

Are You Invested in **Exploitation**?

Why US investment firms should quit financing conflict palm oil and commit to human rights

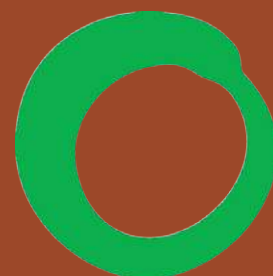


FULL REPORT | July 2016

A briefing paper for U.S. equity investors

for the people | for the planet | for the future





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Any errors or omissions in this report are the responsibility of Friends of the Earth U.S.



Executive Summary

In the past several years, driven by pressure from civil society, dozens of consumer companies with over \$30 billion in annual palm oil sales have instituted voluntary commitments to “No Deforestation and No Exploitation” – showing a willingness to address the risks associated with an industry that causes the loss of millions of hectares of rainforest and that drives widespread social and cultural harm. Not all of these commitments are created equal, and none are being implemented as rapidly or as thoroughly as necessary, given the scale and pace of the destruction. In order for these commitments by agribusiness companies and consumer brands to drive change, they need to be backed up by a similar tidal shift towards environmental and social responsibility in the finance industry.

Like corporations, the finance sector has human rights obligations, which have been articulated in the UN Guiding Principles on Business and Human Rights. Although there are no clear laws in the U.S. requiring that investment firms or institutional investors respect human rights, or even disclose their ESG impacts and risks, private finance must recognize its role in driving deforestation and land grabbing. It should view the current wave of sustainability commitments in the consumer goods arena as an opportunity to shift towards lending and investment practices that foster positive change and reduce Environmental, Social and Governance risk.

Friends of the Earth calls on investors to quit deforestation and commit to human rights by disclosing exposure to deforestation and land risk in palm oil and other soft commodities sectors; committing to a Deforestation and Land Grab-Free Investment policy; excluding companies that cannot meet this standard; and repairing the damage by supporting robust accountability processes and restoration of ecological damage.

Disclose: opaque value chains in the palm oil sector can make due diligence exceedingly difficult. Nevertheless, investors should undertake regular disclosures, institute commitments that hold investee companies to account, and make it clear that investee companies that fail to meet these standards will be excluded from investment portfolios.

Commit: Investment firms should commit to Deforestation-free, Land grab-free investment policies in order to reduce exposure to ESG risk and drive change in investee companies in the palm oil and other soft commodities sectors. There is no one-size fits all investment policy, any more than there is a single approach to managing ESG risk. However, there is abundant guidance available for the development and implementation of such a policy.

Exclude: A robust Deforestation-free, Land grab-free investment policy will impact portfolio selection and should result in the exclusion of the most egregious palm oil companies.

Repair: The UN Guiding Principles require companies to provide “access to remedy,” but the challenge of doing this has yet to be widely taken up. Investment firms and institutional investors can drive investee companies to take up the challenge of providing remedy for past harms by requiring investee companies involved in forests, land acquisitions and commodity crops, to have active grievance mechanisms and to commit to ecosystem restoration.

In the broader context, remedy, and what we at Friends of the Earth call “repair,” implies shifting investments towards sectors that do as little harm and as much social good as possible.





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Introduction: The need for deforestation-free, land grab-free finance

Since the global financial crises and food price crisis of 2007-2008, land and the commodities grown on it have become both significant asset classes inviting investment as well as huge sites of conflict and environmental destruction. Among the land-based commodities leading the charge, palm oil tops the list. Palm oil is used in thousands of consumer branded products around the globe and is now the world's most widely traded and used vegetable oil. With its high profit margins for growers and traders, rapid plantation expansion in many countries, and its incredibly broad range of consumer uses, palm oil has attracted tens of billions of dollars in private investment, which has, in turn, fueled the industry's unprecedented growth.

Palm oil's rise in the last two decades, however, has relied to a great degree on externalizing the real costs of production – the millions of hectares of rainforests and peatlands that have been destroyed for plantations in Southeast Asia, Latin America, and sub-Saharan Africa, and the multitudes of Indigenous Peoples, smallholder farmers and others whose customary lands and livelihoods have been subsumed into the palm oil plantation sector.

Remaining forests across the tropics and peat lands in Indonesia and Malaysia – where 85 percent of the world's palm oil supply is grown – continue to be cleared at alarming rates, as the industry remains on a trajectory of rapid expansion. In Indonesia alone,

plantation area has grown from about half a million hectares in 1985 to a projected 26 million hectares in 2025.ⁱ The industry is growing rapidly in equatorial Africa, Mesoamerica, and South America as well. In all of these regions, deforestation is driving the loss of species, threatening the livelihoods and cultures of millions of local people, and contributing to climate change at an alarming rate.

The palm oil industry employs as many as 3.5 million workers in Malaysia and Indonesia; many of whom are victims of serious labor exploitation.ⁱⁱ Many of these workers are trafficked into bonded labor; forced to work and live under extreme conditions with limited legal recourse; suffer from abuse or the threat of abuse; or are children. At their extreme, these forms of exploitation constitute modern forms of slavery. Palm oil from Indonesia and Malaysia has made the U.S. Department of Labor's List of Goods Produced by Child Labor or Forced Labor.ⁱⁱⁱ

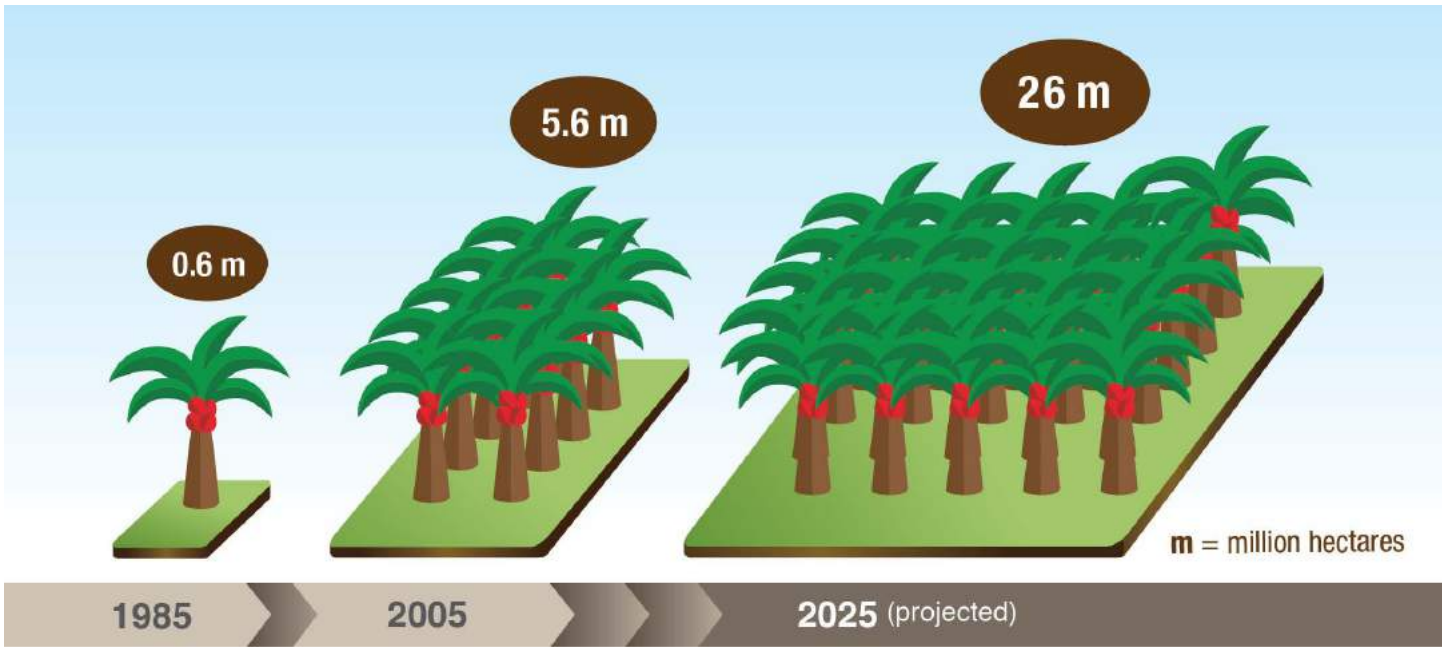
Industrial palm oil plantations require massive extensions of land to generate profit, and land acquisitions are often carried out with a lack of community consultation and consent, human rights abuses, and a disregard for social, economic, and environmental impacts, particularly in contexts where governance and transparency of land transactions are weak.^{iv} The popular term for exploitative land deals at the expense of local farming communities and livelihoods is 'land grabbing'.^v

Examples of palm oil in consumer products

- Instant noodles
- Shampoo
- Cookies
- Soap
- Detergent
- Lipstick
- Chocolate
- Margarine



Projected growth of palm oil plantations in Indonesia, in millions of hectares



What is a land grab?

The most widely referenced definition of what constitutes a land grab is based on the Tirana Declaration^{vi} agreed to by governments, international organizations and civil society groups in May 2011. The Tirana Declaration defines land grabs as land deals, “that are one or more of the following:

1. In violation of human rights, particularly the equal rights of women;
2. Not based on free, prior and informed consent of the affected land-users;
3. Not based on a thorough assessment, or are in disregard of social, economic and environmental impacts, including the way they are gendered;
4. Not based on transparent contracts that specify clear and binding commitments about activities, employment and benefits sharing, and;
5. Not based on effective democratic planning, independent oversight and meaningful participation.”

For the particular ways in which they neglect or violate recognized human rights standards, land grabs are a subset of “land deals” or “land acquisitions”.

As defined by the Land Matrix,^{vii} land deals or land acquisitions more broadly:

- entail a transfer of rights to use, control or ownership of land through sale, lease or concession;
- cover an area of 200 hectares or more;
- imply the potential conversion of land from smallholder production, local community use or important.

It should go without saying that the ultimate definition of whether land has been “grabbed” should take into account the perspectives and positions of the communities who claim customary or statutory ownership over the particular land in question in any given case.

The “governance challenge”: dictators, tycoons and corruption

The countries where the palm oil industry is strongest tend to be former or current dictatorships with high rates of corruption. According to Transparency International’s corruption index,^{viii} every palm oil producer country falls into the group of countries where corruption among public institutions and employees is still common.

A 2014 study highlights the fact that 25 of Indonesia’s largest palm oil companies are owned or controlled by 29 of the country’s wealthiest “tycoons”^{ix} – many of whose wealth can be traced back to the 31-year-long dictatorship of President Suharto, called by Transparency International, “the most corrupted leader in modern history.”^x The total wealth of these 29 tycoon families, estimated at US\$ 69.1 billion, is roughly twelve percent of the country’s GDP (US\$ 878 billion in 2012)^{xi}; the land area they have in palm oil currently totals 3.1 million hectares – fully a third of the nation’s palm oil-planted area.

These figures give a sense of the concentration of economic and political power that dominates the sector, creating an enabling atmosphere for corruption. Indeed, the concern about widespread corruption in the forest sector is such that Indonesia considers the proceeds of forest crimes to constitute a predicate offense for charges of money laundering (see sidebar “Indonesia’s anti-money-laundering statute” below).



Community members in Cross River State, Nigeria protest the sale of their land to Wilmar International, April, 2015.

Photo: Environmental Rights Action/FoE Nigeria

Indonesia’s anti-money laundering statute

In 2003, Indonesia developed an anti-money laundering (AML) statute^{xxvi} that sought to prosecute the financial backers of illegal logging, palm oil production from unpermitted concessions, and other environmental crimes. This legislation identified forest crimes as money laundering “predicate offenses” – meaning actions that provide the underlying resources for money laundering. Under this legislation, the commission of a variety of forest crimes can trigger anti-money laundering investigations and prosecution, leading to the seizure of assets of companies involved in money laundering.

