The Nature Conservancy

EXECUTIVE SUMMARY OCTOBER 2020

ENVIRONMENTAL FRAMEWORK

For Lending and Investing in Soy in the Cerrado

Environmental Framework for Lending and Investing in Soy in the Cerrado

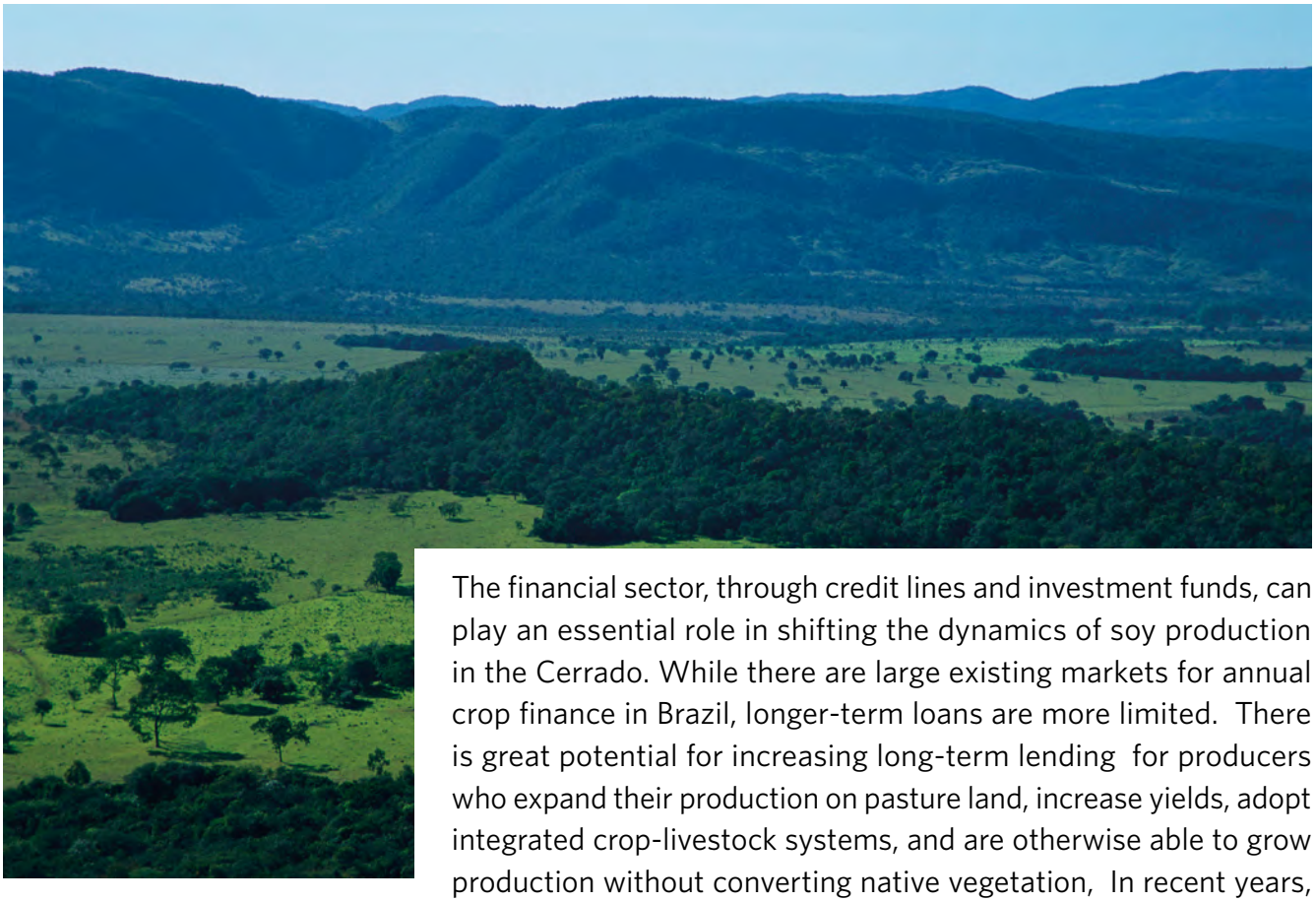
Executive Summary

Brazil is the largest producer and exporter of soybeans in the world. This valuable cash crop is produced throughout the country, but the most significant region for production is the Cerrado, which accounted for about half of Brazil's soy crop and 15 percent of global production in 2018/2019.

