

# The Risks of Financing Forest Conversion

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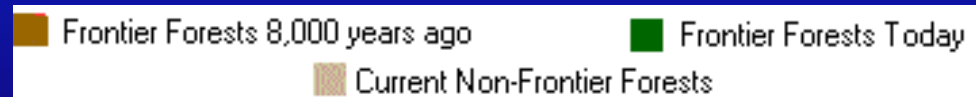
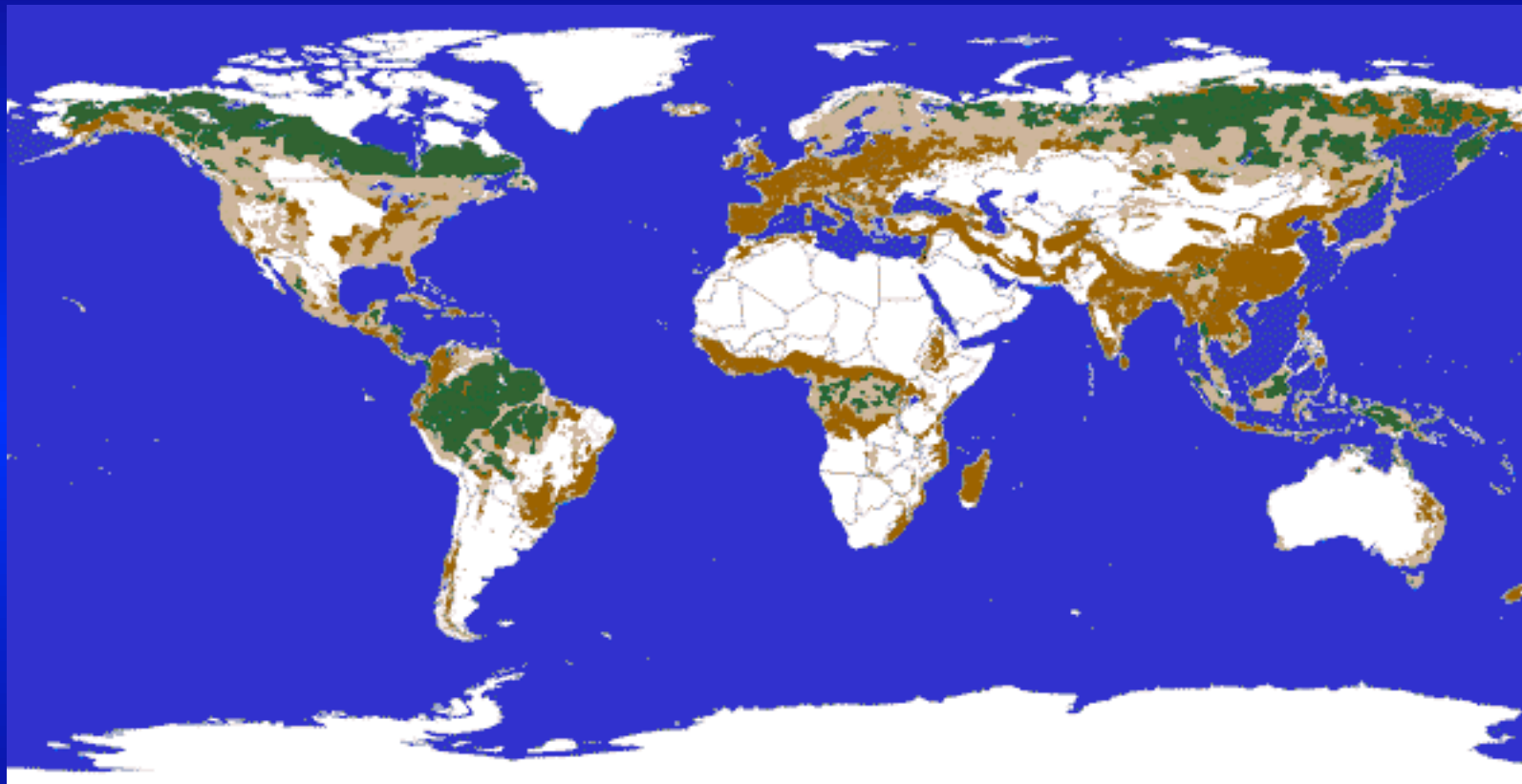
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Sustainable Development"  
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# Brief introduction