In 2010, Indonesia’s anti-money laundering statute was amended and strengthened to include the transfer of the proceeds of such crimes within Indonesia or overseas; as well as efforts to change, hide or disguise transactions.^{xxvii} In addition, a broader range of law enforcement bodies, including Indonesia’s Anti-Corruption Commission (KPK) were given the right to investigate money-laundering cases.

These efforts come as a response to a broad array of types of corruption in the forest sector in that country. For example, it is reportedly an open secret among officials that companies routinely pay government commissioners for favorable treatment.^{xxviii} The use of bribery is so pervasive that the Deputy Director of Indonesia’s Corruption Eradication Commission (KPK) described the forestry sector as “source of unlimited corruption.”^{xxix}

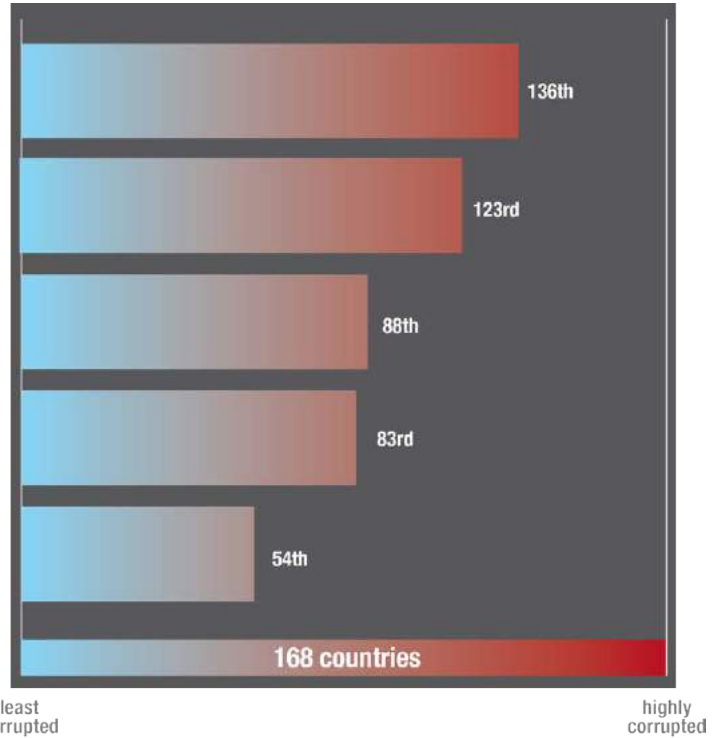
A 2014 investigation by the Environmental Investigation Agency (EIA)^{xxx} documented astonishing levels of criminality in the palm oil sector, finding that palm oil is a primary driver of illegal logging in Indonesia, and that “the unprecedented growth of plantations has been characterized by illegality”^{xxxi} For example, EIA examined 51 companies that should have obtained environmental approval from provincial agencies, and found that about 50 percent of the companies were operating without proper permits.

Another study compared the amount of actual palm oil conversion wood processed by sawmills with official Indonesian estimates of such wood; it found that 82 percent of the timber processed was not officially reported and was therefore illegal.^{xxxii}

In some geographic areas, rates of illegal logging associated with palm oil are particularly high. In 2011, Hanif Budi Nugroho, the head of the Forest Agency in Kotawaringin Timur, a regency in Central Kalimantan, stated that of 52 oil palm firms in the area, not one had obtained a Timber Utilization permit, resulting in illegal logging.^{xxxiii}

Palm oil producers along Transparency International's Corruption Perception Index^{xxii}

(Transparency International has ranked the world's 168 countries from least corrupt to most corrupt; the higher the number, the greater the corruption.)



Awareness of the risks is growing

Through long and highly complex supply chains, industrial plantations are linked to mills, refineries, food manufacturers and consumer goods giants, providing many nodes through which consumers, financiers, and others are tied into the problematic practices of the plantation economy in many countries. Beyond the ethical and ecological concerns, the overdue bill for these externalized costs puts the palm oil market at considerable risk as these real costs are taken into account.

For at least a decade, global environmental organizations have been targeting the palm oil industry for its egregious record of deforestation and related ills – and for most of this time progress came only in very rare, isolated cases. Suddenly in 2013, when virtually every global environmental organization began shining a spotlight on one company – Wilmar International – things gave way. In December of 2013, Wilmar adopted a commitment to No Deforestation, No Peat, and No Exploitation^{xiii} across its supply chains. This commitment was followed by an industry-wide cascade of similar pledges, from Golden Agri-Resources, Musim Mas, Bumitama Agri, and many other companies. By 2015 it was estimated that “over 60 percent of global trade is now controlled by companies that have committed to eliminating deforestation and human

rights violations from their supply chains. These pledges, mostly made since December 2013, are from companies with \$30 billion in annual palm oil sales. Implementing these commitments by 2020 would reduce global warming pollution by the same amount as taking more than 400 million cars off the road for a year.”^{xiv}

This is good news. But policy pledges are one thing and making these policies stick is another. While consumer company commitments to “No Deforestation and No Exploitation” are important, alone they are not enough. Through detailed case studies, Friends of the Earth has shown how palm oil land grabs devastate forest ecosystems and violate the human rights of affected communities through forced evictions, land clearing, forced labor, and other abuses, even after sustainability pledges have been established.^{xv}

We therefore believe that, at this juncture, financiers of palm oil must take measures to strengthen the growing movement toward responsible production. Financiers should without a doubt ensure that any companies they invest in uphold the most robust emerging standards and participate in certification schemes and auditing processes. But financiers themselves must also take on some of their own commitments.

A partial list of companies that have pledged to go 'deforestation free' as of September, 2015



The role of finance in the palm oil sector

Financing for palm oil expansion has been on a steady rise for a decade, amounting to tens of billions of dollars per year. Since 2008, major financial institutions have invested more than \$20 billion in the palm oil industry.^{xxix}

This investment comes in the midst of a growing trend of investment in land and overseas agriculture, which are widely perceived as low-risk asset classes – despite increasing awareness that the global rush for land often involves a lack of community consultation and consent, human-rights abuses, and a disregard for social, economic, and environmental impacts, particularly in contexts where governance and transparency of land transactions are weak.^{xxx}

Of the tens of billions currently invested in palm oil, more than ten percent comes from the United States. Some six percent is in the form of equity shares, much of this managed by institutional investors and other asset management firms in the United States.^{xxxi}

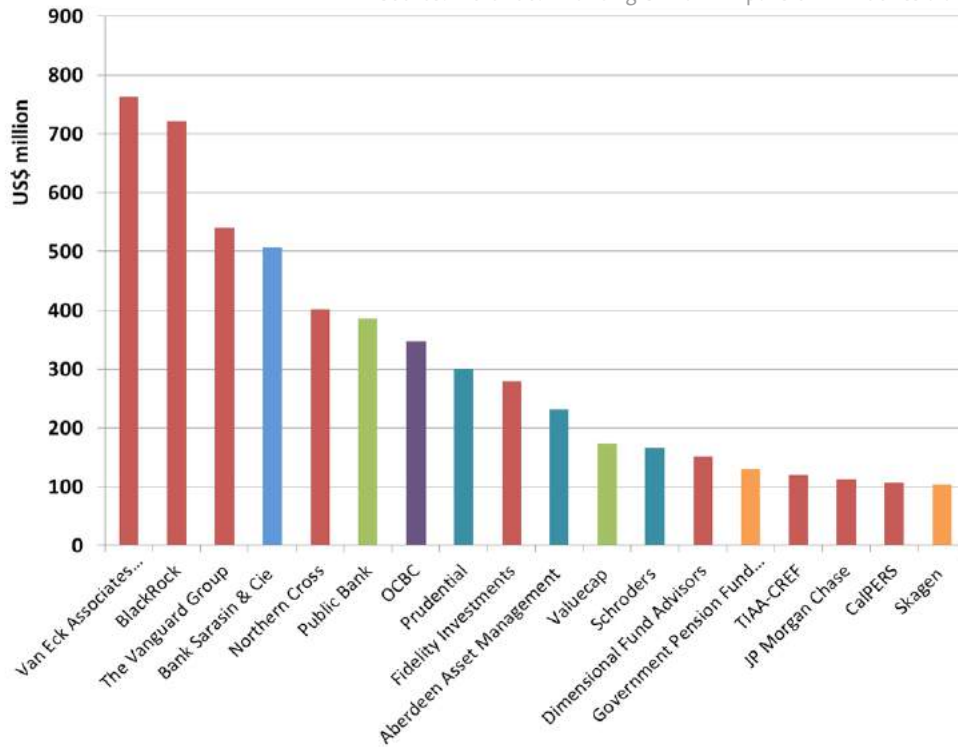
- **Asset owners** are institutions such as pension funds, sovereign wealth funds and insurance companies that have legal ownership of their assets and make asset allocation decisions. These assets originate from individuals and plan sponsors (for pension funds); governments (for sovereign wealth funds); and customers (for insurance companies).
- **Investment managers** manage assets on behalf of others – their clients – and do not legally own those assets. They operate within mandates and contract terms set by their clients.

The largest asset owners and investment managers have many thousands of companies and other individual investments in their portfolio, spread across the entire world, in order to manage financial risk. This makes it exceedingly difficult to directly link a company to the financiers that hold investments in that company – and to establish a sense of accountability up the investment chain.

Some asset owners manage some of their assets in-house and outsource the remainder to investment managers. A pension fund, for example, may outsource all investment management and appoint a single investment manager (or 'fiduciary manager'). This manager may in turn outsource

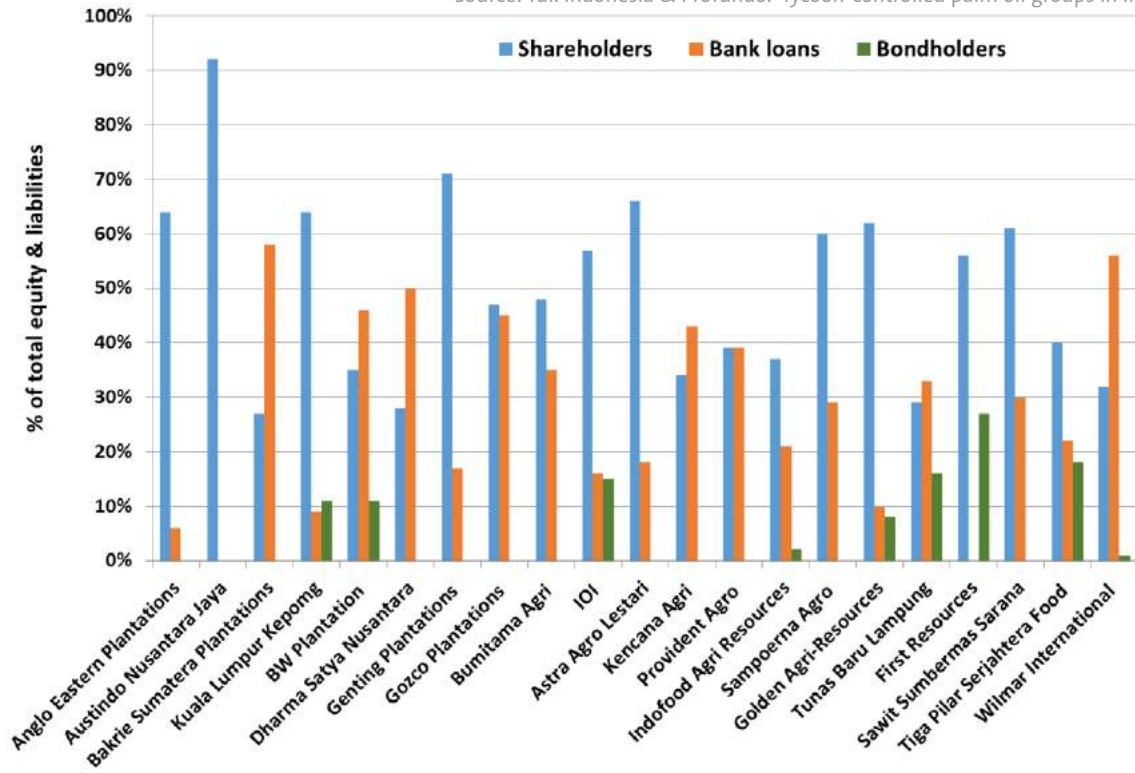
Institutional Investors Financing the Southeast Asian Palm Oil Industry

Source: Profundo. Financing Oil Palm Expansion in Indonesia and Malaysia. January, 2015.

