

# Our approach to engagement with the palm oil industry

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## Investment Stewardship

BlackRock's purpose is to help more and more people experience financial well-being. We manage assets on behalf of institutional and individual clients, the majority of whom are investing to meet long-term financial goals, such as a secure retirement. Investment stewardship is central to our fiduciary responsibilities to our clients to advance their long-term economic interests. We engage with companies to promote corporate governance standards and business models that we believe contribute to the durable, long-term profitability that our clients depend on to meet their financial goals. Specifically, BlackRock Investment Stewardship (BIS) does this through engagement with management teams and/or board members on material business issues, including but not limited to environmental, social, and governance (ESG) matters and, for those clients who have given us authority, through voting proxies in their best long-term economic interests.

As discussed in our [Global Principles](#), we believe that well-managed companies will deal effectively with material environmental and social (E&S) factors relevant to their businesses. Governance is the core structure by which boards can oversee the creation of sustainable, long-term value. Appropriate risk oversight of E&S considerations stems from this construct. For companies – like those in the palm oil industry – with business models that have material dependencies or impacts on “natural capital”, i.e., the supply of the world's natural resources from which economic value and benefits can be derived, the management of these factors can be a defining feature in their ability to generate durable, long-term value for shareholders. BIS' [Approach to Engagement on Natural Capital](#) highlights our view that the efficient management of natural capital is core to a resilient long-term corporate strategy for companies that rely on natural capital. Investors, like our clients, benefit when companies disclose how they work to steward the natural resources upon which their businesses depend, as well as manage risks material to their operations.

BlackRock looks to companies to provide timely, accurate, and comprehensive disclosure on all material governance and business matters, including ESG-related issues. This transparency allows shareholders to appropriately understand and assess how relevant risks and opportunities are being effectively identified and managed. Where company reporting and disclosure is inadequate or the approach taken may be inconsistent with sustainable, long-term value creation, we will engage with a company and/or vote in a manner that encourages companies to address investors' concerns.

Engagement with companies in the palm oil industry can be very complex, largely because of the ownership structures of most producers have a single or small group of affiliated shareholders that control a majority of the shares. This, together with the industry's fragmented supply chain, can potentially limit the impact of engagement and voting by minority shareholders. In addition, the palm oil industry is characterized by the prevalence of smallholders and small-scale farmers.<sup>1</sup> As a result, we focus our engagement efforts on those companies where we believe our feedback might be helpful. We offer our perspective as long-term shareholders to encourage companies to focus on issues that can have a material impact on long-term value, like climate risk and the fair treatment of workers.<sup>2</sup>

## Sustainable palm oil as an investment issue

Over the past several decades, palm oil has become a ubiquitous commodity. Oil and oleochemicals extracted from the fruit and seed of the palm oil tree are widely used in products ranging from cooking oil and dairy substitutes to cosmetics and biofuels. It is estimated that globally, a person consumes an average of 8kg of palm oil a year.<sup>3</sup>

Due to its affordability and high productivity relative to other oil crops as well as its versatility in both food and non-food applications, palm oil production has nearly quadrupled since 1995 to 72.9 MT in 2020.<sup>4</sup> Production is heavily concentrated in Southeast Asia, with Indonesia and Malaysia accounting for approximately 85% of global output.<sup>5</sup>

While palm oil production has been credited for improving living standards for many, it is also associated with a myriad of risks such as deforestation, climate change, biodiversity loss, disputed land use and labor-related issues.

Environmental and social (E&S) issues associated with unsustainable palm oil production can have a material impact on companies across the palm oil value chain, present risks to the long-term sustainability of their operations and/or have implications for revenues and costs. A company that does not effectively manage E&S risks associated with palm oil may face negative regulatory, reputational, or operational consequences, among others. These may include heightened climate-related risks, market-access risks due to possible shifts in consumer demand, or fines and penalties by governments and regulators due to poor company practices. This all has the potential to significantly impact the long-term economic outcomes for some palm oil-dependent business models.