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- < Director of Profundo, Dutch economic consultancy
- < RETRAC Research & Advice is a joint-venture with AIDEnvironment (Dutch environmental consultancy)
- < RETRAC focuses on trade and investment in sectors producing or extracting natural resources
- < RETRAC works for:
  - < NGOs
  - < Financial institutions
  - < Governments

# Frontier forests worldwide



Source: WRI

# Frontier forests disappearing rapidly

- < Worldwide 1,350 mln ha of frontier forests (High Conservation Value, old-growth, primary, etc.) remain:
  - < house indigenous cultures
  - < shelter global biodiversity
  - < provide resources
  - < store carbon
  - < contribute to local and national economic growth
- < Most important areas: the Amazon Basin, Congo Basin, South East Asia, Canada, and Russia
- < 15 mln ha disappearing annually (more than 1%)

# How are you involved?

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- < Financial institutions are strongly involved in forest conversion, by financing companies active in:
  - < Logging and timber trade
  - < Pulp and paper industry
  - < Agribusiness (oil palm, soybeans, a.o.)
  - < Infrastructure development (dams, pipelines, roads, power lines, a.o.)
- < Four cases to illustrate the risks involved:
  - < Oil palm in Indonesia
  - < Pulp & paper in Indonesia
  - < Soybean in Brazil
  - < Logging in Central Africa

# Case 1: Oil palm in Indonesia

- < Palm oil and palm kernel oil used for food, detergents, cosmetics. Palm kernel meal used as animal feed
- < World production expanded from 15 million tons in 1995 to 23 million tons in 2001
- < Malaysia has 50% marketshare; Indonesia (33%) is catching up
- < Indonesia: 600,000 ha in 1985 to 3.2 million ha at present



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# Oil palm in Indonesia - Riau in 2000



Picture:  
Togu  
Manurung,  
FWI

# Oil palm in Indonesia - Sustainability

- < Suharto approved conversion of 9 mln ha of forests to oil palm plantations; most has already been logged and is laying idle
- < Loss of habitat for endangered species such as orang utan, tiger, rhinoceros
- < Forest fires: 9 million ha burned in 1997/98; > 50% originated in plantations
- < Corruption & collusion: many oil palm tycoons were Suharto's friends
- < Indigenous communities deprived of their land



# Oil palm in Indonesia - Financing

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- < Oil palm is perennial crop:
  - < mature in 3 yrs
  - < peak production in 8 yrs
  - < life span 20-30 yrs
- < CPO mill necessary at plantation
- < Plantation development: US\$ 2,500-3,500 / ha
- < Many plantations financed by foreign syndicated bank loans in the mid-1990s

# Oil palm in Indonesia - Banks involved

< RETRAC research for Greenpeace, WWF and Friends of the Earth

< Most important foreign banks financing oil palm plantations in Indonesia:

- < ABN AMRO Bank - The Netherlands
- < BNP Paribas - France
- < CDC - United Kingdom
- < Citigroup - United States
- < Commerzbank - Germany
- < Crédit Suisse - Switzerland
- < Crédit Lyonnais - France
- < DEG - Germany
- < Deutsche Bank - Germany
- < HSBC Bank - United Kingdom
- < HypoVereinsbank - Germany
- < ING Bank - The Netherlands
- < Mizuho Bank - Japan
- < Rabobank - The Netherlands
- < Société Générale - France
- < Sumitomo Mitsui Banking - Japan
- < UBS - Switzerland
- < UFJ Bank - Japan

