

A person in a grey pinstriped suit is shown from the chest up, holding a silver pen in their right hand and a tablet in their left. The tablet displays a document with text and a landscape image. The background is a vast, hazy landscape under a clear blue sky. The overall image has a semi-transparent overlay.

**Palm oil and sustainability:
like oil and water?**

Expanding world population and rising energy prices, not to mention changes in eating habits, have led to a rapid demand for vegetable oils around the world. However, this comes at a cost; destruction of rainforests, extinction of endangered species and exploitation of large monoculture plantations. All of these are reasons to pay attention to the negative environmental and social aspects of palm oil. However, the financial consequences of the impact on the environment and society is underexposed. Palm oil companies are often excluded directly from investment, but is this the right solution for further sustainability? This has led to a growing pressure from investors and financiers on the adoption of environmental and social friendly production methods.

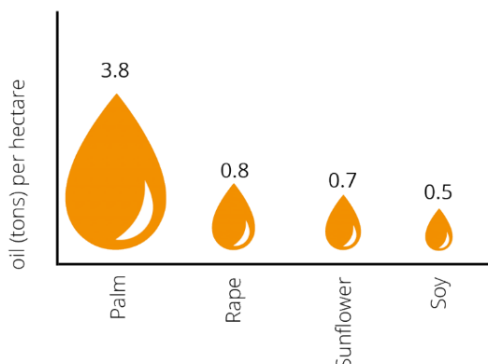
Palm oil is a type of vegetable oil that is derived from the palm fruit, grown on the African oil palm tree. The success of the crop has led to land and forests being cleared for the development of oil palm plantations, primarily in Malaysia and Indonesia. Deforestation for the production of palm oil has led to major problems, such as land grabbing and climate change, as well as several movements asking for a complete ban on the oil.

Sustainable palm oil production is not only important to avoid the negative impact on our planet, but also from an investment risk perspective. For example, the World-Wide Fund for Nature (WWF) identified five categories of material risks for oil palm companies with unsustainable practices already in 2012. In its report the WWF listed multiple ways in which malpractices could negatively impact productivity and ultimately revenues. For example, failure to maintain biodiversity at certain levels, may eliminate natural pest control animals and therewith increase costs and pollution risks from the use of pesticides. Also, plantations continue to be highly labour-intensive and with the increased mobility of workers, good labour management is becoming more important to reduce the turn-over of employees and maintain productivity levels.

The criticism is directed at the production method, however not against palm oil itself. Palm oil has a future, provided it is produced sustainably, a view which is supported by international organisations, such as Conservation International and WWF. Moreover, it uses much less land required by other crops to produce the same amount of oil. Compared with other major oil crops - rapeseed, soy and sunflowers - palm oil is by far the highest-yielding vegetable oils (see figure 1) and therefore an important food product for the low-income groups around the world.

The second step you could consider is integrating ESG-related risks. As reports of SASB and Harvard Business University point out, not every ESG-theme is evenly relevant for every company or sector. The risk of child labour in the headquarters of KPN is very little. Cybersecurity and data privacy however are topics which certainly need attention at KPN. There are two ways to approach ESG-related risks. This approach is very much bottom up. Looking at specific companies and sectors. Again the amount of data that is needed to be able to apply this to the whole portfolio is humongous. On the other hand the reward you might receive does pay up for the efforts. Research of Harvard Business University shows consistent outperformance for companies focussing on the financially material ESG-topics for them.

Figure 1: Yield per hectare of vegetable oils



Source: Oil World 2016

This is a publication of ACTIAM's Sustainability & Strategy team, consisting of 7 professionals with an average of 10 years in the industry.

ACTIAM manages assets of over €56 billion, making us one of the ten largest Dutch asset management companies. Our solid strategies and sound performance track record will help you to achieve your goals. We offer sustainable solutions to insurance companies, pension funds, banks and distribution partners, as well as to private investors.

This is achieved through actively and passively managed investment funds, via impact investing, mandates and ESG advice (Environmental, Social & Governance).

CONTACT

Marketing & Communications

+31-20-543 6777

Sales Belgium, France, Luxembourg

+33-6-4409 3746

marcom@actiam.nl

www.actiam.com

ACTIAM believes that by working with palm oil producers (instead of direct exclusion), we can insist on the transformation to sustainable palm oil. This will ultimately lead to a sustainable trade in palm oil that benefits companies, investors and society.