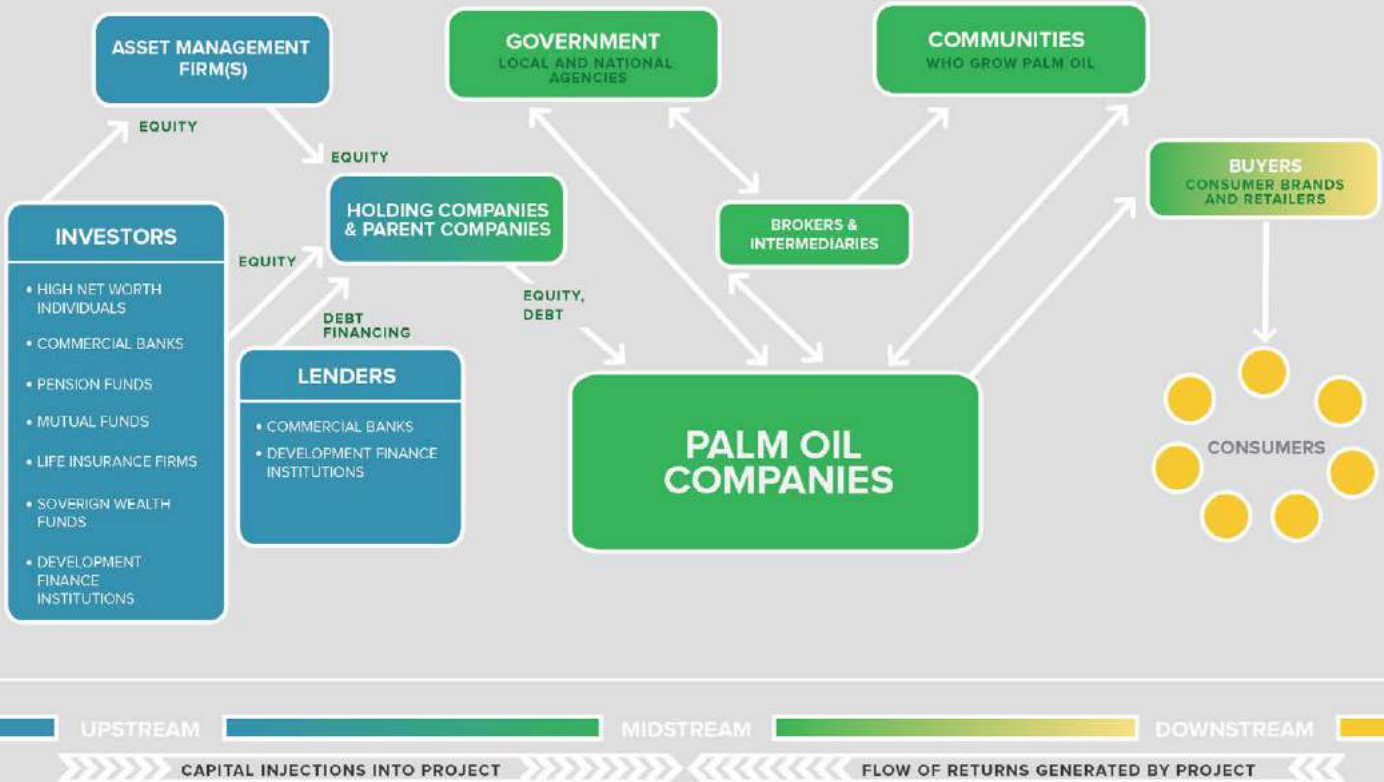


Shareholders are the most important financiers of 15 of the 21 top oil palm holding companies, financing between 27% and 92% of total assets.

Source: Tuk Indonesia & Profundo. Tycoon-controlled palm oil groups in Indonesia. 2014.



A typical agribusiness investment chain



parts of the portfolio to other, specialist managers. An asset owner, or an investment manager that outsources the management of some its assets, may invest in ‘funds of funds’ – structures in which a top-level fund invests in a series of second-level funds, which in turn invest in underlying listed or unlisted companies. Such structures make it exceedingly difficult to understand and unwind the investment chain.

Among the largest U.S. investors and asset managers involved in palm oil are the mutual fund managers BlackRock, Vanguard, Fidelity, and Dimensional Fund Advisors, the asset management arm of JPMorganChase, and the pension funds CalPERS and TIAA-CREF. All of these financial institutions have significant gaps in their policies and practices on land rights and forests. Only two U.S. banks – JPMorgan Chase and Goldman Sachs – explicitly consider palm oil a ‘high-risk’ sector, and none of the top US investment firms have clear policies to prevent investments in deforestation and land grabbing.

Because financial institutions play a key role in driving social and ecological destruction financial institutions have a social responsibility to address it. As a recent study by the

UN Environment Programme notes, “Banks and investors can drive deforestation and land conversion through their lending and investment practices”.^{xxv} Similarly, the Organization for Economic Cooperation and Development (OECD) maintains that financial services companies are “directly linked” to the social and environmental impacts of their investments/ lending, and therefore bear responsibility for resolving them.^{xxvi} By providing both financing and reputational stability, financiers enable and legitimize the sector, in some cases providing cover for its most egregious practices (see case studies for details).

Framing the problem in a positive light, the UNEP study argues that we are currently seeing “opportunities for financial institutions to align their risk policies with emerging trends to incentivize sustainable production of commodities”.^{xxxiv} Indeed, recent guidance from the U.S. Department of Labor clearly recognizes ESG considerations as a part of investors’ fiduciary duty, saying that “ESG factors may have a direct relationship to the economic and financial value of [an] investment” and that “ESG issues are not merely collateral considerations or tie-breakers, but rather are proper components of the fiduciary’s primary analysis of the economic merits of competing investment choices.”^{xxxv}

Because financial institutions play a key role in driving social and ecological destruction – and because social

and ecological considerations are increasingly relevant to fiduciary duty and financial risk – financial institutions have a direct responsibility to address it.

Following the development of the United Nations Guiding Principles on Business and Human Rights, the Organization for Economic Cooperation and Development (OECD) developed a series of working papers in which it clearly laid out that, where financial services are proffered to companies involved in adverse socio-environmental impacts, the providers of those services are “directly linked” to these impacts, and therefore bear responsibility for resolving them.^{xxxvi}

“Financial institutions are exposed to risks related to deforestation and forest degradation if companies they invest in or lend to are affected by biophysical, legal, market or regulatory risks linked to their impacts or dependencies on forest ecosystems. These risks can become material for a financial institution if one or a combination of these risks affects the costs, revenues or other financials of the company.”

– UN Environment Programme, “Bank and Investor Risk Policies on Soft Commodities”^{xxi}



ESG as fiduciary duty: Good environmental and social governance is good business

A second reason financiers should address deforestation and land grabbing in the palm oil sector is because these are material risks in the industry. As one investor's shareholder resolution from 2015 puts it, "Deforestation significantly degrades the environment in ways that pose material risks to agricultural production and therefore to the core business of [unnamed agribusiness firm]. Given that commodity agriculture is the single leading driver of deforestation, [the firm] is both highly exposed to the risks associated with deforestation taking place across its global agricultural supply chains, while also being uniquely positioned as one of the leading agricultural suppliers globally to establish policies that mitigate these risks."^{xix}

Today there is a growing trend moving institutional investors toward greater integration of ESG considerations into their investment strategies, but it has been an uphill march that has continually required those investors committed to environmental and social responsibility to push back on the conventional wisdom.

Fortunately, legal scholarship has begun to dismiss this narrow and often self-justifying interpretation of fiduciary duty. The OECD "Summary Report on Effective Approaches to Support Implementation of the G20/OECD High-Level Principles on Long Term Investment for Institutional Investors,"^{xxvii} for example, says that "Prudent investing on the part of institutional investors gives appropriate consideration to any factor which may materially affect the sustainable long-term performance of its assets, including factors of an environmental, social, and governance character." The same point is articulated by the US Department of Labor, which issued a bulletin in 2015 saying that Environmental, Social and Governance (ESG) considerations can and should be factored into investment decisions "as long as those decisions do not hamper portfolio returns or impose additional risk on the plan."^{xxviii}

In the words of one commentator, "There are extensive in-depth legal, academic, and investor arguments for, rather than against, accounting for ESG factors in investment decisions. Key to these arguments, from an asset steward perspective, is the recognition of aligning liabilities with frameworks that prioritize long-term value creation and the likelihood of increasing materiality across a long-term horizon. Case law as well as fiduciary frameworks recognize the need to preserve assets to satisfy future, as well as present, claims, and requires that trustees take impartial account of the interests of all beneficiaries."^{xlii}

Finally, in addition to the need for fiduciaries to consider all ESG issues that may be material to financial performance, fiduciaries also have a duty of obedience to their clients. A commitment to a clear and comprehensive ESG policy can serve to build and sustain trust between parties. This may be especially true in cases where there is a separation between asset owners and managers.

ESG as a matter of human rights obligations

Finally, the Universal Declaration of Human Rights clearly states that "every organ of society" has human rights obligations. This includes business enterprises and therefore investment firms.

The UN Guiding Principles on Business and Human Rights (Guiding Principles) were adopted by the UN Human Rights Council on 2011 to provide a framework for private companies, including financial firms, to safeguard human rights. This is expressed in the three "pillars": the state has a duty to **protect** against human rights abuses, businesses have a responsibility to **respect** human rights, and victims of human rights abuses have the right to effective **remedy**.

The Guiding Principles provide a blueprint for companies to demonstrate respect for human rights and minimize the risk of harm to people, and to assess business respect for human rights. The Guiding Principles are endorsed by the United States, which cosponsored the Human Rights Council resolution that approved the Guiding Principles and has vowed to support their implementation.^{xliiv}

There is no U.S. law requiring investment firms or institutional investors to disclose their social and environmental impacts, let alone take responsibility for them. Unlike for some industries in which third-party certification processes exist to monitor the respect for certain standards by companies that claim to follow, say, fair labor or sustainable production standards through their supply chain, no such mechanism exists for financial firms. Therefore, until standardized criteria exist, it is up to institutional investors to articulate and disclose their social and environmental policies as a matter of public accountability.



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SERTIPIKAT
(TANDA BUKTI HAK)

KANTOR PERTANAHAN
KABUPATEN/KOTAMADYA
KOTAWARINGIN BARAT

A man in Central Kalimantan, Indonesia holding titles to lands he says were stolen from him by a palm oil company, September, 2015. Photo: Victor Barro/FoE Spain

2

Equity investment and human rights in the palm oil sector



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“The undeniably high and sustained profit potential of land investments is thought to be offset by meager costs. Not only is the land itself cheap, but the ongoing outlays required to convert that land’s output into saleable goods (like palm oil) is quite low. This all seems very compelling when confined to spreadsheets, but as these acquisitions become more common, we see serious discrepancies between concept and practice. Many investors and operators have committed time, money and effort without understanding some considerable risks, such as those related to control over a given parcel of land. Property rights in many emerging markets are dysfunctional to the point that ownership of land can be granted to an investor without the tens of thousands of people living on, or dependent on, that land knowing about it. Generally tied to their land for many generations, these people have little interest in, or have no reasonable option for, moving to urban areas and are practically impossible to relocate. In other words, the risk is unavoidable once these investments are made.”

- The Financial Risks of Insecure Land Tenure: An Investment View^{xlv}

.....

