ESG Viewpoint
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Palm oil – can it ever be sustainable?

Concerns about the sustainability of palm oil production are nothing new. For many years now, investors have contributed their voice to political and public pressure to bring stronger environmental and social standards to the production of this commonly used food ingredient.

But heightened attention to climate change and biodiversity, political pressure in the EU and the US, and concerns about the effectiveness of existing initiatives are further increasing the pressure. One recent indication of this was the move by 2020 presidential candidates Elizabeth Warren and Bernie Sanders with six of their senator colleagues to send a letter to fund managers requesting them to address companies that are responsible for palm oil related deforestation in their portfolios and financial supply chains.

The Roundtable on Sustainable Palm Oil (RSPO) has been a key initiative to improve the sustainability of the industry, but has not been without its critics. Here we recap some of the challenges it faces, and recent developments in the RSPO’s remit that seek to address these.

Palm oil impacts

Around 66 million tonnes of palm oil are produced annually, with more than 50% coming from Indonesia and more than 30% from Malaysia. Its production has a range of serious social and environmental impacts:

Local air pollution: this was particularly severe when the haze of the Indonesian forest fires reached the financial centre of Singapore, closing schools and discouraging outdoor activities for weeks in 2015.

Deforestation: due to clearings for palm oil plantations losing tropical rainforests, biodiversity, habitat and flood protection.

Peat: effectively storing carbon, the draining and converting of peat lands into plantations has severely fostered climate change.

Endangered species: loss of habitat due to deforestation further endangered various species, among them rare orangutans and tigers.

Human and labour rights: neglect of rights for migrant labourers, infringement of the rights of indigenous peoples, as well as displacement of local communities.

1 See https://www.ft.com/content/44f2d30a-1276-3068-b995-a4c8076d40c1 and https://www.schatz.senate.gov/press-releases/schatz-senators-push-financial-firms-to-help-stop-global-deforestation
2 In the mid-1990s the number was at around 15 million tonnes per year
Pressured by activist groups, some food producers are starting to look for alternatives to palm oil, but other oil crops such as rapeseed, soy, sunflower seeds and coconut have their own sustainability issues and substitution could actually worsen the net environmental footprint.

**Role of the Roundtable on Sustainable Palm Oil**

In 2004, the RSPO was formed as a multi-stakeholder initiative, with NGOs as co-founders, to address the severe sustainability issues along the palm oil supply chain. Around 21% of the globally produced palm oil is now RSPO-certified, and it has had some important positive impacts on sustainability practices, as highlighted in research by The Zoological Society of London (ZSL) via their Sustainability Policy Transparency Tool (SPOTT), which shows that companies which are members in good standing of the RSPO and produce certified palm oil are more transparent and perform better across all sustainability-relevant categories.

![Sustainability performance and RSPO certification chart](chart.png)

Average scores for RSPO (left) versus non-RSPO (right) companies. Overall score for RSPO companies is 60%, whereas overall score for non-RSPO companies is 20%.

Source: SPOTT ZSL, February 2019

However, the RSPO has also been criticised for not being effective enough, not penalising those that break its rules, and for reacting too slowly to major human or labour rights breaches or activities harming endangered species. With accusations of its Complaints Panel and grievance mechanisms being too business-friendly/sided, the organisation's accountability suffered. An auditing and certification procedure that did not guarantee the independence of the auditors also added to concerns.

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1 [https://rspo.org/about/goodbadpalmoil](https://rspo.org/about/goodbadpalmoil)
RSPO responds

In 2017 and throughout 2018 the RSPO reviewed its Principles & Criteria (P&C), which form the bylaws of the organisation and outline the requirements of its members. It is a process that is repeated every five years. Without doubt, the latest review has been the most comprehensive one, specifically highlighting human and labour rights aspects.

A Review Taskforce with balanced representation from palm oil producers, supply chain actors, financial institutions and NGOs was formed. Two 60-day public consultation periods were launched, and ten face-to-face meetings across the globe were held. The documents were translated into five languages, and the new standard was field-tested in Africa and Southeast Asia for practicality and auditability, which in turn informed further adaptations. The new P&C were voted upon, and accepted with a big majority, during the RSPO’s 2018 annual Roundtable.

The main additions and amendments include:

No deforestation: new planting should not cause any deforestation, with potential exceptions for local communities on High Forest Cover countries.

No new planting on peat: all peat areas – which store millions of tonnes of carbon and are susceptible to fire if drained – need to be conserved.