VOLUNTARY CERTIFICATION PREMIUM ONLY OFFERS PART OF THE SOLUTION

Multiple initiatives are supporting the shift to sustainable palm oil production. The Roundtable on Sustainable Palm Oil (RSPO) is considered the strongest certification scheme for the commodity. Created in 2004, the RSPO has been leading the push to create an accredited sustainable palm oil industry. Today the RSPO brings together 2,500 companies, from producers and traders to investors and retailers.

The voluntary standards of the RSPO ban planting on peatland and other carbon-rich soils and require companies to implement fire prevention policies, reduce greenhouse gas emissions, pay employees a living wage and commit to zero deforestation. Through certification, palm oil growers can receive a small additional premium for their products while making a positive contribution to for example safeguarding tropical natural forests holding large stores of carbon dioxide (CO₂).

In November last year, the RSPO ratified and adopted new certification standards. At ACTIAM we endorse these new standards as an important step forward in the pursuit of a sustainable industry. However, we do share the findings of NGOs that there is still room for improvement when it comes to transparency and commitment to the standards. For example, the RSPO faces challenges of increasing traceability of palm oil it certifies back to the plantations and the mills. The RSPO therefore needs to strengthen its auditing and enforcement system to be more effective.

At the same time, research shows that upfront and recurrent costs exceed the monetary benefits of RSPO certification, especially for smallholders. Most growers therefore regard RSPO certification as an unjustifiable cost given that the price premiums for certified oil are relatively low: only an estimated 1 to 4% of the crude palm oil price. Due to the investments and recurring costs of producing certified palm oil, a positive business case for certified palm oil is not always immediately viable (source: Salman 2017).

SUSTAINABLE PRACTICE: A LICENSE TO OPERATE

Without wider adoption of certification standards, deforestation and land rights, abuses could continue in palm oil production. However, price premiums and market access are not the only driving forces in the adoption of sustainable practices.

For companies that are already certified, the most serious risk is that the RSPO membership of the company is suspended. While this sanction may appear weak, it raises a financial risk that was well illustrated in the case of the IOI Corporation. In March 2016, the RSPO temporarily suspended IOI due to its clearing of forests in violation of RSPO's policy. As a result, IOI's shares fell by 18% while the company lost 26 major corporate customers (Source: Chain Reaction Research 2016).

For investors in and financiers of the palm oil industry, these examples show that environmental and social concerns are financially relevant. ACTIAM therefore works together with other investors (with a total AUM of USD 2.5 trillion) under the flag of the UN Principles of Responsible Investment (PRI) working group to raise the awareness on this issue. For example, in November 2018 the working group met with local Malaysian banks to explore the possible steps banks and investors can take to manage these risks. Possible steps include developing sustainability policies, screening portfolios and engaging with palm oil clients to support their transformation. Large discrepancies between palm oil growers and their investors and financiers can lead to more expensive financing and shrinking customer bases for companies that fail to operate more sustainably.

Although these are only the initial steps, knowledge and technology are paving the path towards better understanding and incorporating material risks. For example, by using satellites imagery and artificial intelligence, companies such as Satelligence are working to detect the cultivation of oil palm on peat land, an activity that produces high CO₂ emissions. Eventually, by combining the financial information with more transparency in the sector, sustainable palm oil will not any longer be a tick in the box exercise for certification, but unavoidable and a license to operate.

Are the negative consequences for the environment and society being maintained by investing in these companies? By acting as an active shareholder and by actively engaging as an investor in the production method of palm oil throughout the chain, you contribute to the further sustainability of investment portfolios and society!

DISCLAIMER

ACTIAM NV wants to provide accurate and actual information from reliable sources. However, ACTIAM cannot guarantee the accuracy and completeness of the information (hereinafter called: the Information) that is given in this presentation. The information can contain technical or editorial inaccuracies or typographic errors. ACTIAM does not give guarantees, explicitly or implicitly, with regard to the question if the information obtained by this presentation is accurate, complete or up-to-date. ACTIAM NV is not obliged to adjust the provided information or to correct inaccuracies or errors. The recipients of this information cannot derive rights from this information. The Information provided in this presentation is based on historical data and is no reliable source for predicting future values or rates. The Information is comparable with, but possibly not identical to the information that is used by ACTIAM for internal purposes. ACTIAM does not guarantee that the quantitative yields/profits or other results with regard to the provided Information will be the same as the potential profits and results according to the price models of ACTIAM NV. The discussion of risks with regard to any Information cannot be considered as a complete enumeration of all recurring risks. The here mentioned Information shall not be interpreted by the recipient as business, financial, investment, hedging, trade, legal, regulating, tax or accounting advice. The recipient of the information himself is responsible for using the Information. The decisions based on the Information are for the recipient's expense and risk. The recipient can therefore derive no rights from the provided Information..
