Sustainability and Commodities

We are seeing increasing alignment of expectations for financing and investment in soft commodities (food, fuel, and fiber). Compliance with credible voluntary standards is becoming the default performance hurdle for many institutions, and "certified" products are serving as the common currency of supply chain assurance.

There are critics to this evolution, and rightly so, since there is a need for more transparency and better auditing in some instances. However, WWF is of the opinion that good ecological and social standards that can be efficiently applied at scale will drive large scale change in production practices. These tools are increasingly important as we see large scale investment into soft commodity production and an urgent need to increase the clarity with which investors make decisions about investments. Standards and better environmental and social governance (ESG) metrics will both play a role here, and this edition of WWF's Commodity Update highlights recent developments in these areas.

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Evaluating Risk in Food and Fiber Commodity Sourcing Policies

by Joshua Levin, Senior Program Officer, Finance & Commodities, WWF-US

On April 27th, WWF and SIRAN (the Social Investment Research Analysts Network) hosted a webinar with a broad set of investors entitled *Commodities Sourcing in the Global Marketplace: Key Challenges and Indicators for Responsible Financiers, Managers, and Analysts*. The purpose of the event was to engage the finance community on a topic of significant interest in today's news stream and of critical long-term importance, namely, how to properly assess the sustainability performance of publicly traded food and agriculture companies in terms of their management of risk from the sourcing of global food and fiber commodities. The webinar was attended by more than 40 listeners from leading ESG ratings firms, pension fund and foundations, non-profits, and multi-lateral banks including the International Finance Corporation (IFC) and the Inter-American Development Bank.

Mark Eckstein opened the *Commodities Sourcing in the Global Marketplace* webinar with an overview on the integral role that financiers play in affecting company behavior around commodities sourcing. He was followed by Jason Clay, Senior Vice President of Market Transformation for WWF-US, who spoke on the unprecedented global impact of agricultural commodities production, the need to intensify agriculture to produce twice the output per capita by 2030, and the critical role large firms will play.

Steve Yucknut, Global Vice President of Sustainability for Kraft Foods Inc., completed the presentations with a fascinating discussion of Kraft's work to tackle these challenges head-on in their supply chains—particularly for cocoa, coffee, palm oil, and cashews. Yucknut agreed with Clay's assessment of global trends and described supply chain sustainability as a business strategy for the company, as opposed to a CSR objective. Kraft Foods started by conducting a land-air-water impact analysis on its value chain and found that 70 percent of their impact is in sourcing. Yucknut then detailed specific mitigation steps the company has taken, including incorporating output per hectare as a sourcing metric in their selection of vendors. He also highlighted Kraft's work with the African Cashew Initiative to improve cashew production in Africa as a pre-competitive issue.

The presentations were followed by group discussion, which focused on issues such as key metrics for distinguishing true firm performance versus greenwashing, whether company spend on supplier technical assistance can serve as a metric, and the role of genetically modified organisms in addressing food security risks. The *Commodities Sourcing in the Global Marketplace* webinar was a direct result of WWF's increasing engagement with the investment community. WWF's engagement with corporate banking partners has revealed that the starting point for many commercial investment products is output from ESG data providers. Furthermore, the investment community is increasingly turning to civil society actors and conservation scientists in order to inform their metrics. WWF is well positioned to fill that role in the area of global soft commodities.

WWF is working in conjunction with ESG data providers to develop KPIs for sourcing and production of high-impact commodities, such as palm oil, cotton, and fisheries.

WWF is now working in conjunction with ESG data providers to develop key environmental and social performance indicators for sourcing and production across a range of high-impact commodities, including palm oil, soy, cotton, and fisheries. These key performance indicators (KPIs) are derived from our conservation scientists and our experiences engaging private sector leaders. The indicators represent basic, responsible sourcing policies for mainstream companies; nonetheless, they easily have a greater environmental impact than the rest of a company's combined operations.

To learn more about evaluating risk in commodity sourcing policies, listen to a recording of the webinar. Furthermore, WWF is willing to share the "Minimum Standards for Responsible Sourcing and Production of Global Soft Commodities" with investors and analysts on a case-by-case basis. To make a request, briefly state your interest in an email to internationalfinance@wwfus.org.

