

Why cheap palm oil is a price the planet can't pay



Palm oil can be found in everything from food to soap. Strong demand and high yields make it an attractive crop for growers, but the clearing of tropical rainforest for palm oil plantations is a major contributor to climate change and biodiversity loss.

Setting the scene

Tropical rainforests are home to more than half¹ the world's plant and animal species. They also play a vital role in climate change mitigation by storing carbon and absorbing a third of the carbon released from burning fossil fuels every year. But the rate of deforestation rose in Asia, Africa and Latin America during the Covid-19 pandemic, with extensive monocropping for palm oil production one of the main causes of deforestation alongside urbanisation, cattle ranching, soybean production and logging.

Demand for palm oil continues to grow due to its cheapness and versatility, as it can be used in everything from household cleaning products to ice cream, while growers benefit from high yields. But the removal of tree cover from peatland, often carried out in Southeast Asia for palm oil plantations, releases highly concentrated carbon stores. Halting and reversing tropical deforestation is therefore essential if we are to avoid the consequences of severe climate change and biodiversity loss.

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The UK supermarket chain Iceland had to temporarily revert to using palm oil in some of its own-brand products this year, after Russia's invasion of Ukraine sent the price of sunflower oil soaring.² Iceland has tried to remove palm oil from its staple products since 2018, but the difficulties it encountered have underscored the ubiquity of palm oil and the scale of the challenge.

Palm oil is used in 70% of cosmetic and personal hygiene products, including soap bars, toothpaste and face creams. It is also a key ingredient in staple foods such as bread and margarine, as well as treats such as chocolate, ice cream and biscuits due to its creamy texture and absence of odour. Its natural preservative qualities help to extend the shelf life of food products, reducing waste. It can be used in the production of biodiesel and biofuel for cars and power plants, and is a primary cooking oil in many Asian and African countries.

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¹ <https://education.nationalgeographic.org/resource/rain-forest>

² <https://www.theguardian.com/business/2022/mar/28/iceland-reverts-to-palm-oil-with-regret-as-ukraine-war-hits-food-prices>

This diversified demand makes it an attractive cash crop for low and middle-income nations such as Indonesia and Malaysia. These two countries account for around 84% of all palm oil production globally, according to US Department of Agriculture data.³

It is also appealing to growers in tropical regions because palm trees produce between four and 10 times more oil than other crops per unit of cultivated land, and consume less water in the process. Alternatives such as sunflower or coconut oil are likely to result in even greater environmental damage as more land would have to be cleared to produce the same amount of oil.⁴

Palm oil's high yield makes it the cheapest vegetable oil on the market. This is important to food manufacturers trying to keep consumer staples within the reach of strained household budgets as the cost of living crisis continues. Eradicating palm oil from staple foods and household products may therefore be neither achievable nor desirable. But this \$64bn growth industry⁵ poses an existential threat to life on earth.

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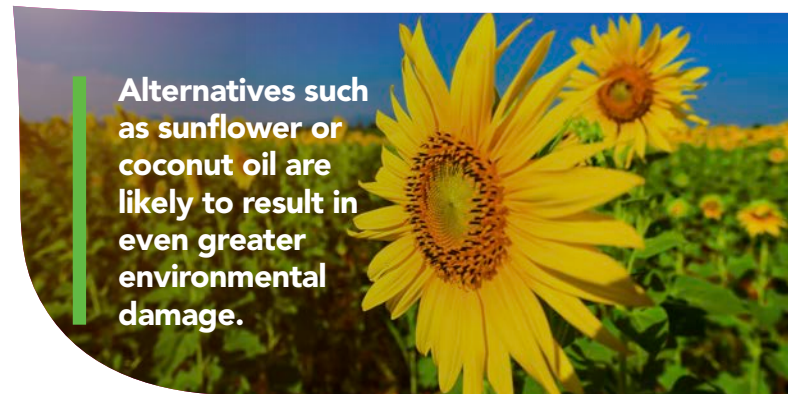
10 times more oil than other crops per unit of cultivated land, and consume less water in the process.

