



SUSTAINABILITY FOCUS

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BANKS AND FOOD SPECULATION: A LESSON FROM THE NGO CAMPAIGNS

KEY TAKEAWAYS

NGOs' campaigns have influenced or anticipated the EU recent announcement of rules to curb speculation on commodities.

Half of European diversified banks rated by Vigeo have been challenged by NGOs on their involvement in food speculation.

Banks' core role is to finance the real economy. Involvement in activities with negative societal impacts can affect the credibility of banks' efforts in this regard.

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INTRODUCTION

On January 14, 2014 the EU Parliament and the EU Council announced the introduction of specific measures to curb speculation on commodities by financial institutions, as part of the larger financial market reform **Markets in Financial Instruments Directive (MiFID II)**¹. In particular, position limits will cap the size of the net positions in commodity derivative contracts that traders can hold, thus reducing their potential influence on prices. In addition, trading on derivative contracts in private, unregulated "over the counter" operations and high-frequency trading, that may contribute to destabilize the financial markets, will be regulated with specific frameworks.

These measures have been warmly received by the many civil society groups and NGOs (including Oxfam, the World Development Movement, Friends of the Earth, Foodwatch) which worked in recent years to raise the public and regulators' awareness on the role of speculation and passive investments in increasing the price volatility of agricultural commodities, such as rice, corn and wheat.



However, as also pointed out by Oxfam², the new European rules are far from being perfect because of some remaining loopholes due to the lobbying of financial institutions. A major point of weakness of the Directive is that the setting of position limits will be a responsibility of each individual Member State, rather than of EU authorities: some countries may thus be tempted to set weaker rules and low position limits in order to attract capital, in what has been considered a potential 'race to the bottom'.

THE COST OF FOOD SPECULATION

Food derivatives, which are financial contracts derived from products such as corn, wheat, soybean or sugar, are not a recent financial innovation: they were created centuries ago in order to offset the price risks inherent to some business activities, such as the risks linked to adverse climate conditions. However, in early 2000s an international wave of financial deregulation radically distorted the scope and functioning of the commodity derivative market, which in few years passed from being dominated by hedgers (operators using derivatives to offset the risks of their businesses) to being dominated by speculators.

In 2007–2008, hedge funds, pension funds and banks redirected trillion of dollars from collapsing financial markets to the food commodities market, considered a new alternative source of returns. In the same period the world economy faced a deep food crisis, with the FAO Food Price Index increased by 63% between January 2007 and June 2008 which caused economical instability and food riots in many countries all around the world. In the second half of 2008 the bubble of food price suddenly burst, and between 2010 and 2011 the FAO Food Price Index increased again by 21%. These crisis have roots in a multitude of real demand and supply factors, such as the growth of world population, the price increases of fertilizers, the presence of large subsidies for the

production of biofuels, the change of diet in emerging markets and the negative effects of climate change. However, none of these long-term factors can exhaustively explain the large boom and bust cycles observed after 2007–2008. Empirical evidence³ show that an **excessive financialization** of the market is a major driver of the price volatility of food commodities: the herding behavior of large investors and speculators can very quickly redirect large flows of capital in or out of a market, significantly amplifying the effects of shocks⁴. Higher food price volatilities exacerbate the problems of hunger in poor countries, where households spend most of their disposable income for nutrition and sharp increases of food prices can further worsen their living conditions.

Especially after 2008, the real societal cost of food speculation has raised the concerns of an increasing number of stakeholders and international institutions, including the UN FAO⁵. Major **International NGOs** (including the World Development Movement, Oxfam, Concord, Somo, Corporate Europe Observatory, Friends of the Earth, Foodwatch) have undertaken campaigns against food speculation⁶, with the double objective of challenging banks to stop their involvement in this controversial practice and lobbying for the introduction of stricter financial rules at the European level.



In September 2011, the **UN Principle for Responsible Investments** (UNPRI) published the set of guidelines “The Responsible Investor’s Guide to Commodities”⁷, which presents a special focus on investment in agricultural commodities. According to the UNPRI, “*Given food’s unique status among commodities as a **basic human right** and the fact that food price swings disproportionately impact the poor, investors should only*

participate in soft commodity derivatives markets where they are sure they do no harm”. These UNPRI guidelines explicitly recommend not to participate in smaller, more illiquid markets where investors can have a large influence on prices, and not to participate in markets where financial investors are already known to have caused increased volatility.

VIGEO FINDINGS

Due to the ESG risks and challenges faced by financial companies active in investments in food commodities, **Vigeo** integrated this topical issue in its 2013 update of the **European Diversified Banks sector**, including 28 large banks with a total assets of more than EUR 200 billion.

commodities, nor does it actively market or recommend them (also applying to third-party products). The bank also reported to have revised its fund recommendation list accordingly.

The majority of companies in the sector disclosed formal commitments to support social development, but no one made explicit references to avoid investments with negative effects on food price volatility or disclosed specific programs to address this issue. Indeed, **15 out of the 28 Diversified banks** under review have been challenged by International NGOs to stop their involvement in food speculation. The reactions of banks have been heterogeneous.