## Case 2: Pulp & paper in Indonesia

- < Annual pulp capacity: 0.6 mln tons (1988) - 5.3 mln tons (2002)
- < Annual paper capacity: 1.2 mln tons (1988) - 8.3 mln tons (2002)
- < Largest companies:
  - < Indah Kiat & Lontar - Asia Pulp & Paper (APP)
  - < Riau Andalan - APRIL
  - < Tanjungenim Lestari
  - < Kiani Kertas
- < Located in Sumatra and Kalimantan

# Pulp & paper - Sustainability

- < Wood consumption 1988-1999: 120 million m<sup>3</sup>
  - < 8% from timber plantations
  - < 92% from converting natural forests
  - < 40% illegal
- < 9 mln ha allocated for timber plantations:
  - < 2 mln ha is planted
  - < 7 mln ha deforested and laying idle, as logging is too cheap
- < Annual shortage of plantation fiber: 4.4 m<sup>3</sup>
- < Habitat loss, land right issues, forest fires: see oil palm

# Forest clearing by Riau Andalan



Photo by: Retno Kusuma

# Pulp & paper - Financing

- < Investment per ton pulp capacity/yr: \$1,100 - \$2,700
- < Investment in pulp & paper in 1990s: US\$ 12 billion
- < Financed to a large extent by:
  - < Foreign bank and ECA loans to all major pulp projects
  - < Share issuances of APP and APRIL on the NYSE
  - < Foreign bond issuances by APP
- < All pulp projects defaulted on their debt since 1997/98:
  - < Excessive capacity expansion vs. market growth
  - < Collapse of global pulp prices because of over-production
  - < Rupiah devaluation
  - < Cheap wood supplies (natural forests) are running out

# Pulp & paper - The APP drama

- < US\$ 13.4 billion debt - largest corporate debtor in Asia
- < Stopped interest and principal payments in March 2001 and appointed Crédit Suisse First Boston to restructure its debts
- < Restructuring discussions dragging on
- < And on ...
- < Court case:
  - < Deutsche Bank and BNP Paribas
  - < Demanding independent judicial managers
  - < Lost in August 2002



# Pulp & paper - Banks involved

- < RETRAC research for WWF and Friends of the Earth
- < FI's most prominent in financing Indonesia's pulp & paper mills:
  - < ABN AMRO Bank - The Netherlands
  - < Bank of America - United States
  - < Barclays Bank - United Kingdom
  - < Bayerische Landesbank - Germany
  - < BNP Paribas - France
  - < Capital Group - United States
  - < Citigroup - United States
  - < Crédit Lyonnais - France
  - < Crédit Suisse - Switzerland
  - < Deutsche Bank - Germany
  - < Dresdner Bank - Germany
  - < FleetBoston Financial - US
  - < Fortis Bank - The Netherlands
  - < Franklin Templeton - US
  - < ING Bank - The Netherlands
  - < Mizuho Bank - Japan
  - < Morgan Stanley - United States
  - < Nordea - Denmark/Sweden
  - < Overseas Union Bank - Singapore
  - < Rabobank - The Netherlands