In addition to being one of the most important centers of food production in the world, the Cerrado is a critical region for storing carbon in its soils and native vegetation, providing water for Brazil's farms and people, and serving as home to about a third of Brazil's plant and animal life. The expansion of soy and cattle ranching has been the primary driver of habitat conversion in the Cerrado in recent decades, resulting in the loss of approximately half of the region's native vegetation.

To meet the world's growing demand for soy, it is estimated that soy cropland in the Cerrado will need to expand by 7.2 million hectares by 2030[1]. The Nature Conservancy further estimates that this expansion will result in the clearing of 2.2 million hectares of native vegetation[2] .

Currently, **the Cerrado has 18.5 million hectares of already cleared pastureland that is suitable for soy production. This represents more than double the total area needed to accommodate the projected soy expansion.** For producers, the financial returns of clearing versus expanding on pastureland are roughly equivalent[3]. There is also a significant, untapped potential to further increase productivity on soy farms by up to 25 percent simply by improving farming practices[4]. Consequently, it is possible to supply the growing global market for soy, while halting further conversion of native Cerrado vegetation.



The financial sector, through credit lines and investment funds, can play an essential role in shifting the dynamics of soy production in the Cerrado. While there are large existing markets for annual crop finance in Brazil, longer-term loans are more limited. There is great potential for increasing long-term lending for producers who expand their production on pasture land, increase yields, adopt integrated crop-livestock systems, and are otherwise able to grow production without converting native vegetation, In recent years, several traders and banks have created lending programs to do this, including Bunge, Santander, Louis Dreyfus and Rabobank, and others are actively developing programs in this area. Existing products, such as annual crop finance and farmland investment funds can also be adapted to a deforestation- and conversion-free (DCF) approach.

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As the pressure for deforestation-free supply chains grows both internationally and in Brazil, increasing the capital committed to DCF financial mechanisms can generate benefits for stakeholders across the soy value chain. Lenders and investors can gain reputational benefits and new business opportunities from better serving producers. Traders can create longer-term contractual relationships with farmers and improve access to markets with stricter environmental requirements. Producers can gain access to improved lending terms to expand their businesses and avoid reductions in yield losses attributed to the effects of regional deforestation[5].

[1] CONAB (2019)
[2] TNC(2019)
[3] TNC (2019)
[4] TNC (2019)
[5] Avery S Cohn et. al (2019)

The Environmental Framework

"The Environmental Framework was created to guide lenders and investors in successfully expanding their environmental finance programs"

The Nature Conservancy's Environmental Framework was created to guide lenders and investors in successfully expanding their environmental finance programs or adapting existing products to a DCF approach. It contains a consistent set of requirements and monitoring approaches that is effective in ensuring DCF production while also practical for producers and investors to implement.

The Environmental Framework is intended to support more rapid scaling of DCF mechanisms by lenders and investors seeking to promote the sustainable growth of soy production in the Cerrado, while also benefiting producers with practical, streamlined compliance requirements.

The Nature Conservancy developed the framework through extensive engagement of 120 knowledgeable individuals from nearly 40 institutions representing key stakeholders throughout the soy value chain, including traders, banks, producers, development finance institutions, academia and NGOs.

Core Requirements

The Environmental Framework requires lenders and investors to incorporate the following core environmental requirements in their financial instruments:

- **Legal compliance:** A producer must comply with the applicable laws and regulations on all properties it owns and operates, not just the farm being financed. These include valid land title and leases, compliance with the Forest Code, and specific labor and environmental regulations. The Framework offers a checklist of relevant documents and online registries to assess legal compliance.
- **Conversion-free reference date:** The framework sets January 2018 as the reference date from which there can be no additional deforestation or conversion during the period the farm receives DCF funding. The reference date represents a practical balance - ensuring that recent deforestation is not rewarded with better financing terms, while avoiding a more restrictive date that would limit the adoption by lenders and producers
- **Irrigation:** Any investments in irrigation systems must anticipate growing water stress in the Cerrado. The Environmental Framework allows financing for efficiency-improving modifications to existing irrigation systems, but prohibits installation of new irrigation systems in areas expected to experience water stress.