The climate and biodiversity impacts of deforestation

The insatiable demand for palm oil exacts a steep environmental toll, despite its more efficient use of acreage. In Indonesia and Malaysia, the clearance of tropical forests for palm oil plantations accounted for 47% and 16% of all deforestation respectively, between 1972 and 2015.⁶ Deforestation fuelled by palm oil plantations has also expanded in some parts of Africa in recent years, as Ghana, Cote d'Ivoire and the Democratic Republic of Congo have embraced the crop.

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Of course, palm oil isn't the only contributor to deforestation. Over two-thirds of the habitat loss in Brazil and Argentina is driven by beef and soy production, with soy grown primarily for animal feed.⁷ Deforestation in the Amazon rainforest surged to a 12-year high under Brazil's President Bolsonaro,⁸ and the Amazon is now a net emitter of CO₂.⁹



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Deforestation contributes to climate change and biodiversity loss, with about 22% of anthropogenic greenhouse gas emissions coming from agriculture, forestry and other land use, according to the Intergovernmental Panel on Climate Change.¹⁰ Forests absorb carbon dioxide from the atmosphere, providing a valuable carbon store, while producing oxygen during photosynthesis. Clearing and burning forests releases carbon dioxide back into the atmosphere.

Forests are also home to an estimated 80% of the world's plant and animal life, including endangered species such as the orangutan, Bornean elephant and Sumatran rhino.¹¹ Addressing climate change and biodiversity loss go hand-in-hand.

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Although the impacts of global heating and deforestation are clear, the 2022 Forest 500 report¹² found that too many of the most influential companies were still failing to act. The ranking by UK charity Global Canopy found that 72% of the 350 companies assessed did not have a deforestation commitment for all the forest-risk commodities in their supply chains.

Even when companies had made commitments, many failed to provide evidence of how they were implementing these, the report noted. The finance sector was a notable laggard, with 93 of the 150 most exposed financial institutions without a deforestation policy covering their investments and lending to companies in key forest-risk commodity supply chains.

³ <https://ipad.fas.usda.gov/cropexplorer/cropview/commodityView.aspx?cropid=4243000>

⁴ <https://rspo.org/about#about-sustainable-palm-oil>

⁵ Palm Oil Market Size & Share Report, 2022 - 2030 (grandviewresearch.com)

⁶ ZSL

⁷ <https://www.worldwildlife.org/magazine/issues/summer-2018/articles/what-are-the-biggest-drivers-of-tropical-deforestation>

⁸ <https://www.theguardian.com/environment/2020/dec/01/amazon-deforestation-surges-to-12-year-high-under-bolsonaro>

⁹ <https://www.theguardian.com/environment/2021/jul/14/amazon-rainforest-now-emitting-more-co2-than-it-absorbs>

¹⁰ <https://www.ipcc.ch/srccl/>

¹¹ <https://www.worldwildlife.org/places/borneo-and-sumatra>

¹² <https://forest500.globalcanopy.org/>

¹³ <https://www.consilium.europa.eu/en/press/press-releases/2022/06/28/council-agrees-on-new-rules-to-drive-down-deforestation-and-forest-degradation/#:~:text=The%20Commission%20published%20its%20proposal,the%20scope%20of%20the%20regulation;https://chainreactionresearch.com/report/eu-deforestation-regulation-implications-for-the-palm-oil-industry-and-its-financers/>

¹⁴ <https://www.gov.uk/government/news/government-sets-out-plans-to-clean-up-the-uks-supply-chains-to-help-protect-forests>

¹⁵ <https://www.gov.uk/government/news/over-100-leaders-make-landmark-pledge-to-end-deforestation-at-cop26>

Regulatory risk

As well as the twin systemic risks of climate change and biodiversity loss, companies could face regulatory, financial and reputational risks by failing to act. New EU¹³ and UK¹⁴ legislation will introduce mandatory due diligence rules, ensuring that operators and traders assess their exposure to illegal deforestation in their supply chains. We responded to the UK government’s consultation on this, supporting the proposal to ensure companies use forest risk commodities that have been sourced in accordance with the relevant laws in the country where they are grown.