Opaque and complex value chains in the palm oil sector can insulate investors from awareness of the social and ethical impacts and risks of their investments. Similarly, opaque and complex investment chains can distance asset owners from their investee companies. Therefore, asset owners should undertake proactive due diligence into the social, human rights and environmental impacts of the positions they take, and push these due diligence requirements down the investment chain by ensuring that asset managers, sub-managers, etc. comply with their general ESG policies (assuming they have any).

Similarly, institutional investors and other financial institutions should be accountable to their members, clients, and shareholders by demanding accountability from their investee companies, and providing thorough disclosure of ESG risks and impacts. However, leading US palm oil financiers provide relatively little reporting to their clients and shareholders about their ESG policies, particularly with respect to palm oil, deforestation and/or land grabbing.

Environmental Social and Governance Policies of the Top U.S. Financiers of Palm Oil

Current ranking among US equity investors with stocks in palm oil production, by dollar amount invested.

(Based on financial data from Q4 2015)

1 BLACKROCK \$8.73 billion**No explicit commitment to preventing deforestation or land grabbing.**BlackRock's professes adherence to a particular vision of ESG, but has no public position on palm oil, forests, land grabs or human rights.^{xxxix}**2 Vanguard**® \$2.88 billion**No explicit commitment to preventing deforestation or land grabbing.**

Vanguard has no publicly available ESG policies, and no public position on palm oil, forests, land grabs or human rights.

3 J.P.Morgan
Asset Management \$581.17 million**No explicit commitment to preventing deforestation or land grabbing.**

JP Morgan Chase has a reasonably strong Environmental and Social Risk Management policy for its commercial and investment banking, which recognizes palm oil as a high risk sector; but no such policy guides its asset management.

4 Fidelity INVESTMENTS \$538.40 million**No explicit commitment to preventing deforestation or land grabbing.**

Fidelity Investments has no publicly available ESG policies, and no public position on palm oil, forests, land grabs or human rights.

5 TIAA CREF \$433.65 million**No explicit commitment to preventing deforestation or land grabbing.**TIAA-CREF has public commitments to ESG, but no public position on palm oil, forests, land grabs or human rights.^{xi}**6 NORTHERN CROSS** \$410 million**No explicit commitment to preventing deforestation or land grabbing.**

Northern Cross has no publicly available ESG policies, and no public position on palm oil, forests, land grabs or human rights.

7 Dimensional
DIMENSIONAL FUND ADVISORS LTD. \$369.26 million**No explicit commitment to preventing deforestation or land grabbing.**

Dimensional Fund Advisors has no publicly available ESG policies, and no public position on palm oil, forests, landgrabs or human rights.

8 CalPERS \$106.90 million**No explicit commitment to preventing deforestation or land grabbing.**CalPERS is proud of its sustainable investment approach, but it has no public position on palm oil, forests, land grabs or human rights.^{xli}**9 VanEck** \$56.15 million**No explicit commitment to preventing deforestation or land grabbing.**

Van Eck has no publicly available ESG policies, and no public position on palm oil, forests, land grabs or human rights.

10 Prudential \$52.11 million**No explicit commitment to preventing deforestation or land grabbing.**

No explicit commitment on palm oil, forests, or human rights.

A closer look at two investment firms

In 2014, Friends of the Earth reviewed the environmental, social and governance (ESG) policies of the top U.S. investors in palm oil. We contacted each of the firms, but none responded at the time – so the information below is based on publicly available information. It is noteworthy that some of these firms do have explicit ESG policies, and some claim to take ESG issues into account in their investment analysis. But when it comes to explicit policies governing their investments in palm oil, they all come up short.



Teachers Insurance and Annuity Associate-College Retirement Equities Fund (TIAA-CREF), a large pension fund for people in the U.S., Canada and Sweden who work in the academic, government, research, medical and cultural fields, is an example of an asset owner. TIAA-CREF says ESG is one of its priorities when developing a new investment. “Where appropriate, we incorporate Environmental, Social and Governance (ESG) considerations into the selection and monitoring of our investments across a variety of asset classes and products, including our responsible investment funds, community and impact investing programs, alternative investments, real estate, as well as the individual portfolios that we offer at our clients’ request.”

They are signatory to a series of international voluntary agreements, including:

- The United Nations-supported Principles for Responsible Investment (PRI)
- The Principles for Investment in Inclusive Finance
- The Global Impact Investing Network
- The Principles for Responsible Investment in Farmland
- The Forum for Sustainable and Responsible Investment (USSIF)

International Corporate Governance Network

TIAA-CREF has constructed a report on Farmland investments where they specifically express the need to respect existing land and resources rights under the signage of the PRI and the Principles of Responsible Investment in Farmland.

In it, the firm acknowledges “[...]We are cognizant of concerns around key issues like ‘land grabbing,’ displacement of local farmers, and deforestation, and we believe our investment approach sets us apart in addressing these concerns.” They assert that “Our core investment strategy is based on a partnership model focused on acquiring existing, high-quality farmland and identifying best-in-class local farmers who operate the farms via a leasing arrangement. In doing so, we facilitate the growth of local family operators and agribusinesses while also contributing capital (in the form of the purchase price) to the local market. By employing a comprehensive asset management and farm oversight program, we are able to assess and validate adherence to strict operating practices and analyze potential capital investments that will support enhanced production and sustainability into the future.” But this approach has not insured TIAA-CREF against exposure to land grabs.

Recent investigations by civil society groups and the New York Times have revealed that TIAA-CREF’s global farmland fund, TIAA-CREF Global Agriculture LLC (TCGA) has purchased several farms in the Brazilian states of Maranhão and Piauí where land conflicts and land grabbing are rife; that some of the farms were previously owned by a Brazilian businessman who is the subject of several criminal investigations; and that TCGA’s investments in Brazilian farmland are contributing to a process of land speculation and expansion of industrial agriculture plantations that are fueling land grabbing, environmental destruction, labor exploitation and social and health calamities across rural Brazil.^{xlviii}

As of September, 2015, TIAA-CREF had \$433.65 million invested in palm oil through at least nine company groups: Felda Global Ventures, Genting Group, Harita Group, IJM Group, IOI Group, Jardine Matheson Holdings, QL Resources Group, Unilever, and Wilmar International.

BLACKROCK ^{xlix}

BlackRock, an example of an asset manager (as opposed to an asset owner), manages more than \$2 trillion in equity assets, of which 90 percent are managed in passive or equity-index strategies. The firm is a signatory of UN-PRI, and is involved in the International Corporate

Governance Network, among other industry groups. They also participate in numerous other organizations focused on standards setting, corporate governance, and social, ethical and environmental investments.

BlackRock has extensively detailed its ESG related policies and documented specific examples of how it has referenced these policies in investment projects. Blackrock states clearly that it has a hands-on approach, in which it monitors its investee companies' ESG and financial performance throughout the duration of its investments:

“Our fiduciary duty to clients is to protect and enhance their economic interest in the companies in which we invest on their behalf. It is within this context that we undertake our corporate governance activities. We believe that well-managed companies will deal effectively with the social, ethical and environmental (‘SEE’) aspects of their businesses

BlackRock expects companies to identify and report on the material, business-specific SEE risks and opportunities and to explain how these are managed. This explanation should make clear how the approach taken by the company best serves the interests of shareholders and protects and enhances the long-term economic value of the company. The key performance indicators in relation to SEE matters should also be disclosed and performance against them discussed, along with any peer group benchmarking and verification processes in place. This helps shareholders assess how well management is dealing with the SEE aspects of the business. Any global standards adopted should also be disclosed and discussed in this context.

We do not see it as our role to make social, ethical or political judgments on behalf of clients. We expect investee companies to comply, at a minimum, with the laws and regulations of the jurisdictions in which they operate. They should explain how they manage situations where such laws or regulations are contradictory or ambiguous.”

BlackRock uses as example of this process its interest and engagement with investees on broad issues of ESG, including human rights in the supply chain, water management and hydraulic fracturing. They are actively engaged with investees in the palm oil sector, though the form their engagement takes is not clear. What is clear is that BlackRock's approach to sustainability is focused on conventional environmental concerns such as pollution reduction and waste management, but does not explicitly account for human rights concerns or land tenure or land management conflicts. (See case studies for examples of such conflicts associated with Blackrock investees.)

Interestingly, in February 2016, Larry Fink, BlackRock's CEO, issued a public letter¹ warning companies to do a better job of integrating long term concerns such as ESG factors, into their business models.

“Generating sustainable returns over time,” Fink wrote, “requires a sharper focus not only on governance, but also on environmental and social factors facing companies today. These issues offer both risks and opportunities, but for too long, companies have not considered them core to their business – even when the world's political leaders are increasingly focused on them, as demonstrated by the Paris Climate Accord. Over the long-term, environmental, social and governance (ESG) issues – ranging from climate change to diversity to board effectiveness – have real and quantifiable financial impacts.

At companies where ESG issues are handled well, they are often a signal of operational excellence. BlackRock has been undertaking a multi-year effort to integrate ESG considerations into our investment processes, and we expect companies to have strategies to manage these issues”

As of September, 2015, BlackRock had \$721.52 million invested in palm oil through at least nine company groups: Boon Siew Group, Felda Global Ventures, Genting Group, Harita Group, IJM Group, IOI Group, Jardine Matheson Holdings, QL Resources Group, and Wilmar International. This figure jumps to more than \$8 billion, if you calculate BlackRock's holdings in Unilever, the company that purchases roughly three percent of the world's entire palm oil output.ⁱⁱ



3

Deforestation-free, land grab-free finance: The four pillars of responsibility

4 pillars of Responsible Investment



Following the development of the United Nations Guiding Principles on Business and Human Rights, the Organization for Economic Cooperation and Development (OECD) developed a series of working papers in which it clearly laid out that, where financial services are proffered to companies involved in adverse socio-environmental impacts, the providers of those services are “directly linked” to these impacts, and therefore bear responsibility for resolving them.^{lii}

“If an enterprise identifies a risk or is made aware of adverse impacts being directly linked to its operations, products, or services through its business relationships, it should seek to use its leverage to influence the entity causing the adverse impact to prevent or mitigate the impact and future impacts. This can be done by the enterprise itself or in cooperation with other entities, as appropriate.”^{liii}

Investors with relatively small holdings, or with holdings through index funds, may argue that their leverage is too small to make a difference. But to this point, the OECD Guidelines are clear: “A lack of leverage does not imply that an enterprise should not apply the recommendations of the Guidelines. The degree of leverage it has over its business relationship with the entity causing the adverse impact is useful in considering what it can do to persuade that entity

to take action, but is not relevant to considering whether it should carry out due diligence and exercise any leverage it may have. It should.”^{liiv}

The approach that investors use to take responsibility can be sliced in many different ways, and each investment firm, and NGO for that matter, will have its own guidelines with regards to “responsible investment.” For purposes of clarity, we have developed a four-pillar approach to responsibility when it comes to deforestation-free, land grab-free finance:

Disclose, Commit, Exclude, Repair.

- 1. Disclose** their exposure to deforestation and land risk in palm oil and other soft commodities.
- 2. Commit** to a Deforestation and Land Grab Free Investment policy.
- 3. Exclude** bad actors and **advocate** for responsible financing.
- 4. Repair** the damage: ensure justice for affected communities through accountability processes and support companies that restore ecological damage as part of their commitment to forests.

1. Disclose

Just a decade ago, the global financial system was virtually impenetrable to outsiders. Today, NGOs, media and people's movements are learning how to uncover banks' and investors' links to a host of environmental and social issues. In the 21st century, banks and equity investors can choose to proactively report on ESG issues or read about them in the headlines

Often the issue of transparency is dismissed by appealing to a general principle of privacy – a cultural norm in the finance sector that can be so entrenched that some banks refuse to publish substantial information about policies supposedly intended to increase accountability.^{lv} But there is a vast difference between an asset management fund listing the names of companies in which it holds shares – which has no impact on client privacy – and the privacy needs in transactional banking, for example.