Additional Elements

The Environmental Framework sets out five additional elements that lenders and investors can choose to incorporate into their DCF financial mechanisms to enhance conservation impact, but are not considered essential to achieve critical environmental results. This customization beyond the core requirements allows lenders and investors to manage their portfolios to meet even greater institutional ambitions for positive environmental impact or apply a more conservative approach to minimizing exposure to environmental risks.

The additional elements may be integrated as mandatory requirements of a lending or investment program or can be strongly encouraged through preferential access to the program for producers who will follow them, or through producer incentives such as lower interest rates or other more favorable financing terms. The additional elements include:

- **Cross-farm Applicability:** Applying the conversion-free reference date to all properties owned or operated by the borrower, not just the property being financed, is highly encouraged. While this requirement is difficult for many farmers to accept and is therefore not included in the core requirements, it is the most important of the additional elements for enhancing environmental impact and should be incorporated into DCF mechanisms whenever possible.
- **Spatial Prioritization:** DCF financial mechanisms can encourage investment and loan deployment in areas of the Cerrado where they can have the greatest impact in avoiding conversion of native vegetation. The guide includes a TNC list of "high conservation impact" municipalities and a tool to help users create their own prioritized list.
- **Good Practices:** DCF financial mechanisms can promote adoption of recognized management practices that improve environmental and social outcomes while reducing risk to the lender. Examples of good practices are contained in standards such as RTRS, Pro Terra and the standards established by trading companies.
- **Land Conflict:** In addition to the legal requirements governing land conflict (i.e. valid land title or a lease, and that no property overlaps with Conservation Units or Indigenous or Quilombola Lands), DCF financial mechanisms may screen for land conflict controversies, which can be monitored through the Pastoral Land Commission (CPT) database, ongoing legal procedures and media reports.
- **IFC Performance Standards (PS):** Many IFC PS components are already embedded in the Environmental Framework. Mandating full compliance with the IFC standards is at the discretion of the institutions designing the finance mechanism.

Monitoring and Performance

The Framework offers guidance on monitoring the environmental requirements to assist lenders and investors in understanding capacity needs and adapting internal procedures to ensure producer compliance. The guidance outlines five steps (active origination, eligibility assessment, preparation for monitoring, annual monitoring and ongoing oversight) and includes suggested documentation and information needed for meeting each environmental requirement.

The Framework also provides specific metrics and practical measurement methodologies that lenders and investors can use to evaluate their portfolio's performance. These metrics include observable outcomes such as hectares of pasture converted to soy, as well as methodologies for estimating avoided habitat conversion and avoided carbon emissions.

The Environmental Framework includes two new public tools to assist in designing high-impact lending and investment programs and measuring results:

- The TNC Dashboard is a dynamic mapping tool that allows the user to review projected soy expansion dynamics to 2030, identify their own high-impact geographic priorities for lending and investing, and estimate a farm's exposure to certain environmental risks, such as projected water stress risk.
- The TNC Carbon Benefit Calculator estimates the avoided habitat conversion and avoided carbon dioxide emissions from expanding production on already cleared land.

A Final Note

There is a growing interest among a range of stakeholders to decouple future soy expansion in the Cerrado from deforestation and conversion of native vegetation. Emerging new lending and investment products that support producers in expanding on cleared lands and raising yields have the potential to play a key role in this transition. The Environmental Framework offers a practical guide to help financial institutions design and implement these programs, and to finance the growing global market for soy while avoiding the conversion of an additional 2.2 million hectares of Cerrado habitat over the next decade.

Increasing Brazil´s soy production without further habitat conversion will require expanding on already-cleared pasturelands. Most of these pastures are currently used for relatively low-productivity cattle ranching. Raising the productivity of cattle ranching in Brazil can free up pastures for soy expansion while also supporting a growing export demand for Brazilian beef. The Nature Conservancy is developing a complementary Environmental Framework to guide lenders and investors in financing the sustainable intensification of cattle ranching in the Brazilian Amazon and Cerrado.

For more information, please visit this link, or contact:

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