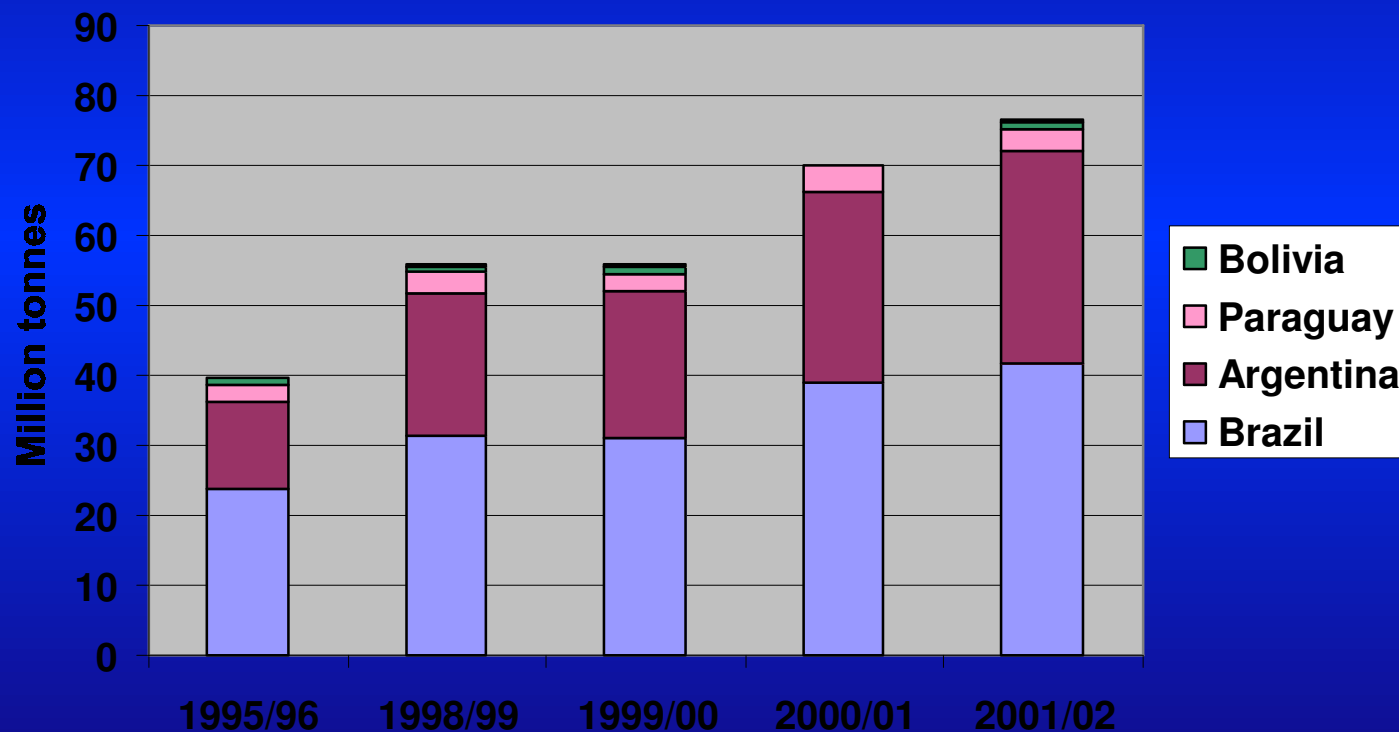
## Case 3: Soybeans in South America

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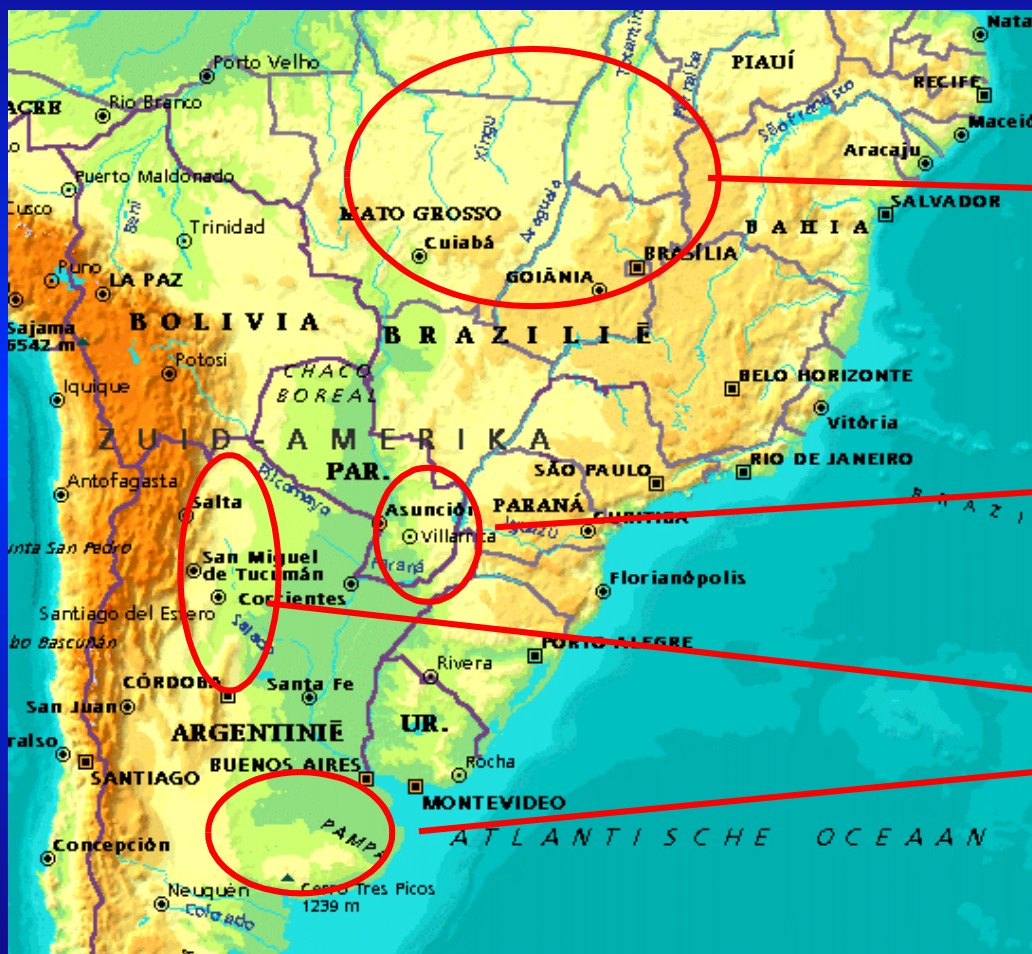
- < Soybean oil used for food, detergents, cosmetics. Soybean meal used as animal feed
- < World production increased from 125 mln ton in 1996 to 183 mln ton in 2002
- < United States marketleader (47%) but Brazil (23%) and Argentina (16%) catching up; Paraguay (2%) and Bolivia (1%) less important
- < European Union main export market for South American soybeans and soy meal

# South Am soybeans - Production

Soy bean production South America up 92%



# South Am soybeans - Expansion areas



Cerrado & Amazon  
rainforest in Brazil

Atlantic  
rainforest in  
Paraguay

Pampa's in  
Argentina

# South Am soybeans - Deforestation



# South Am soybeans - Sustainability

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- < Planted area in South America increased from 18 mln ha in 1996 to 30 mln ha at present, in forest and cerrado areas
- < Brazilian cerrado is one of the largest intact savannah's in the world
- < Very high biodiversity:
  - < 6,600 plants
  - < 400 birds (60 endemic)
- < Land right issues with indigenous people

# South Am soybeans - Financing

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- < Four companies dominate trading & crushing in South America and EU
  - < Archer Daniels Midland (ADM) - United States
  - < Bunge - United States
  - < Cargill - United States
  - < Louis Dreyfus - France
- < Traders invest in pre-financing soybean crops, crushing plants and trading infrastructure
- < Syndicated bank loans and credit facilities for the Big Four are very important for the whole soybean chain

# South Am soybeans - Banks involved

- < RETRAC research for WWF
- < Most important banks financing the Big Four soybean traders:
  - < ABN AMRO Bank - The Netherlands
  - < Bank of America - United States
  - < BNP Paribas - France
  - < Citigroup - United States
  - < Commerzbank - Germany
  - < Crédit Agricole - France
  - < Crédit Lyonnais - France
  - < Crédit Suisse - Switzerland
  - < Deutsche Bank - Germany
  - < HSBC Bank - United Kingdom
  - < ING Bank - The Netherlands
  - < IntesaBci - Italy
  - < J.P. Morgan Chase & Co. - US
  - < Rabobank - The Netherlands
  - < Société Générale - France