But we stressed that the legislation should be applicable to a wide range of companies and not just a small number of large companies, which may already have a due diligence process in place. We also emphasised the importance of going beyond legality, referencing some countries where governments are attempting to deregulate, which may increase the risk of accelerating deforestation.

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Our engagement approach

The critical role of nature in climate change adaptation and mitigation was recognised at COP26, with some 130 countries agreeing to halt and reverse forest loss and land degradation by 2030.¹⁵ In support of this pledge, Federated Hermes Limited (FHL) endorsed the financial sector’s commitment letter on eliminating commodity-driven deforestation, also released at COP26. This requires FHL to make best efforts to eliminate commodity-driven deforestation from its portfolios, principally through active ownership, ongoing stewardship, and other measures, including public policy advocacy.

We expect companies to take responsibility for deforestation in their supply chains, including monitoring the risk and going beyond certification to trace commodities back to their source.

To this end, EOS will engage with relevant companies including palm oil producers, processors, traders, consumer goods and retail companies, and banks providing financing. We already ask companies to ensure that the components for their products are not derived from deforested areas. We expect companies to take responsibility for deforestation in their supply chains, including monitoring the risk and going beyond certification to trace commodities back to their source.

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Companies that source palm oil, soy, beef, leather, pulp and paper, amongst other relevant commodities, must commit to clear timelines for eliminating deforestation from their supply chains. This commitment should cover all commodities, regions and suppliers, including indirect suppliers. We expect companies to communicate a clear strategy for how a deforestation-free supply chain will be achieved through implementation measures, monitoring, independent verification and collaboration. Companies that can achieve traceability of commodities back to source will be best placed to achieve a deforestation-free supply chain.

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For palm oil, we include a commitment to no deforestation, no expansion on peat and no exploitation (NDPE) in our expectations for companies and banks. No exploitation means addressing the risk that communities and workers may be exploited by palm oil producers. When land is cleared for palm plantations, disputes can arise with local communities over access to resources, meaning that companies may be directly or indirectly responsible for human rights violations.¹⁶ It can be difficult to resolve legacy issues related to the absence of free, prior and informed consent (FPIC) in older plantations, so it is important to have a process to address land conflict where it is too late for FPIC.



Companies should also carry out human rights due diligence to monitor labour practices and working conditions to ensure that employees earn a living wage, there is good health and safety on site, and no modern slavery or child labour exists anywhere in the supply chain.¹⁷ Palm oil produced under an NDPE policy may be described as sustainable, as NDPE¹⁸ goes beyond legal or certification requirements (see box, page 9), although some leakage still occurs.

¹⁶ <https://www.hrw.org/report/2019/09/23/when-we-lost-forest-we-lost-everything/oil-palm-plantations-and-rights-violations>

¹⁷ <https://www.washingtonpost.com/climate-environment/2021/10/09/png-palm-oil-undercover-sting/>

¹⁸ <https://chainreactionresearch.com/report/ndpe-policies-cover-83-of-palm-oil-refineries-implementation-at-75/>





Posco International



We began engaging with South Korea's Posco International on sustainable palm oil in 2016. This followed a divestment by a major pension fund in 2015 and severe criticism of the company by NGOs over deforestation related to palm oil development in Indonesia.

Following our suggestion, Posco International began a discussion with the Roundtable on Sustainable Palm Oil (RSPO) to develop its sustainable palm oil strategy. In 2017 our engagement intensified, including a joint meeting with the company and NGOs that resulted in a robust discussion about the company's potential commitment to a no deforestation, no peat, no exploitation (NDPE) policy and contribution to reforestation.

In July 2018 the company became a member of the RSPO and committed to a plan to obtain Indonesia Sustainable Palm Oil (ISPO) certification by 2020. In August 2019 this goal was met. We continued to engage, and in March 2020 the company committed to an NDPE policy, promising to preserve areas of high conservation value and high carbon stock. It also said it would implement a programme outside its concessions on a scale that corresponds to the size of the developed plantation. In September 2021 the company achieved RSPO certification for all its plantations and mills, including smallholders.

