALM OIL AND BRAZILIAN SOY/BEEF

With support from Trase Finance, a collaboration with the Stockholm Environment Initiative and Global Canopy, and Neural Alpha, we conducted an analysis of the UK's exposure to Brazilian beef and soy supply chains, and Indonesian palm oil.

Data is derived from a range of standard public and financial platforms, as well as annual reports and company documents, financial statements and media. Data covers both direct financing through issuance and holders/lenders of equity, bonds, loans (including syndicated loans and revolving credit) to companies and subsidiaries, and indirect financing of commodity trading companies through other financial institutions. Trase assesses the deforestation risk directly associated with commodity expansion, and includes the clearance of native vegetation in all biomes where data is available, measuring the risk that the commodity buyer is exposed to deforestation in its supply chain based on the jurisdiction of sourcing. It does not attribute direct responsibility, but it does adjust the estimates of risk exposure to reflect the improved risk profile of companies actively reducing deforestation in supply chains. The values of loans, shareholdings and bond holdings were aggregated by ultimate parent or at the same level if no ultimate parent existed. More detail is included in the Annex.

Some key differences exist between the Comprehensive Assessment and this assessment:

- Bondholdings and shareholdings are current disclosed holdings as of 20 August 2021, not historical holdings, unlike loans data which is timestamped annually.
- Trase.Finance data excludes bookrunning and issuance services covered by Forests & Finance – this is because some double counting will exist given bookrunners underwrite deals but this does not necessarily mean unsold shares and bonds are taken onto their books.
- The assessment covered corporate loans, revolving credit, bonds and shareholdings, and assessed direct and indirect exposure through UK domiciled and headquartered funds, which are primarily for a UK market. Note that UK funds, although domiciled in the UK so most likely aimed at UK investors, can often be passported and distributed to the rest of Europe through regimes such as UCITS passporting.
- Total loan amounts between Trase.Finance and Rainforest Action Network will differ slightly given Trase.Finance is focused on Brazilian soy and beef and Indonesian palm oil companies with a deforestation risk modelled by Trase. Forests & Finance generally covers a universe of companies deemed to have an unknown exposure to deforestation which is not modelled or calculated. This means it has a larger universe of companies covering other parts of the supply chain but with unknown/unmeasured exposure to deforestation risk.

KEY PARTNERS

TRASE is a data-driven transparency initiative that maps the international trade and financing of agricultural commodities, providing tools that enable companies, financial institutions and governments to address tropical deforestation. Trase is a not-for-profit partnership founded in 2015 by the Stockholm Environment Institute and Global Canopy. Trase Finance (trase.finance) is a partnership between Stockholm Environment Institute, Global Canopy and Neural Alpha.

Neural Alpha Ltd. was founded in 2016 to fuse cutting-edge connected data technologies with deep financial services expertise to deliver data and software solutions for NGOs and financial industry organisations wishing to integrate financial data sets with key sustainability metrics in areas such as the fossil fuels industry and global commodity supply chains. These solutions include investment screening, research, risk and portfolio management with a focus on sustainable and environmental, social & governance (ESG) investment requirements. Connected data is the intersection of semantic technology, artificial intelligence and graph databases.

METHODOLOGICAL AND DATA LIMITATIONS

This empirical analysis faces a series of limitations due to data availability and transparency around financial and company-related data. The following limitations can be identified:

Individual banks' contributions to syndicated loans are not directly obtainable and have to be estimated. The share of syndicated loans to the financial institution's overall loan book further varies significantly across banking institutions and depends on the overall size and investment behaviour of banks, so cannot be easily derived.

The analysis covers only a subset of companies trading with deforestation-risk commodities and does not capture the entirety of companies in the supply chain of these commodities, such as the local producers themselves in high-risk jurisdictions. The **Broad Assessment** further cannot capture complex indirect financial links among financial institutions and only establishes the direct financial exposure banks and their direct subsidiaries have to these companies. However, the **Detailed Assessment** does capture these indirect risks.

These limitations further highlight the need for more consistent financial disclosures and increased efforts to harmonise existing information. Both assessments only cover regions where tropical deforestation is most rife and this should not mean that these are the only priority areas. A wide range of valuable and biodiverse ecosystems are under threat from production, for example, the Great Plains, Asian steppes, African and South American savannahs, grasslands, wetlands etc. But these are outside the scope of this assessment.