Credible Voluntary Standards Define the Compliance Ask

by Mark Eckstein, Managing Director of International Finance, WWF-US

The current revision of IFC's Performance Standards (PS) is now complete, and IFC's Board will be signing off on the new framework this month. The updated PS will have a broad impact on Equator Principles Financial Institutions (EPFIs) and the wider financial community. I want to focus on one area that WWF views to be of particular significance to our finance partners and the wider finance sector: IFC's PS 6.

What Makes a Voluntary Standard Credible?

To be credible, a standard should comply with ISEAL's Code of Good Practices. However, it is also useful to consider some of the practical lessons learned. Credible standards must, at a minimum:

- Be based on objective, science-based and measurable performance standards. This creates objectivity and replicability in controlled conditions, promotes innovation, and doesn't discriminate against different classes of producers;
- Be developed through a process of consultation and dialogue (i.e., a multi-stakeholder process) which takes into account the views of producers, industry, NGOs, scientists and other relevant stakeholders. Standards that have been developed without broad consultation cannot be considered credible because they represent only a part of society;
- Have decision-making procedures which are fair, transparent, independent, and designed to avoid conflicts of interest;
- Be focused on minimizing or eliminating the most important negative environmental and social impacts and providing achievable targets which are clearly linked with environmental and social performance;
- Require independent, third-party assessment of management performance by competent, credible auditors.

PS 6 defines IFC's expectations in relation to biodiversity conservation and the sustainable management of living natural resources. It clarifies some of the complexities surrounding terminology and mitigation of impacts, including the use of biodiversity offsets. Furthermore, PS 6 confirms that transactions involving the financing of soft commodity (food and fiber) production will be required to demonstrate compliance with credible voluntary standards—such as the Forest Stewardship Council (FSC) and the Roundtable on Sustainable Palm Oil (RSPO)—where they exist and to commit to working with others to create such standards where they do not. Traders and others involved in the processing, storage, transport, and use of soft commodities will also be expected to demonstrate commitments to credible standards depending on where they are in the supply chain.

Reputational and other risks in soft commodity markets have become all too apparent in recent years and many food and fiber companies are now proactively assessing and managing their supply chains so as to reduce reputational and other material risks. Thus the new "PS ask" is not a huge step beyond what many companies are already planning. Importantly, of course, this requirement aligns the interests of the value chain and commodity financiers, which potentially reduces transaction costs.

As the EPFIs look at application of the Principles beyond project finance (and as other financial institutions begin applying the PS in their lending and investment decisions more broadly), the application of PS 6 becomes even more significant. It seems likely that there will be a rapid scale up in demand for certification (or progress towards certification) as financial institutions increasingly rely on this as a proxy for due diligence and compliance or investment requirements. For example, investment in a soy or sugar cane producer will be predicated on evidence that the companies are certified or can become so with an acceptable period of time.

As ever, the devil is in the details, and at least, in the near term, the interpretation of these requirements will be a work in progress. There are many questions for consideration, including:

- Many commodity standards are relatively new and the universe of certified producers is small, so investors and banks will continue to do business with companies that are on track to become certified at some stage in the future. What conditions and expectations should be applied to such deals?
- When transactions are being considered with traders, processors or others involved in a commodity supply chain have limited leverage over the environmental and social performance of producers, what level of expectation or assurance should a financial institution require?
- How can financial institutions mainstream these requirements across new business lines and products in an effective and efficient way, one that does not engender more resistance and push back from deal teams?
- Is there an upside opportunity for FIs that can demonstrate they understand clients' or investees' needs by developing new products, such as the sustainable supply chain financing models that reward and incentivize producers towards certification?

To help provide clarity and greater guidance on these and other issues, WWF is working with the EPFI Biodiversity Working Group and others to develop a set of PS 6 capacity building materials to help clarify requirements. We are also developing tools and boiler plate language for banks and others. We plan to deliver a series of regional workshops and training sessions later this year and to provide specific guidance on the interpretation and application of PS 6 and soft commodities. If you want to learn more about this program drop me a line.

Next Edition

Our next edition of the Commodity Update will be available in August 2011 and will provide our annual summary of the state of play for voluntary standards across key commodities (status of standards, key factors for adoption and scale-up.

Sustainable Finance Specialist Opening

WWF's partnerships with financial institutions are growing rapidly, and we are seeking to recruit sustainable finance specialists for a range of exciting international positions (including Singapore and China). If you know of people who might be interested in discussing these opportunities, please email Mark Eckstein.

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