Human & labour rights: extended criteria including measures around the implementation of grievance mechanisms, whistleblowers, protection of indigenous peoples’ rights, migrant labour rights, no forced labour and no child labour. An overall better alignment with International Labour Organisation standards, with gender aspects being newly covered.

Living wage: the Global Living Wage Coalition’s method for calculating what would amount to a decent Living Wage for its workforce needs to be applied.

Smallholder standard: increased access to RSPO certification and procedures tailored to smallholder conditions.

Third party suppliers: stronger criteria asking for geolocations of fresh fruit origins and demonstrating valid planting and trading licences.

Certification Bodies of the RSPO were included in the consultation procedure and will be trained on the new P&C as well. To increase accountability further, the RSPO needs to ensure that annual assessments for compliance are rigorously performed and audit items, if critical, highlighted accordingly.

These are welcome developments, which broaden the remit of RSPO on some key issues. However, there remain tensions around the overall level of ambition, and the balance between social and environmental objectives. One on the one hand, RSPO must be sensitive to the needs of smallholders, as well as to local community development priorities; but on the other hand, it also needs to respond to demands for zero-deforestation/no loss of primary forest at all costs in all regions.

The one-year grace period for implementation of the P&C by November 2019, which is accompanied with roadshows and trainings, might also be too ambitious for the industry and for some of the aspects to be implemented (e.g. implementation of High Carbon Stock Approach or living wage concepts). This may particularly be the case for new production areas with low penetration of RSPO certification, such as Papua New Guinea, Nigeria, Liberia and Colombia.

The reforms set RSPO in the right direction. But expanding its reach beyond the current 21% of global certified production and ensuring implementation remain huge challenges, and investor involvement will continue to be critical.

RSPO has gained in financial power and capacity in recent years and has been working to address these concerns.
BMO engagement

Over the past decade, BMO Global Asset Management, on its own and in collaboration with others⁴, has been engaging with investee companies that are either directly or through its supply chains – including financial institutions – exposed to palm oil risks to encourage them to:

- develop, publish and implement a deforestation policy, covering the supply chain;
- develop, publish and implement a human and labour rights policy, covering the supply chain; as well as
- overall align their standards with the RSPO and consider membership.

Going forward, and in the context of ever-increasing risks linked to deforestation in our investee companies and clients’ portfolios, we will continue our active engagement with the palm oil industry. We have recently spoken with senior management of two major palm oil producers in Malaysia, specifically aiming to understand their ability to successfully implement the new P&C. Whilst one of these companies seems to be ahead of the curve with comparably strong policies and procedures, the other is mostly treading water, highlighting the gap between leaders and laggards.

We are also engaging with banks exposed to this industry through their loan portfolios, as they are potentially powerful in leveraging change through their lending conditions. One key engagement is with PT Bank Mandiri, Indonesia’s largest bank.

Case study

PT Bank Mandiri

Bank Mandiri is Indonesia’s largest bank and is one of the largest lenders to the country’s palm oil industry, which accounts for approximately 9% of its loan portfolio. Serious ongoing concerns about the sustainability of the industry present risks to these assets.

We have met the company several times to encourage it to move beyond a compliance-based approach to financing palm oil into one that considers risks more holistically. Specifically, we asked that a No Deforestation, No Peat and No Exploitation (NDPE) policy be adopted. This would require the bank’s palm oil clients to end all deforestation, protect high conservation value areas and implement best plantation management practices.

Louder calls to curb Indonesia’s rising carbon emissions put additional pressure on banks to improve the management of risks from financing high-impact customers. A stricter approach to palm oil financing would improve the ability of Bank Mandiri to anticipate headwinds from regulatory developments, while contributing to more sustainable agricultural practices.

Conclusion

Investor pressure has been influential in making progress in this industry, but with new areas of palm oil production emerging and demand ever increasing, the road ahead remains unclear, despite the improvements in the RSPO’s rules. We will continue to seek efforts to engage and hope that our work with banks provides a new angle to achieve change.

⁴ E.g. the PRI’s Investor Working Group on Sustainable Palm Oil

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We will continue our active engagement with the palm oil industry.
How BMO Global Asset Management can help you

BMO Global Asset Management incorporates material ESG issues into its investment processes across asset classes. We also offer our Responsible Funds range, which invests in companies operating sustainably and excludes those not meeting our ethical and ESG criteria, and our reo® engagement service, through which we provide engagement and voting services covering global equities and credit.

Key risks

The value of investments and any income derived from them can go down as well as up as a result of market or currency movements and investors may not get back the original amount invested.

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