POLICY ASSESSMENT

We conducted a review of publicly available information including existing voluntary frameworks; relevant mandatory due diligence frameworks and proposed legislation; current bank policies on forestry and agricultural commodities across a range of UK and international banks; environmental NGO publications; corporate literature; and international media. What followed was in-depth interviews with 22 stakeholders. These included UK headquartered banks, an ASEAN bank and regional subsidiary, and a Brazilian subsidiary of one of the EU's largest global banks. We also interviewed various civil society organisations and deforestation experts in Brazil, along with representatives from UK policy and regulatory bodies for finance and commerce. We also completed two 90-minute workshops with bank representatives to test the model policy and assess existing barriers and limitations to implementing due diligence, and interviewed various deforestation experts from the UK in regions of focus.

ANNEX 2: GLOSSARY

Below we set out the definitions we use throughout this report.

TERM	DEFINITION
Accountability Framework (AFi)	The AFi is a WWF core reference for DCF supply chains and backbone of these asks. The asks complement AFi in indicating WWF suggestions and preferences on pathways, strategies and concrete actions. It sets out a suite of definitions that can pave the way to a global standard around what constitutes deforestation and conversion. It requires companies to set cut-off dates and target dates for more effective supply chain management. *For more, see AFI guidance on Supply Chain Management.*
Cut-off date	This is the reference date from which newly converted areas would not have access to markets or investments. Cut-off dates must respect previously set commitments, and in cases where there are none, are not set beyond 2020. A cut-off date is different from the target date.
Conversion-free	Avoiding destruction of all natural ecosystems, beyond forests – including (but not limited to) natural grasslands, savannahs, peatlands and wetlands – as well as all related human rights abuses, as defined by the AFi.
Conversion	Change of a natural ecosystem to another land use or profound change in a natural ecosystem's species composition, structure, or function. **Notes from the AFi:** Deforestation is one form of conversion (conversion of natural forests). Conversion includes severe degradation or the introduction of management practices that result in substantial and sustained change in the ecosystem's former species composition, structure, or function. Change to natural ecosystems that meets this definition is considered to be conversion regardless of whether or not it is legal.
Deforestation	Loss of natural forest as a result of: (i) conversion to agriculture or other non-forest land use; (ii) conversion to a tree plantation; or (iii) severe and sustained degradation. **Notes from the AFi:** This definition pertains to no-deforestation supply chain commitments, which generally focus on preventing the conversion of natural forests. Severe degradation (scenario (iii) in the definition) constitutes deforestation even if the land is not subsequently used for a non-forest land use. Loss of natural forest that meets this definition is considered to be deforestation regardless of whether or not it is legal. The Accountability Framework's definition of deforestation signifies "gross deforestation" of natural forest where "gross" is used in the sense of "total; aggregate; without deduction for reforestation or other offset."
Due diligence	A risk management process implemented by a company to identify, prevent, mitigate, and account for how it addresses environmental and social risks and impacts in its operations, supply chains, and investments.
Forest	Land spanning more than 0.5 hectares with trees higher than 5 metres and a canopy cover of more than 10%, or trees able to reach these thresholds in situ. It does not include land that is predominantly under agricultural or other land use. Forest includes natural forests and tree plantations. For the purpose of implementing no-deforestation supply chain commitments, the focus is on preventing the conversion of natural forests. **Notes from the AFi:** Quantitative thresholds (e.g. for tree height or canopy cover) established in legitimate national or subnational forest definitions may take precedence over the generic thresholds in this definition. The Accountability Framework should not be interpreted as weakening or qualifying any protection or provision of national forestry laws, including when these laws apply to legally classed forests that are tree plantations or presently have little or no tree cover. The AFi advocates that natural forests be distinguished from tree plantations for the purpose of conducting forest inventories and quantifying forest loss and gain. This will facilitate comparability between government forest monitoring and the tracking of supply chain commitments focused on human-induced conversion of natural forests.
Forest and ecosystem-risk commodities	Agricultural and forest commodities whose production is associated with deforestation and the conversion of other natural ecosystems.
Target date	The date by which a given entity intends to have fully implemented its commitment or its policies to be deforestation and conversion-free or similar. Target dates are set in the present or near future and should be established immediately.

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