Too often, genuine concerns about privacy, legal compliance and commercial competitiveness are conflated with efforts to avoid reasonable levels of scrutiny by shareholders, asset owners and the general public, including communities affected by a given firm's financing. This is compounded by the “first mover” problem, where no financial institution wants to be the first to open its books – but once the step is taken, others tend to follow.

Due to the dire consequences of land grabs and human rights violations, and the associated financial risks,^{lvi} it is critical for investors to adopt greater transparency in dealings that are exposed to land-related risks. While the industry adoption of voluntary ESG policies is a step in the right direction, a lack of transparency undermines their accuracy and efficacy. More robust disclosure also provides an opportunity to note positive exposure to companies that have committed to, and implemented, “No Deforestation, No Exploitation” policies.

To this end, financiers should:

- Publish an annual list of palm oil and other soft commodity holdings in which they hold shares, including through passive index funds.
- Develop a coherent approach for how the firm assesses and takes action on agriculture- and forestry-related land risks in its investment decisions and report on this approach, with priority placed on operations in countries with high reported levels of land conflicts and corruption.^{lvii}
- Share information on the firm's approach to deforestation and land rights and its disclosure in a form accessible to at-risk communities, and proactively provide this information to civil society groups

advocating on behalf of these communities. Such information should be publicly available and easy to find on the firm's website.

- Specify the framework it uses for monitoring and reporting on implementation of its ESG commitments, audit its investments annually to assess compliance through an independent third party, and make the summary results public and accessible.

Taking such measures will increase trust in the firm, and will drive positive change in the finance sector.



2. Commit to deforestation-free, exploitation-free finance policies and procedures

Asset owners—including institutional investors such as pension funds and asset managers, including mutual funds—and retail investment firms that manage mutual funds and other investment vehicles, should commit to policies and procedures that ensure deforestation-free, exploitation-free finance. Where asset owners have adopted such commitments, they should require any external investment managers to apply them in their management practices as well.

These policies and procedures should be an integral part of the firm's overarching risk management and policy framework to address Environmental, Social and Governance (ESG) issues. Such a framework generally also includes having a department dedicated to evaluating ESG risks and opportunities and having staff as well as board members responsible for the implementation of the firm's ESG policies.

ESG policies should be wide in scope, covering all of the firm's products. They should be publicly available on the firm's website and should be reviewed and updated regularly in consultation with stakeholders. Many sector standards exist and can be referred to in developing and updating commitments. Indeed, so many standards exist on paper that it is a daunting task to know which standards to refer to, and a comprehensive listing here might be both overwhelming and counter-productive. A good start would be to make any ESG policies for forest and land related investments align with the UN FAO Voluntary Guidelines on the Responsible Governance of Tenure of Land, Fisheries and Forests in the Context of National Food Security.^{lviii} For recommendations regarding ESG policies that will respect and protect labor rights in the palm oil sector, the 2015 document produced by a coalition of environmental and labor rights organizations, *Free and Fair Labor in Palm Oil Production: Principles and Implementation Guidance*^{lix} provides strong and clear recommendations.

The recommendations that follow apply to the palm oil sector specifically, but they may also apply to the others sectors that are major drivers of deforestation and forest degradation – timber and pulp and paper – as well as to other commodity sectors that are drivers of deforestation and forest degradation, like soy, cattle, biomass and biofuels, sugar cane, rubber and cacao. These recommendations are partial, and should not be considered static, as they will need to be updated to incorporate new developments and to include specific requirements for different commodities.

Enhanced due diligence

Deforestation-free, exploitation-free finance policies and procedures begin with enhanced due diligence.^{lx} In the banking sector, most countries require banks to implement customer due diligence protocols to target terrorism financing, the drug trade and political corruption^{lxi} as part of broader Know Your Customer (KYC) principles legislated by banking regulators.^{lxii} These regulations require financial service providers to collect and monitor client data including identities, employment, business affiliations, normal income flows and habitual financial transactions.^{lxiii} There is increasing recognition that similar protocols are needed for addressing forest-related crimes such as illegal logging, illegal agricultural expansion, land-related corruption and illegal wildlife trade.^{lxiv} Equity investment firms should take note of this trend.

A strong due diligence process should be employed to review each potential investment as well as to review the compliance of existing investments with the firm's policies. Apart from an assessment of the actual and potential social and environmental impacts of the client's activities, due diligence should also include an analysis of the company's institutional and management capacities and deficiencies as well as an assessment of the host country's legal framework and its capacity to implement legislation.

Asset managers should require evidence that companies are acting in compliance with the law and with deforestation-free, land grab-free practices. This should begin with





Land clearing for palm oil, Kalangala, Uganda, 2012.

Photo: Jason Taylor/FoE International

reviewing documentation such as a potential investee palm oil company's land bank (planted and unplanted) and expansion plans (even if financing is not directly related to expansion); its policies and practices of Free, Prior and Informed Consent (of which, more below); its land and production permits and Social and Environmental Impact Assessments (SEIAs); supply chain maps; employment and contracting policies and procedures; as well as governance concerns such as beneficial ownership and offshore accounts. Investors should require that palm oil companies have credible and robust No Deforestation, No Exploitation commitments, and that these commitments are being thoroughly implemented.

For screening purposes, corporate conglomerates should be treated as a single unit when the group operates as a single business or when the outside world perceives it as a single entity. This is needed to address common practices in the palm oil industry linked to the use of shell companies or the "hollowing out" of companies, where profits are sent offshore or to other companies in the group, leaving a largely asset-less company. These business practices render it highly difficult for communities to achieve compensation, among other problems.

Companies should have clear sourcing policies and practices that require "No deforestation, no exploitation and no peat development," and should have strong due diligence systems to ensure that their entire chain of custody meets

this standard. A company's products should only be sourced from suppliers that comply with both the company's sourcing policies and the financier's ESG policies, and which operate in full compliance with all relevant local and national laws.

In the case of smallholders, this presents an ongoing need to ensure that smallholders have access to the resources and support needed to be able to produce in ways that are thoroughly acceptable – and that support their own economic, social, and cultural needs and conditions.

Beyond requiring the company to provide all the relevant documents to prove it is compliant, potential investors should also consult affected communities, civil society organizations, governmental bodies and other experts. NGOs and civil society groups generally welcome inquiries from banks and institutional investors and will often provide information and contacts with their networks as a routine part of their social and environmental mission.

Finally, a basic guideline for due diligence is that financiers should always adopt a precautionary approach to companies active in high-risk sectors in vulnerable regions, and should only proceed if it is clear that no concerns are present.

Social and Environmental Impact Assessments (SEIAs)

An inability to understand the local social and environmental context, as well as the local land rights context exposes financiers to operational, expropriation, credit and reputational risks, as well as attendant financial risks. A 2012 report from financial consultancy The Munden Project notes that “unresolved conflicts over land tenure significantly augment the financial risks for companies in infrastructure, mining, agriculture and forestry.”^{lxv} More broadly, the report points out that investors are so distanced from the local land context where they invest that they are unlikely to understand it. Munden also notes that proxies for assessing environmental, social and land risk, including reliance on certification schemes like the Roundtable on Sustainable Palm Oil (RSPO) are often inaccurate and that common tools for managing operational risk, such as political risk insurance, are unlikely to protect land-related investments.^{lxvi}



Land grabbing victim, Kalangala, Uganda



Land grabbing victim, Cross River State, Nigeria.

Photo: Jason Taylor/FOE International



Land grabbing victim, Central Kalimantan, Indonesia

Photo: Victor Barro/Foe Spain

Most national governments require large-scale infrastructure and agribusiness projects to conduct Social and Environmental Impact Assessments (SEIAs) as a prerequisite for legal permitting – but many governments fail to uphold this requirement as thoroughly as they should. Investors should expect all investee palm oil companies to commission independent third-party social, environmental and human rights impact assessments, before operations begin in any given location.

Investors should also be aware that such processes are subject to tremendous gaps in implementation and a wide array of possible manipulation. For example, local people who have the most knowledge about existing land use and who have the biggest stake in new projects rarely contribute to SEIAs,^{lxvii} despite legal mandates. As a result there are many examples of SEIAs failing to capture land-related issues such as non-compliance with local laws and human rights law, likelihood of forced resettlement, companies’ prior land rights records and the impact on women’s rights.^{lxviii} There are countless examples of SEIAs not being shared with stakeholders for consultation,^{lxix} or being shared without sufficient time or in languages that are not understood by stakeholders – all of which undermines both the intent and the legal requirements behind SEIAs. In short, without very close scrutiny of local conditions, histories, and political realities, it is exceedingly difficult to assess the quality of SEIA reporting.^{lxx}

Forest and plantation management plan

Any company operating in the palm oil or other forest-based sector should have a sustainable forest and/or plantation management plan which covers all the forests and/or plantations that it owns, leases, manages or sources from. The plan should adopt best practices for the management of forests and plantations, following relevant national and international sector guidelines and adopting the principles and criteria from the strictest relevant certification scheme.

Space limitations prevent us from elaborating on these best practices here, but in brief, current best practices include a mandate to identify, map and establish procedures for the protection of High Conservation Value (HCV) and High Carbon Stock (HCS) areas, and a moratorium on any logging or conversion, pending the outcome of HCV and HCS studies. A forest/plantation management plan should take ecosystem functions into account and establish measures to protect these using an area based management approach.

Companies operating in forest-based sectors should also have a Biodiversity Action Plan consisting of the measures that will be taken to protect biodiversity, including

precautionary measures to avoid the introduction of invasive species. The measures in this plan should be in accordance with international conventions regarding biodiversity, like the Convention on Biological Diversity,^{lxxi} Ramsar Convention on Wetlands,^{lxxii} the Convention on the Conservation of Migratory Species of Wild Animals,^{lxxiii} the Convention on International Trade in Endangered Species of Wild Flora and Fauna,^{lxxiv} the World Heritage Convention, the UN Convention to Combat Desertification,^{lxxv} the International Plant Protection Convention, and the Millennium Ecosystem Assessment.

Respect the principle of free, prior and informed consent (FPIC)

Local communities and Indigenous Peoples are estimated to hold as much as 65 percent of the world's land area under customary systems – yet many governments formally recognize their rights to only a fraction of those lands.

^{lxxvii} This means that investors who interact chiefly with government agencies may be doing little to avoid serious missteps in land acquisition.

Good due diligence starts with financial service providers



having an accurate situation analysis of the countries that they work in. This requires understanding the extent to which legitimate land rights may not be recognized, or protected, through judicial frameworks, particularly in emerging markets. This also involves incorporating land-risk into all assessments of risk in the palm oil and broader soft commodity sectors. Where financiers opt to invest in countries and industries with high land-related risks, full recognition of the principle of FPIC is essential. The realization of FPIC is also dependent on appropriate transparency through disclosure and accountability to ensure that communities know who is financing activities in their area and that they have access to meaningful redress if abuses do occur (see Pillar 4, Repair, below).

Done well, FPIC establishes a relationship with local communities capable of sustaining ongoing support and cooperation. Emphasizing that communities can give, or withhold, consent also decreases operational risks from local protest and direct action. A comprehensive approach to FPIC safeguards financiers against misrepresentation or corruption in land deals, by ensuring companies have consent from a broad cross-section of the local community.

Recognition of the principle of FPIC for both local and indigenous communities facilitates compliance with existing national and international laws, particularly on the rights of indigenous people, and contributes to future-proofing soft commodity investments in light of FPIC's rapid incorporation into buyers' guidelines and industry standards. Unlike other tools in use by the financial sector, only an FPIC based approach can pre-emptively identify land issues. For example, the limitation of media monitoring or reputational databases is that even in a best-case scenario they can only identify problems after they occur. Environmental standards that prohibit investment in companies involved in current, or recently cleared, high conservation value forests, peatlands, wetlands on the Ramsar list and UNESCO World Heritage Sites are also critical, but limited in their geographic application and social scope.