In an August 2022 virtual meeting with parent Posco, it confirmed that its palm oil subsidiary's NDPE policy was being implemented in close co-operation with the RSPO. According to the company, a large-scale environmental conservation and community development programme has been developed in accordance with RSPO guidelines. This is being carried out by transparently communicating with relevant stakeholders, including indigenous peoples. We verified that the company's human rights grievance mechanisms were available to domestic and overseas workers, as well as people in impacted communities.



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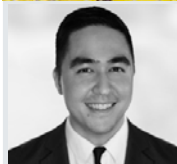
DBS and palm oil financing



We began engaging on palm oil financing with Singapore's largest bank DBS in January 2019. We urged the bank to demonstrate that its palm oil lending criteria were able to meet the latest Roundtable on Sustainable Palm Oil (RSPO) standard for all borrowers, and that it closely monitored implementation. The bank confirmed that its new borrowers were asked to demonstrate alignment with no deforestation, no peat and no exploitation (NDPE) or an equivalent.

We continued to engage, urging the bank to ask its existing borrowers to obtain RSPO certification in September 2020, as this would help to ensure compliance with NDPE through its auditing process. In March 2021, we were pleased to learn that DBS had raised its ESG standards for the palm oil sector, encouraging its customers to apply an NDPE policy throughout the supply chain. Its clients are also asked to achieve full RSPO certification via a time-bound action plan that is communicated to DBS.

The bank pledges not to knowingly finance companies that are involved in the conversion of high carbon stock forests, planting on peat, or planting without securing both the legal right and community support to use all the land involved. DBS has adopted a zero-tolerance approach to forest burning.



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In addition to our in-depth, multi-year engagements on palm oil, we engaged with US food producer General Mills in June, asking if it would commit to being deforestation-free by 2025. The company said that it was working to eliminate deforestation from its key commodities such as palm oil and cocoa, and engages with suppliers to monitor land use change. We also asked Japan's Sumitomo to commit to NDPE, and encouraged it to source 100% certified RSPO palm oil. The company said that one of its consolidated subsidiaries SC Foods obtained RSPO supply chain certification in 2021.

Beyond palm oil, we have engaged with commodity trader Cargill on accelerating its efforts to tackle deforestation associated with soy production in South America. We asked the company to bring forward its time-bound deforestation- and conversion-free commitment from 2030, to 2025 at the latest, in line with best practice and peers.

We have also engaged with Brazilian meat producer JBS on traceability to eliminate deforestation. In 2021, JBS promised to have full traceability of its supply chain in the Amazon by 2025 and in other regions in Brazil by 2030. We followed up in 2022 to discuss the progress made, and learned that in its first year of operation, the tracking system processed 14.8% of the total number of animals. The CEO confirmed JBS's commitment to achieving 100% of the animals processed with full traceability by 2025.

Deforestation considerations in our vote policy

We hold the chair or other responsible directors accountable through voting recommendations where we believe companies' actions are materially misaligned with the goals of the Paris Agreement or where companies are not responding sufficiently to the risks and opportunities posed by climate change. We include a focus on companies that are involved in activities that are clearly incompatible with limiting global warming to safe levels, such as causing deforestation.

In 2021, we recommended voting against directors at companies that were failing to address deforestation risks, including at Yakult Honsha and Li Ning Company. In 2022, we recommend votes against directors at TJX, Kikkoman Corp and WH Group. We also included financial institutions in our policy for the first time, which led to recommended votes against directors at Power Corporation of Canada, Malaysia's Public Bank and Industrial and Commercial Bank of China due to concerns about deforestation.

Public policy advocacy

We are active participants in several industry working groups, including the PRI's Sustainable Commodities Practitioners Group, which explores how the finance sector can address deforestation by sharing best practice. We serve as co-chair of the Engagement and Public Policy Advocacy Working Groups within the Finance for Biodiversity Foundation, where participants commit to protecting and restoring biodiversity through their activities. With a small group of investors, we are also working to establish a Nature Action 100 initiative, which would facilitate collaborative engagements with companies that have the greatest impact on biodiversity.



Certification schemes and their limitations

The Roundtable for Sustainable Palm Oil (RSPO)¹⁹ is the main certification scheme for palm oil operations and supply chains. The strongest level of RSPO certification is Identity Preserved Certified Sustainable Palm Oil (CSPO), which can be traced back to a single certified mill and its supply base.