## Case 4: Logging in Central Africa

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- < 4 mln ha logged annually in the Congo Basin
- < Log & timber production in Central Africa doubled from 5,300 mln m<sup>3</sup> in 1991 to 9,700 mln m<sup>3</sup> in 2000
- < More than 50% is exported
- < Cameroon and Gabon most important, the Congo's and Central African Republic expanding
- < Most logging companies from Europe, Lebanon and Malaysia



# Logging in Central Africa



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# Logging in Africa - Sustainability

- < Forests in Congo Basin have very high biodiversity levels, with many endemic species
- < Habitat for chimpansees, lowland gorilla's, forest elephants, leopards, etc.
- < Logging makes tropical forests accessible for hunters, stimulating the trade in “bush meat”:
  - < 18 mln kg/yr in Gabon alone
  - < Creating forests without wildlife



# Logging in Africa - Sustainability

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- < Land right issues with indigenous peoples
- < 70% of all logging in Gabon is illegal, and 50% in Cameroon:
  - < Without concession or outside concession area
  - < Wrong species or undersized trees
  - < In excess of quota
- < Government capacity to monitor and control illegal logging is limited, but improving

# Logging in Africa - Financing

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- < Logging itself needs limited investments
- < Investments needed in sawmills, plywood factories, etc., in Africa and in consumer countries
- < Trading needs financing facilities

# Logging in Africa - Banks involved

- < RETRAC research for WWF
- < Financial institutions involved in financing logging companies in Central Africa:
  - < ABN AMRO Bank - The Netherlands
  - < American International Group - US
  - < ATP - Denmark
  - < Banca Nazionale del Lavoro - Italy
  - < Banco Comercial Português - Portugal
  - < Banco Português de Investimento - Port.
  - < BNP Paribas - France
  - < Caixa Geral de Depósitos - Portugal
  - < Commerzbank - Germany
  - < Crédit Agricole - France
  - < Crédit Lyonnais - France
  - < Danske Bank - Denmark
  - < DEG - Germany
  - < Deutsche Bank -Germany
  - < Dexia - Belgium/France
  - < HSBC Bank - United Kingdom
  - < IntesaBci - Italy
  - < Norddeutsche Landesbank - Germany
  - < Standard Chartered Bank - UK
  - < UniCredito Italiano - Italy

# What does it mean for your risks?

- < Sectors often involved in conversion of valuable forests
  - < Logging for timber
  - < Pulp and paper industry
  - < Agribusiness (oil palm, soybeans, a.o.)
  - < Infrastructure development (dams, pipelines, roads, a.o.)
- < Financial services to these sectors involve high risks:
  - < Sustainability risks
  - < Market risks
  - < Regulation & liability risks
  - < Reputation risks
- < These risks are addressed insufficiently in normal due diligence procedures

# Sustainability risks

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- < Another 39% of global Frontier Forests is threatened by logging, agricultural clearing, a.o.
- < Loss of habitat for endangered species
- < Changing the hydrological balance in wide areas
- < Land conflicts with indigenous peoples
- < Giving access to loggers, hunters (bush meat trade), and others
- < These sustainability risks also cause market, regulation, liability and reputation risks for FI's

# Market risks

- < Excessive expansion of production capacities, causing market prices and profits to plunge:
  - < World palm oil price: \$640/ton (1997) - \$300/ton (2002)
  - < World soybean price: \$307/ton (1997) - \$191/ton (2002)
- < Customers of your clients will increasingly look for other, more sustainable suppliers:
  - < DIY shops converting to FSC timber
  - < Migros (leading supermarket chain in Switzerland) demanding sustainable palm oil
- < Boycotts in foreign markets and occupations by local people will hurt your clients bottom-line



# Regulation & liability risks

- < Licences and concessions of your clients can be revoked because of:
  - < Involvement in illegal operations, corruption, etc.
  - < Court cases on land right issues: f.i. communities in North-Sumatra regained their land after 15 yrs of conflict with oil palm company LonSum
- < Fines and remediation costs hurt your clients revenues
- < Regulations could close export markets for illegal or non-sustainable products:
  - < EU is discussing a ban on illegal timber
- < Financiers could be held liable for the environmental damages of their clients (remember CERCLA)

# Reputation risks

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- < NGOs will step up the pressure against companies converting forests AND their stakeholders:
  - < Governments which should control them
  - < Their customers
  - < Their financiers (shareholders, banks, bondholders, a.o.)
- < Financial institutions are attractive targets for public NGO campaigns:
  - < Highly visible
  - < Many private customers in their home markets
  - < Possibly influential agents of change

# Citigroup: Forests and oil



# WestLb: OCP / Ecuador

WestLB-Kredit stoppen!