Free, Prior, and Informed Consent^{lxxviii}

is a right established within the United Nations Declaration on the Rights of Indigenous Peoples and other international human rights instruments that guarantees that Indigenous Peoples and other local communities have the right to say yes or no to any project that will affect their lands, territories, natural resources, knowledge or culture. FPIC is an important policy mechanism to keep extractive industries, international financial institutions, and other interests from violating the rights, livelihoods, and interests of local communities. Unfortunately, it is poorly understood and poorly implemented.

FPIC implies informed, non-coercive negotiations between investors, companies or governments and indigenous peoples prior to the development and establishment of oil palm estates, timber plantations or other enterprises on their customary lands. This principle means that those who wish to use the customary lands belonging to indigenous communities must enter into negotiations with them. It is the communities who have the right to decide whether they will agree to the project or not once they have a full and accurate understanding of the implications of the project on them and their customary land. As most commonly interpreted, the right to FPIC is meant to allow for indigenous peoples to reach consensus and make decisions according to their customary systems of decision-making.

In addition, equity investors should commit through a group-wide policy to respect the land rights of communities impacted by the operations of its investees. Any investees should be able to prove that they obtained the legitimate land titles over the land where their operations will (or are) taking place, in a transparent and corruption-free way and that the land is not being contested by local people who can demonstrate they have legal, customary or user rights over the land. Land acquisition should never involve the use of force or coercion.

In order to strengthen the firm's commitment to land rights, it should require that investees ensure contract transparency and disclosure to affected communities for any concession agreements/operation permits; avoid exposure to production models that involve the transfer of land rights away from small-scale producers; comply with all applicable laws and regulations pertaining to land including social and environmental requirements; and apply ESG policy commitments as a required code of conduct for all downstream business relationships with suppliers, with regular auditing of the policy accordingly.

Avoid corruption, tax evasion and money laundering

As Blackrock CEO Larry Fink has noted, "At companies where ESG issues are handled well, they are often a signal of operational excellence."^{lxxxix} Conversely, failures or missteps in environmental and social practices may easily go hand-in-glove with failures in governance, or worse. As previously mentioned, land-related corruption is common in the countries where palm oil is produced, and is a common feature of land grabs.

Some forms that corruption commonly takes include false or improper permitting enabled by local officials, land leases that fail to recognize or effectively extinguish community land rights and titles, and pay-outs to officials or community members to act in the interests of foreign businesses. In 2011, an Indonesian government analysis found that 81 percent of oil palm plantations in Central Kalimantan were operating without proper permits,^{lxxx} and a September 2014 study by Forest Trends and Chatham House, which focused on one regency in that province, found an 89 percent rate of illegality in 32 plantations surveyed.^{lxxxi}



Residents of Suka Jaya Village in Central Kalimantan, Indonesia holding titles to their lands that they claim were stolen by a palm oil company, September, 2015.

Photo: Victor Barro/FoE Spain

Asian Agri's Tax Scandal

In December, 2012, the Indonesian Supreme Court found Asian Agri Group – one of the largest palm oil conglomerates in Asia – guilty of tax evasion by fourteen of its palm oil companies. In addition to demanding payment of approximately \$115 million still owed in taxes, the Supreme Court levied a fine of \$230 million USD against the company.^{lxxxii} These fantastic amounts made this incident the largest of its kind in Indonesia's history.^{lxxxiii} The tax evasion occurred between 2002 and 2005, but was not detected for years; when journalist Metta Dharmasaputra brought the facts to light, he faced enormous political pressure – including possible arrest – to bury the story. The case is fully detailed in Metta Dharmasaputra's 2014 book, *Key Witness*.^{lxxxiv}



Vincentius Amin Santoso, Asian Agri's finance controller, was arrested for embezzlement, and then became the whistleblower who uncovered years of tax fraud by the company.

Photo: Tempo/Muradi

Companies should be committed to ethical conduct in all business operations and transactions and should have a zero tolerance policy for corruption and tax evasion in all their forms. Therefore, an equity investor's due diligence should look for adequate internal controls, ethics and compliance programs or measures for the purpose of preventing and detecting bribery. They should inquire into the use of ownership structures that are clearly meant to avoid the payment of taxes in the country where the production activities are taking place. They should actively question the conditions under which lands have been purchased or leased, including requiring documentation that free, prior and informed Consent has been granted by local rights-holders. Investors should be cognizant of efforts by potential investees to secure exemptions from the statutory or regulatory frameworks

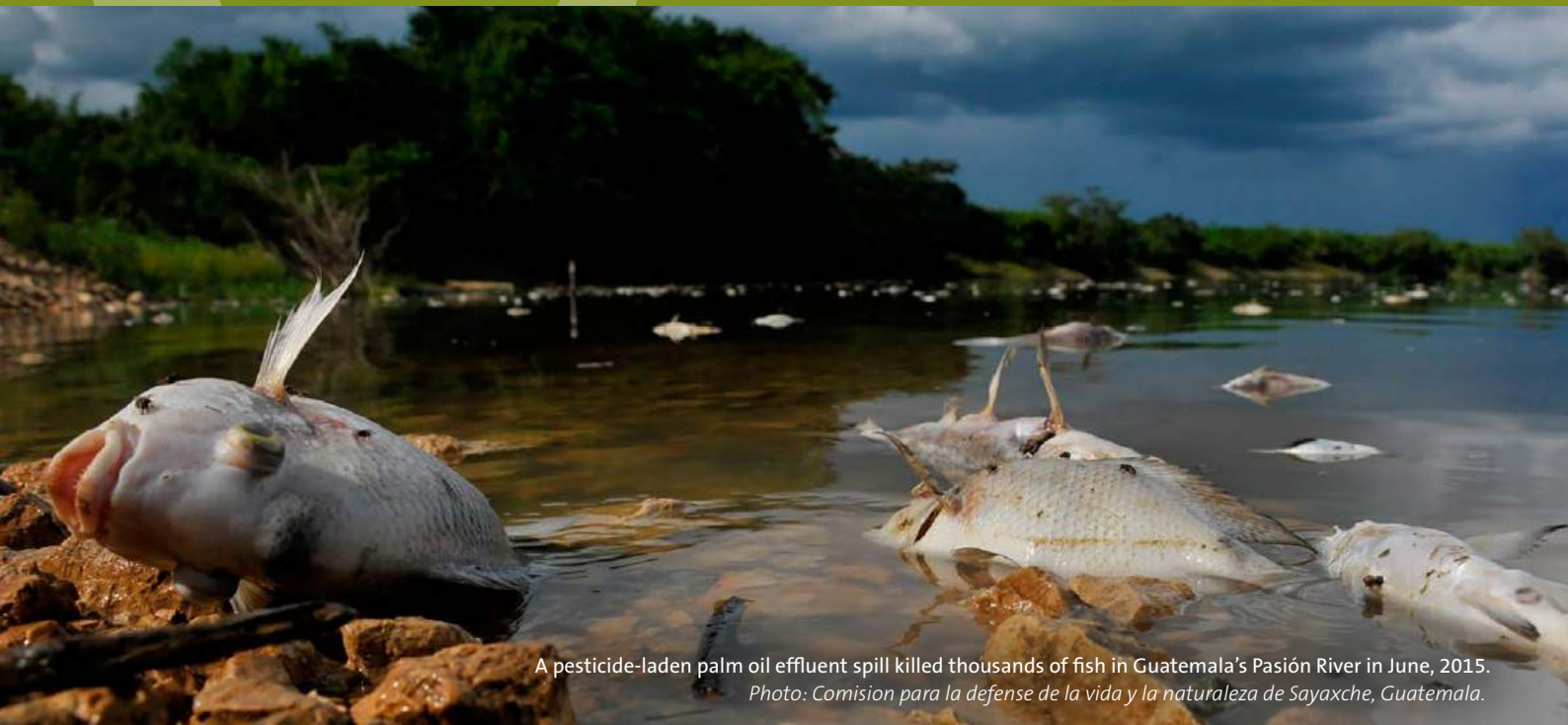


Questions Institutional Investors should ask of palm oil investee companies

- Investors should require that palm oil companies have credible and robust No Deforestation, No Exploitation commitments, and clear plans for ongoing implementation of these policies across their supply chains and company groups. The company should also have a clearly documented “non-compliance” process for terminating relationships with suppliers that fail to adhere to sustainability standards over time. Under what conditions are non-compliant suppliers penalized?
- Companies should identify, map and establish procedures for the protection of High Conservation Value (HCV) and High Carbon Stock (HCS) areas, and should refrain from any logging or conversion within their land bank pending the outcomes of HCV and HCS studies. Areas identified as HCV/HCS should be placed under a strict forest conservation plan, taking ecosystem functions and biodiversity into account, in partnership with credible conservation organizations and local communities. What third party and independent certifiers does the company employ to ensure protection of HCV/HCS areas?
- Size of land bank area, planted and unplanted. What plans does the company have to purchase or lease more lands
- What plans does the company have for plantation expansion? How is the company making best productive use of existing land banks?
- Are there local communities and indigenous peoples in the areas where the company operates? What is the company’s relationship with these companies like? Have there been conflicts? If so, how have they been resolved? What third party entities, civil society groups or government agencies are involved?
- How does the company implement its practice of Free Prior and Informed Consent (FPIC), and how are FPIC procedures documented in all areas where the company has land? The company should maintain documentation that Free, Prior and Informed Consent has been granted by local rights-holders. If FPIC has not been explicitly granted in a given area, how does the company justify its continued presence?
- Are there current, legally acquired permits for all land where the company operates and production permits for all land the company has in production? Are there any questions regarding whether these permits were acquired through legal means?

- Have Social and Environmental Impact Assessments (SEIA) been carried out for all company operations? Is there documentation to show that affected communities have fully and meaningfully participated in the SEIA process?
- The company should have supply chain maps showing all plantations, mills, refineries and other facilities used in the company’s operations, and should publish these maps on a publicly accessible website.
- What are the company’s employment and contracting policies and procedures? Is there third party verification that these policies and procedures are actively adhered to?
- Are there active labor disputes? If so, how are they being resolved? Which third party entities, unions, or government agencies are involved?
- Which outstanding grievances have been filed against the company, and in what venues (i.e., through a company level grievance mechanism, a multilateral development bank accountability process, etc.)? If so, how are they being resolved? Which third party entities, civil society groups or government agencies are involved?
- Governance concerns: who is the company’s beneficial owner and what is that person or entity’s relationship with the company’s operations?
- Company financial structure: does the company maintain offshore accounts, subsidiaries, joint ventures?
- What internal controls, ethics and compliance programs or measures exist for the purpose of preventing and detecting bribery?

Beyond requiring the company to provide all the relevant documents to prove it is compliant, potential investors should also periodically consult affected communities, civil society organizations, governmental bodies and other experts. Such periodic “reality checks” can considerably influence investors’ understanding of changing dynamics on the ground.



A pesticide-laden palm oil effluent spill killed thousands of fish in Guatemala's Pasión River in June, 2015.
Photo: Comisión para la defensa de la vida y la naturaleza de Sayaxché, Guatemala.

3. Exclude bad actors

Since the establishment of socially responsible investing, several asset classes and geographies have become subject to exclusion from investment portfolios, either voluntarily or as mandated by law. These include conflict minerals, tobacco, arms, and products or resources from certain volatile and high-risk countries. However, U.S. equity investors are loathe to exclude companies from their portfolios. Most, if not all, favor engagement to drive improvement of performance, be it financial or ESG performance.

Investors regularly debate the efficacy of taking the negative approach of exclusion versus the positive incentives to be gained from engagement with problem companies. One argument in favor of exclusion is that, without the “stick” of an investors’ willingness to withdraw financing, the “carrot” of positive engagement may be less effective. Especially when it comes to investments in emerging markets where most U.S. financiers have relatively small stakes, and where engagement is both costly and uniquely challenging due to cultural, political, and informational barriers, the possibility of exclusion and the benefits it brings, especially in questions of ESG risk, may outweigh the perceived advantages of engagement.