Another example is **BNP Paribas** that, in February 2013, announced the suspension of a EUR 160 million agricultural commodities fund and the closure of its Easy ETF Ultra light Energy fund, which had EUR 43 million in assets by end-January 2013, of which 37% linked to food commodities. BNP Paribas said the move was taken after regular meetings with Oxfam, and indeed Oxfam France welcomed the moves.

A first group reacted positively, among them **Commerzbank, Nordea, Danske Bank, BNP Paribas, Societe Generale** and **Credit Agricole**, publicly announcing the total or partial exclusion of derivatives on agricultural commodities from their structured products and funds.

Barclays, the largest UK trader in food commodities and one of the three biggest global players in this business, in February 2013 announced it would stop speculating on food, saying the practice is not compatible with its purpose. NGOs welcomed this shift of policy, although in February 2013 Oxfam and the World Development Movement noticed⁸ that Barclays still markets investment products linked to food commodities to other investors.

For example, in August 2012 **Commerzbank** announced the removal of agricultural products from its commodity index funds applying this decision on investment instruments in basic-foods commodities also to its Private Customers business. Commerzbank declares that it does not issue any listed products referencing basic foods

Some major banks argued that the effect of large financial investments on the instability of food markets remains a **disputable issue** from an empirical point of view, partially declining the responsibility attributed to the financial sector by NGOs.



For instance, in the course of the SRI rating process, **UBS** declared to Vigeo that it does not agree with the view that speculation is the key reason for the growing of food prices. However, since some studies show that the role of financial investors may impact commodity price developments creating potentially substantial price distortions, UBS said that it will choose a prudent approach to ensure their actions do not destabilize the markets, without further details.

In February 2013 the co-CEO of **Deutsche Bank** – which offers a variety of agriculture funds and commodity ETFs – announced that the bank would, “in the interest of its clients”⁹, keep dealing in financial derivatives linked to commodities, arguing there was no conclusive evidence to prove speculators were responsible for rising prices of agricultural products.

BUSINESS RISKS AND LESSONS FOR THE FUTURE

Banks have a key role to play to support local economies. Indeed, the core business of the banking sector is, or at least should be, to promote the social and economic development by lending money to the real economy. The efforts of banks in this sense can, therefore, have a clear impact on their **reputation**, also given the increased scrutiny by investors, clients and the public opinion after the financial crisis. As emerges by Vigeo findings, almost all European Diversified Banks under review disclose some forms of commitment to support local and social development. However, the involvement in activities with negative impacts on the society (as direct and indirect involvement in food derivatives or tax avoidance) seem not in line with reported commitments and might affect the credibility of banks’ strategies in this field. Indeed, it may indicate a reluctance of banks to give up high short-term returns, even when they might be in conflict with fundamental collective rights.

influence on or anticipation of the law making process. Companies that have been able to identify stakeholders’ expectations, assess their materiality for the business and take them into account in the definition of their strategies reveal a good ability to preserve and enhance their **operational efficiency and license to operate**.

Finally, in a period when an increasing number of investors are retreating from the commodity markets due to low returns because of increased regulatory and capital costs¹⁰, anticipating this trend by reducing their involvement in food derivatives seems to have been the right decision also from a pure financial point of view.

This case also illustrates the materiality of stakeholders’ concerns and their potential



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Notes and Sources

- 1) European Parliament, Economic & Monetary Affairs, "Deal to regulate financial markets and products and curb high-frequency trading", press release, January 14, 2014: <http://www.europarl.europa.eu/news/en/news-room/content/20140110IPR32414/html/Deal-to-regulate-financial-markets-and-products-and-curb-high-frequency-trading>
- 2) Oxfam, "EU Deal on curbing food speculation comes none too soon", press release, January 14, 2014.
- 3) See for instance Gutierrez , Luciano (2012) : "Speculative bubbles in agricultural commodity markets", European Review of Agricultural Economics , 2012 , pages 1–22
- 4) For a broader overview on the effects of speculation on the prices of food commodities, see for instance: "Food Commodities Speculation and Food Price Crises. Regulation to reduce the risks of price volatility", Briefing note by Olivier De Schutter, Special Rapporteur of the United Nations Human Rights Council on the right to food, September 2010.
- 5) Among other initiatives, the UN FAO in July 2012 held in Rome the high-level debate "Food Price Volatility and the Role of Speculation".
- 6) For instance, in January 2012 Friends of the Earth Europe published the report "Farming Money: how European banks and private finance profit from food speculation and land grabs".
- 7) Available at www.unglobalcompact.org
- 8) See for instance: Oxfam, "Key Eurozone banks step back from food speculation", press release, February 18, 2013; the World Development Movement, "Barclays ends food speculation that made up to GBP 278 million in 2012", press release, February 14, 2013.
- 9) Reuters, "Deutsche Bank backs food derivatives in face of critics", January 19, 2013.
- 10) Deutsche Bank, for instance, recently decided to close its commodities trading business: Financial Times, "Deutsche Bank slashes commodity trading operations", December 5, 2013