# Canadian funds: Great Bear rainforest

**Investing in the Future**

If you are like most Canadian investors, you are probably simply handing over your hard-earned wages to your mutual fund company, to invest in your name, while you know precious little about where or how your dollars are being used.

Would it trouble you to find out that your money, invested in good faith, may be contributing to the clearcutting of our ancient forests? [more>>>](#)

**Why is the Great Bear Rainforest so important?**

On the west coast of Canada, between high alpine mountains and the Pacific Ocean lies the Great Bear Rainforest. This ancient rainforest is home to thousands of species of plants, birds and animals, 1000 year old trees, 50 metre Sitka spruce, and as tall as 250m high buildings, and the rare white bear which exists nowhere else on earth. Rich salmon streams weave through valley bottoms providing food for magnificent creatures such as otters, black bears, grizzlies and eagles. [more>>>](#)

**Is this your Mutual Fund at work?**

DON'T LET THE CLEARCUTTING OF CANADA'S ANCIENT RAINFORESTS...

...companies... in rainforest destruction. You help...

**Mutual Funds**





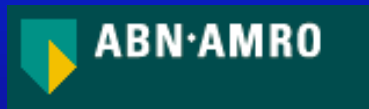








# Dutch banks: Oil palm in Indonesia



# How to mitigate these risks?

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- < Face reality
- < Formulate objectives, policies, and standards
- < Implement your policies
- < Monitor, evaluate and be transparent

# Facing reality

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- < For financial institutions, sustainability is NOT about:
  - < Reducing your office waste
  - < Signing declarations
  - < Donating large sums to WWF or other good causes
  - < Setting up SRI funds
- < For financial institutions, sustainability is about:
  - < Integrating sustainability in your core business
  - < Selecting the clients your FI wants to offer financial services to, and aiding them to operate more responsible
  - < Avoiding the clients your FI certainly DOESN'T want to offer financial services to



# Formulating objectives and policies

## < Objectives:

- < For what kind of clients does your FI want to work?
- < Do you want to be involved in forest-related sectors, given the risks and the high due diligence costs?
- < How do you see your role in improving the sustainability of your clients operations?

## < Sector-based policies and standards:

- < Minimum standards your (potential) clients have to adhere to
- < Incentives to improve the operations of your clients
- < For forest-related sectors, but also for oil&gas, mining, electricity, chemicals, etc.

# Implementation

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- < Assure acceptance of your objectives in your organization
- < Disseminate your policies and standards
- < Formulate procedures and assign responsibilities
- < Train and educate your staff
- < Invest in environmental audits and due diligence capacities, including stakeholder dialogues
- < Standardize monitoring and reporting procedures

# Reporting

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- < Communicate your objectives, policies and standards to all stakeholders
- < Be transparent on how you apply your policies
- < Stop with being secretive about names and details of your clients, NGOs will find out anyway
- < Evaluate and monitor if your policies are implemented well and are reaching your objectives
- < Constantly innovate the incentives and advice you can offer your clients to operate more responsible

# Conclusions

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- < Financial services to forest-related sectors involve high risks, which are acknowledged insufficiently:
  - < Sustainability risks
  - < Market risks
  - < Regulation & liability risks
  - < Reputation risks
- < Financial institutions choosing to be involved in these sectors should formulate clear objectives, policies and standards
- < Careful implementation is essential, as is transparent monitoring and reporting to all stakeholders