In the framework of our ‘four pillars of responsibility’, the rationale for exclusion is that certain companies, and arguably, certain sectors, are intractable and are inextricably tied, through their business models, to ecological destruction and social exploitation. Therefore, if taken seriously, a firm-wide commitment to deforestation-free and exploitation-free finance will invariably lead to the exclusion of “bad actors” from a responsible investment portfolio. Indeed, rather than being perceived as a loss of market share, exclusion of bad actors should be viewed as an indicator of a serious commitment, as well as a risk mitigation strategy.

Far and away the leading example of this approach is the \$880 billion USD Norwegian Sovereign Wealth Fund,^{lxxxv} which has excluded dozens of palm oil companies from its portfolio. In April 2013, the fund announced zero tolerance for investments in deforestation and social conflict and divested from 23 palm oil companies because of their unsustainable business practices.^{lxxxvi} In mid-2015, the fund excluded an additional four companies,^{lxxxvii} showing an ongoing commitment to its deforestation-free and exploitation-free finance. An example that may be more pertinent to private sector investors, also from Norway, is that of the private insurance firm, Storebrand, which has blacklisted dozens of palm oil companies for breaching its sustainability standards.^{lxxxviii}

When bad actors are excluded from investment portfolios, it should be done as publicly as possible in order to maximize the reputational benefits to the firm and the reputational risks to any other firms that may consider investing in the entity. Financial firms should develop and publish an exclusion list of companies that the firm will not finance until and unless they come into sustained and documented compliance with the investor’s deforestation and land grabbing policies.

Companies from which the Norwegian Government Pension Fund Global has completely divested

Divested in 2016:

Kulim Malaysia, [Malaysia](#)
First Pacific, [Hong Kong](#)

Divested in 2015:

IJM Corporation Berhad, [Malaysia](#)
Genting Berhad, [Malaysia](#)
Posco, [South Korea](#)
Daewoo International Corp, [South Korea](#)

Divested in 2012:

Astra International Tbk PT, [Indonesia](#)
Berjaya Corp Bhd, [Malaysia](#)
Boustead Holdings Bhd, [Malaysia](#)
First Resources Ltd, [Singapore](#)
Genting Plantations, [Malaysia](#)
Golden Agri-Resorces Ltd, [Singapore](#)
Indofood Agri Resources Ltd, [Indonesia](#)
Kuala Lumpur Kepong Bhd, [Malaysia](#)
Ta Ann Holdings Bhd, [Malaysia](#)
United Plantations Bhd, [Malaysia](#)
Wilmar International Ltd, [Singapore](#)
WTK Holdings Bhd, [Malaysia](#)

Divested in 2011:

Astra Agro Lestari Tbk PT, [Indonesia](#)
Bakrie Sumatera Plantations Tbk PT, [Indonesia](#)
Bakrie & Brothers, [Indonesia](#)
Hap Seng Plantations Holdings, [Malaysia](#)
IJM Plantations Bhd, [Malaysia](#)
IOI Corp Bhd, [Malaysia](#)
Kim Loong Resources Bhd, [Malaysia](#)
Medco Energi International, [Indonesia](#)
Perusahaan Perkebunan London Sumatra, [Indonesia](#)
PPB Group Bhd, [Malaysia](#)
Sarawak Oil Palms Bhd, [Malaysia](#)
Tradewinds Plantations Bhd, [Malaysia](#)
TSH Resources, [Malaysia](#)

Divested in 2010:

Barito Pacific Tbk PT, [Indonesia](#)
Oriental Holdings Bhd, [Malaysia](#)
Sampoerna Agro, [Indonesia](#)
United Malacca Bhd, [Malaysia](#)
YNH Property Bhd, [Malaysia](#)



A few palm oil companies excluded by the Norwegian Sovereign Wealth Fund

Ta Ann Holdings (TAH:MK)

Ta Ann, a Malaysian timber and forest resource company is in the process of clear cutting at least 250,000 acres of tropical forest in Sarawak, and is the major driver of logging operations destroying large areas of old growth and high conservation value forests in Tasmania. When the Norwegian Government Pension Fund blacklisted Ta Ann “due to an unacceptable risk of the company being responsible for severe environmental damage,” the Fund’s Council on Ethics stated that “there can be no doubt that [this destruction] will have serious, irreversible consequences for biodiversity and the ecosystem services delivered by the forest.”

More information:
<http://taann.net/who-is-ta-ann/>

Golden Agri-Resources (GGR:SP)

Golden Agri-Resources Ltd (GAR) is the world’s second largest palm oil plantation company and is a subsidiary of the massive Sinar Mas conglomerate. In December 2009, Unilever ended its contracts with GAR; Mars, Nestlé and Burger King, Carrefour, Gucci, H&M, Hugo Boss, Volkswagen, Fuji Xerox, Ricoh, Sainsbury’s, Marks & Spencer and Tesco soon followed – all due to serious history of deforestation and human rights exploitation.

After years of pressure from environmental groups, in 2011, the company began working with The Forest Trust (TFT) to implement a “no deforestation footprint” policy. In March 2014 it announced that it would extend its forest conservation policy to third-party suppliers. However, abuses continue: In 2014, GAR subsidiary PT KPC was found to have cleared and planted community lands against community objections in West Kalimantan. GAR subsidiary PT BNM has been in conflict with indigenous communities in West Kalimantan since 2008, and has repeatedly cleared and bulldozed community lands.

In Liberia, where GAR subsidiary Golden Veroleum has 220,000 ha of palm oil concessions, The Forest Trust (TFT) has confirmed allegations of land clearing without consultation, pollution of community water sources, and destruction of cultural and spiritual sites. An analysis of the concession agreements between the Liberian government and Golden Veroleum concluded that the company “failed to ensure compliance with their corporate responsibility to respect human rights.”

As of March 2016, it appears that GAR may be pulling out of Liberia, due to “lingering disputes with villagers” and poor prospects for generating profits after spending US\$290 million since 2010.^{lxxxix}

More information:

http://www.banktrack.org/show/companyprofiles/golden_agri#tab_companyprofiles_issues

<http://www.forestpeoples.org/sites/fpp/files/publication/2014/01/pt-kpc-report-january-2014final.pdf>

Kuala Lumpur Kepong (KLK:MK)

KLK, Malaysia’s third largest palm oil plantation company, is involved in four cases of serious abuse spanning several countries. KLK partner Equatorial Palm Oil destroyed community crops, forest reserves and sacred sites on land held by eleven villages under customary law in Liberia. After company guards assaulted community members, the communities filed formal complaints before every authority in Liberia, and have been trying to kick the company out of Liberia. In Indonesia, KLK subsidiary PT Adei is on trial for deliberately setting forest fires that led to record-setting air pollution levels in 2013, and KLK employees face jail time for their role in the fires. Two other KLK plantations are charged with threatening endangered Bornean Orangutans in violation of national law, and still others have revealed gross violations of basic labor rights, use of child labor, and conditions amounting to modern day slavery -- allegations that earned KLK a feature in a BusinessWeek titled, “Indonesia’s Palm Oil Industry Rife with Human-Rights Abuses.”

More information:

<http://chainreactionresearch.com/2014/05/30/analysis-on-kuala-lumpur-kepong-klk-kuala-lumpur-and-papua-new-guinea/>

http://www.banktrack.org/show/companyprofiles/kuala_lumpur_kepong#tab_companyprofiles_issues

Wilmar International (WIL:SP)

Through a raft of subsidiaries, Singapore-based Wilmar International holds a land bank of over 1,500,000 acres in Malaysia, Indonesia, West Africa and the Congo basin. Together with its refining and trading businesses, Wilmar’s operations account for about 45 percent of all globally traded palm oil. Wilmar recently gained a measure of praise from the environmental community for its 2013 commitment to ‘No Deforestation, No Peatland Destruction, No Exploitation’, though the company failed to meet its declared deadline of December 2015 to achieve full implementation of the policy. Immediately prior to the announcement of

A few palm oil companies excluded by the Norwegian Sovereign Wealth Fund

this commitment, however, Newsweek ranked Wilmar the world's worst company in terms of environmental performance for two years running, due to its long history of land-grabbing, fueling of social conflicts, illegal burning of peatlands, forests and endangered habitat; failure to adhere to the law, and other abuses.

The list of human rights and environmental concerns tied to Wilmar includes Wilmar's association with companies burning and planting within Sumatra's protected Tesso Nilo Forest Complex; complaints against Wilmar subsidiary PT Mustika Sembuluh for taking over customary lands, water pollution and ongoing land disputes; charges that another subsidiary, PT Permata Hijau Pasaman I, bribed local authorities; and involvement by Wilmar supplier PT SIL in ongoing violent conflict with villagers in Bengkulu, Indonesia. In Africa, Wilmar is charged with failure to engage in full consultation with affected communities and failure to produce an environmental impact assessment before establishing 50,000 acres of palm oil plantations in Nigeria, and with violating customary rights in its joint venture in Uganda. During the fires of summer and fall, 2015, plantations in Central Kalimantan, Indonesia owned by Wilmar and one of its largest suppliers, Bumitama Agri Ltd, were found to have significant fire hotspots on peatland areas that had formerly been protected under a presidential decree.^{xc}

In January, 2016, Wilmar International released an assessment of its progress in implementing its 'No Deforestation, No Peatland Destruction, No Exploitation', in which it acknowledged that much more remained to be done. Among the concerns is that even after two years of efforts to make its supply chain more transparent, the company cannot prove that its suppliers are not responsible for ongoing deforestation.

More information:

http://libcloud.s3.amazonaws.com/93/7b/3/3078/Issue_Brief_5_-_Wilmar_in_Uganda.pdf

http://libcloud.s3.amazonaws.com/93/95/4/4719/FOEE_wilmar_factsheets_eng_US_letter_lr.pdf

http://webiva-downton.s3.amazonaws.com/877/22/9/6057/FOE_ExploitationAndEmpty_LOWRES_rev.pdf

http://webiva-downton.s3.amazonaws.com/877/87/4/6987/Up_in_Smoke_hr.pdf

<http://www.theguardian.com/sustainable-business/2016/jan/26/worlds-largest-palm-oil-trader-criticised-progress-deforestation-wilmar>

Felda Global Ventures (FGV:MK)

Felda Global Ventures, a Malaysian company, is the world's largest producer of crude palm oil, with operations in ten countries. Felda is a member of the Roundtable for Sustainable Palm Oil (RSPO) and supplies a number of multinational companies including Cargill, Nestlé and Procter & Gamble. In July, 2015, a Wall Street Journal investigation reported serious allegations of abuses of migrant workers rights at Felda Global Ventures palm oil plantations in Malaysia.^{xcii} Allegations involved links with human traffickers, violence, exploitation and lack of payment of workers. After the report, a coalition of NGOs called on the Malaysia government, the RSPO and those international companies to open an investigation into the allegations.^{xciii} Felda has denied all allegations. Cargill, Nestlé and Procter & Gamble have said they were unaware of the abuses and will investigate. As of this writing, we are unaware of any legal investigation.