The Indonesia Sustainable Palm Oil (ISPO) and Malaysian Sustainable Palm Oil (MSPO) certifications are national schemes with less stringent sustainability criteria. NGOs have repeatedly raised questions about the effectiveness of certification schemes given the markets in which palm oil producers operate.²⁰

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We have engaged with Bank Rakyat Indonesia Persero, which in 2022 confirmed it had implemented a mandatory requirement for all small, medium and corporate borrowers in the palm oil plantation sector to be ISPO or RSPO certified. It carries out site visits and checks that borrowers are not clearing land.

We said that we want to see the bank take a leadership position in palm oil financing. This would include a commitment to implementing robust palm oil requirements, in addition to the current standards, a policy of RSPO or NDPE, and free, prior and informed consent financing only. There should also be a requirement for supply chain transparency, the exclusion of leakage palm oil refiners, engagement with local communities, and grievance mechanisms. The company said it was planning to improve its focus in this area.

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¹⁹ <https://rspo.org/about/our-organisation>

²⁰ https://www.greenpeace.org/static/planet4-southeastasia-stateless/2021/10/85efa777-illegal_palm_oil_in_forest_estate.pdf



CASE STUDY

Kuala Lumpur Kepong (KLK)



Malaysia's KLK focuses on the production and processing of palm oil products and natural rubber. It sources primarily from its own plantations in Indonesia, Malaysia and Liberia, but also takes a proportion from suppliers.

We began our engagement in 2012 following the company's lack of response to NGO and media reports alleging its involvement in deforestation in Indonesia, and poor labour conditions and wages. In our first meeting, the company was quite defensive and denied the allegations.

In 2013 further allegations were made about poor labour conditions in the company's supply chain, and we urged KLK to provide clarity on how it was investigating. While KLK was gradually more willing to discuss labour issues, details on policy implementation were still lacking. We continued to raise our concerns in calls and correspondence over the next few years.

Since our initial engagement, KLK has strengthened its labour standards and disclosure, training suppliers on labour standards compliance as part of its commercial contracts, and commissioning external audits of its supply chain. KLK also partnered with a reputable consultant for a human rights impact assessment of its Liberian operations.

In addition, we are part of the Global Canopy Aligned Accountability project, which seeks to bring together existing data sets on deforestation and package this in a more usable way for financial market participants. The aim is to develop a comprehensive, collaborative and open database on company performance on deforestation, aligned with the Accountability Framework, which will provide standardised data. We are supporting this project to refine the development of the database and ensure its relevance for end users.

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The disclosure of the audit findings and action plans have provided greater clarity for investors and other stakeholders. In 2014, the company also achieved 100% Roundtable on Sustainable Palm Oil (RSPO) certification of its Malaysia operation.

In a September 2021 call, we heard that the company had made good progress in tracing mill and refinery third-party supply chains back to plantations. It was open about the challenge of getting to 100% due to the lack of visibility regarding smallholders and challenges in visiting sites due to Covid-19.

We sought more information about how the company ensures that its commitments to no deforestation, no peat and no exploitation (NDPE) are met, especially at third-party plantations. KLK said it has teams based at operating centres (estates) to monitor this. It is also working with a satellite imaging company to monitor plantations and any contravention of its no deforestation, no peat commitment.

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KLK has carried out a third-party assessment of labour standards at some key sites, has published the results and is working on an action plan. It has also implemented improvements for migrant workers. Passports are not retained by the company and workers do not pay recruitment agency fees. It has monitored prevailing wages while waiting for the RSPO to complete the living wages benchmark.

Outlook

Globally, sustaining efforts to halt and reverse deforestation will be critical over the next few years. For EOS, this will mean stepping up our engagement on deforestation and continuing to focus on this topic within our vote policy, escalating where necessary. This systemic issue requires extensive collaboration and political will, so we will continue to conduct advocacy on climate and nature-related topics. From 2023, FHL will disclose its assessment of deforestation risk in its portfolios and its mitigation activities, which will include ongoing engagement.

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