In late 2014, Felda Global Ventures acquired several plantations in Sarawak, Malaysia through its acquisition of Asian Plantations Ltd., a Singapore based holding company for Malaysian companies with plantation leases. Researchers have shown how Asian Plantations Ltd.'s subsidiaries in Malaysia systematically acquired forested land for below market value from political insiders, removed the tree cover, and installed oil palm plantations.^{xciii} Analysts estimate that Asian Plantations had cleared at least 12,000 hectares of forest, and the acquired land areas contained about 5,600 of uncleared forests.^{xciv} A 2015 assessment of the High Conservation Value areas on the property FGV acquired from Asian Plantations Ltd. found evidence of multiple endangered species and sites of cultural significance.^{xcv} Proceeds from the Asian Plantations Ltd. sale to FGV have been linked to massive, new illegal deforestation in the Peruvian Amazon.^{xcvi}

More information:

<http://business-humanrights.org/en/malaysia-migrant-workers-abuses-reported-at-felda-palm-oil-plantation-supplying-us-companies>

<http://www.wsj.com/articles/palm-oil-migrant-workers-tell-of-abuses-on-malaysian-plantations-1437933321>

http://eia-global.org/images/uploads/EIA_Peru_Palm_Report_APRIL_7.pdf

Issue exclusion list

Every firm should develop its own issue exclusion list consistent with its ESG commitment, outlining that the firm will not finance, underwrite securities, manage assets or advise companies whose production, sourcing or selling activities involve a clearly delineated set of concerns. Some of the top issues of concern in the forest and palm oil sector would include the following:

Illegality – Non-compliance with local, national and international norms, regulations, laws and conventions.

Human rights abuses – Human rights abuses include but are not limited to assault, intimidation, the employment of private militias and other direct and indirect forms of physical coercion and abuse.

Lack of an Environmental and Social Impact Assessment – A lack of an independent Environmental and Social Impact Assessment, including participation of all relevant stakeholders and duly approved by the competent authorities when this is required by law.

Lack of Free Prior and Informed Consent – Operations for which the client has not obtained free, prior and informed consent (FPIC) from all affected communities.

Forced relocation or involuntary resettlement – The involuntary resettlement by use of threat to their personal safety of any number of people, whether full or partial, permanent or temporary, physical or economical, that are dependent for their livelihoods on the area that will be affected by projects of the company seeking financing.

Deforestation and forest degradation including –

- › Loss or degradation of High Conservation Value areas (HCV) as defined by the High Conservation Value Resource Network, or areas needed to maintain one or more HCV areas;
- › Loss or degradation of High Carbon Stock areas (HCS) as defined by the High Carbon Stock Approach Steering Group, or areas needed to maintain one or more HCS areas;
- › Loss or degradation of areas for which independent and peer-reviewed HCV and a HCS assessments have not been completed, according to the methodology set out by the High Conservation Value Resource Network and the High Carbon Stock Approach Steering Group respectively;
- › Loss or degradation of regionally, nationally or internationally protected areas UNESCO Natural World Heritage Sites, UNESCO Man and the Biosphere Reserves, IUCN Protected Areas, Key Biodiversity Areas, and wetlands designated under the Convention on Wetlands of International Importance (the Ramsar Convention) and sites that maintain conditions vital for the viability of these protected areas;
- › Degradation of areas where forest restoration is taking place.



This orangutan, rescued from a plantation in Central Kalimantan, will likely spend the rest of its life behind bars.

Photo: Anouk van Baalen/FoE Netherlands

Photo: Victor Barro/FoE Spain



Rare, threatened and endangered species – The harvesting of, or trading in species that are protected under host country laws or regulations, the CITES convention or that are listed on the IUCN Red List for endangered species.

Genetically Modified Organisms – The introduction of genetically modified trees or crops.

Invasive alien species – The introduction of invasive alien species.

The use of fire – The use of fire for the conversion of land for commercial plantations. (Note: Fire is part of the natural dynamics of some forest ecosystems, but this should never be confused with the application of fire to clear land for development.)

Food crops for biofuels – The production of biofuels made from food crops. (The use of food crops, including soy, palm oil, and corn, for biofuels, by increasing aggregate demand, drives direct and indirect land use change, leading to further deforestation risks, particularly in tropical regions. In addition, when food crops are used as biofuel feedstock, this puts upward pressure on food prices, with negative impacts on food nutrition and food security, particularly among the urban poor.)

The use of toxic substances – The production, trade in, or use of any product deemed illegal under host country laws and regulations or international conventions and agreements, even if the host country has not signed these agreements.

Exploitation of labor – The use of child labor, forced labor, debt bondage or any other form of exploitation of labor force. For a comprehensive list of labor rights considerations, see *Free and Fair Labor in Palm Oil Production: Principles and Implementation Guidance*.^{xcvii}

Corruption and tax evasion – Involvement in corruption or the elaboration of ownership structures that are clearly meant to avoid or evade the payment of taxes in the country where the production activities are taking place.

Association with companies involved in any of the above mentioned issues – sourcing forestry or agricultural commodities from third parties that are involved in activities named in this exclusion list, or association with these activities through parent companies, subsidiaries or company groups.

4. Repair

The UN Guiding Principles are clear on the need for businesses to provide “access to remedy” in the event of human rights impacts, but the challenge of doing so has yet to be widely taken up. Directly providing remedy may be beyond the purview of equity investors, but investors should ensure that the companies they finance are held to account and have clear mechanisms in place to resolve grievances and restore landscapes that have been destroyed or unduly degraded.

To help repair damage that has been done, investors should:

- commit, as previously stated, to ensuring justice for affected communities by requiring all investees in sensitive regions to undertake independent third-party social, environmental and human rights impact assessments;
- commit to analyze on a regular basis patterns of grievances in order to derive conclusions that will lead to better remediation in the future.
- require all investees to maintain robust, fully-staffed, transparent grievance mechanisms and access to remedy, with time-bound processes to systematically respond to crises and concerns. Company self-managed grievance processes are fundamentally less robust than external mechanisms,^{xcviii} as well as less trustworthy, as they suffer from the structural concern that they are owned and operated by the same company that caused the grievance in the first place. However, to put it bluntly, they are better than nothing, and they can serve to mitigate risks and to indicate a company’s willingness to take responsibility for its impacts. The third-party ESG processes that do apply to the finance sector, such as the Organization for Economic Co-operation and Development (OECD) National Contact Point process under the OECD Guidelines for Multinational Enterprises, have little capacity for enforcement and even rarer facility for providing remedy.^{xcix}
- require investee companies to have a compensation and mitigation plan for all agreed land acquisitions, relinquishments of rights, reduced food security, loss of shelter and other structures, loss of assets of cultural, spiritual and other social importance, loss of income sources and other impacts, and to commit to remediation, mitigation and ongoing monitoring of any such cases to ensure human rights and legal abuses do not reoccur. This plan should cover all impacts, whether caused directly by the project or by activities that are related to the project, and should ideally be financed through a “compensation bond” – a pool of money reserved for covering the costs of compensation.



Plantation worker fighting a peat fire, Central Kalimantan, Indonesia, September 2015.
Photo: Victor Barro/FoE Spain



Such a plan should also address the needs of all the displaced people, whether permanent or temporary, physically or economically, as well as the needs of the host communities. Where a company has pulled out of the investment, investors should follow-up with communities and their advocates to support meaningful redress proportional to the firm's role as a stakeholder. The company should consult extensively with all affected communities and relevant stakeholders to receive input for these plans and give full consideration to the options preferred by them.

- develop and support the ability of project-affected small-holders, forest-dependent communities and women to improve forest management, strengthen food security, increase diversified local sources of income and advance resilience and sustainable development goals.
- require investee companies to maintain policies and capacity to restore landscapes that have been destroyed or unduly degraded. While it has yet to be fully implemented in practice, a good example of such a policy is embedded in Wilmar International's No Deforestation, No Peat, No Exploitation policy: "Where Feasible, [Wilmar will] explore options for peat restoration by working with expert stakeholders and communities as crops planted on peat meet the end of their current rotation, Wilmar will explore options for the long-term restoration of peat land and peat forest."

Finally, at the broadest level, "repair" implies shifting investments from industries with destructive footprints toward sectors that proactively address climate risk and associated human rights impacts.

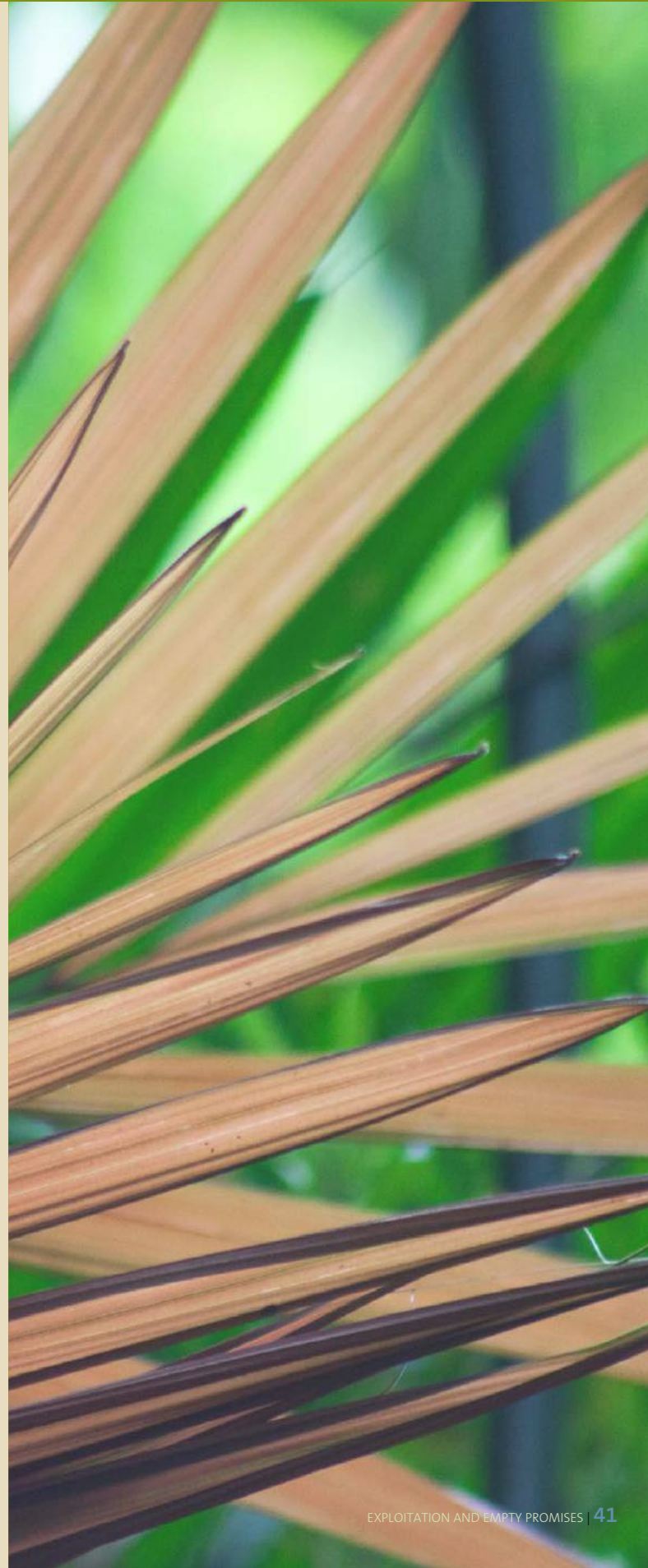


4

Conclusion

Financial institutions and their clients that operate in the sectors that drive deforestation and land grabbing have been responsible for unquantifiable ecological damage and social conflict. But these impacts can be minimized and transformed, if financial institutions commit to taking responsibility, and ensuring that their clients comply with responsible forest practices and respect the rights of local and indigenous communities. They will otherwise remain vulnerable to claims of being complicit in environmental and social harms.

The only way that financial institutions with exposure to these risks can confidently fulfill their range of responsibilities is if they themselves **disclose** their palm oil and forest sector relationship, **commit** to forest-sector policy standards and robust due diligence procedures, **exclude** specific impacts and bad actors, and **repair** past social and environmental damage.



Endnotes

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- ^{viii} <https://www.transparency.org/cpi2015#map-container>
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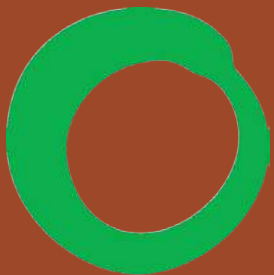
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for the people

for the planet

for the future



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