To address and manage these E&S issues, industry stakeholders, including producers, downstream consumers, regulatory bodies and non-governmental organizations (NGOs) have begun promoting and certifying sustainably produced palm oil. Such production is done in accordance with E&S criteria that minimize the negative impacts of palm oil. This includes not clearing primary forests, areas of significant biodiversity or fragile ecosystems; reducing the use of pesticides, protecting the rights and lands of local communities, and the fair treatment of workers, among others. The Roundtable on Sustainable Palm Oil (RSPO), founded in 2004 by a group of producers, downstream consumers and conservation organizations, is perhaps the most well-known organization promoting the growth and use of sustainable palm oil products through global standards and multistakeholder governance.<sup>6</sup> The governments of Indonesia and Malaysia introduced the mandatory certification standards Indonesian Sustainable Palm Oil (ISPO) and Malaysian Sustainable Palm Oil (MSPO) in 2011 and 2013 respectively.<sup>7,8</sup> As of early 2021, more than one-third of the 16.38 million hectares of oil palm plantations in Indonesia are ISPO-certified, and approximately 86% of Malaysia's total planted area for oil palm has been certified sustainable under MSPO.<sup>9,10</sup>

## BlackRock's engagement approach

On behalf of our clients, BIS has multi-year engagements with palm oil companies in Southeast Asia to further our understanding of how they address the environmental and social risks associated with the palm oil industry that can impact the creation of durable, long-term value. **In 2021, BIS met with more than a dozen companies in the Asia ex-Japan markets that represent over 75% of BlackRock's clients' total exposure to palm oil companies in the region.<sup>11</sup>**

While most palm oil companies are members of the RSPO or other sustainable palm oil certification schemes, our engagements helped further our understanding that there are various factors – including consumers' price sensitivities and a lack of demand for sustainable palm oil in crucial markets – that serve as challenges for the industry to achieve progress towards full compliance with standards and procedures for certified sustainable palm oil.<sup>12</sup>

Furthermore, there are other characteristics of the industry that introduce additional E&S risks and serve as potential hurdles for investors including:

- ✔ Most palm oil companies in the Asia ex-Japan markets have ownership structures that involve a controlling shareholder, which potentially limits the effectiveness of stewardship activities by minority investors
- ✔ Listed entities we engage with may have links with private entities that are implicated in environmental and/or social-related issues through mutual beneficial owners and directors

- ✔ The palm oil industry is characterized by a highly complex and fragmented supply chain where independent smallholders and small-scale farmers supply fresh fruit bunches to mills.<sup>13</sup> Smallholder production accounts for approximately 40% of Indonesia and Malaysia's total oil palm plantation area, however, public equity investors like BlackRock are often unable to directly invest in or engage with them<sup>14</sup>
- ✔ Investors have limited mechanisms for verifying E&S-related allegations across the palm oil value chain, and rely on existing grievance mechanisms set up by organizations like the RSPO or High Carbon Stock Approach (HCSA). In addition, the investigation, verification and remediation processes take time during which period these controversies often continue to evolve

Given these considerations and the unique complexity of the sector, we have enhanced our approach to engagement with palm oil producers, traders and buyers to ascertain their awareness and management of risks that could impact long-term shareholder value. In our engagements, we seek to determine what actions a company is taking to address E&S risks. Where BIS finds companies are not effectively managing, overseeing, or disclosing relevant risks, we may signal our concerns in our voting, either by voting against the re-election of responsible board directors and/or supporting relevant shareholder proposals.

### **BIS' framework for engagement with companies on palm oil-related risks and opportunities**

We assess from public disclosures whether a company has taken an appropriate approach to the unique governance, oversight, strategy, and management of risks and opportunities relating to palm oil. We determine whether a company provides disclosures regarding:

#### *Sustainable Palm Oil Program*

- ✔ A clearly stated Sustainability Policy that demonstrates an awareness of the salient environmental, social and reputational risks and opportunities relating to the production of palm oil and its management strategy
- ✔ A Sustainability Policy and/or strategy to include an explicit commitment to no deforestation, no development on peatland, and no exploitation of workers (NDPE) policies given the impact of these factors on long-term value creation<sup>15</sup>
- ✔ A sustainable palm oil program with a commitment to achieve sustainable palm oil certification, a disclosed timeframe in which they may achieve it, as well as disclosure on the company's progress on certifying its palm oil operations to an established certification scheme

#### *Management of Environmental Risks and Opportunities*

- ✔ Demonstrated procedures and programs in alignment to its NDPE policy – including commitments to established standards and practices, for instance zero burning, no conversion of High Conservation Value (HCV) and High Carbon Stock (HCS) forests, and no planting on peatlands
- ✔ A due diligence processes to identify and monitor adverse E&S impacts
- ✔ Audited programs and processes to ensure alignment and compliance to policies for managing environmental risks, ideally via third-party assurances and verification
- ✔ Where necessary, enlisted subject matter experts or independent consultants to build the company's and/or board's expertise and knowledge on environmental-related risks and opportunities in its value chain

#### *Management of Social Risks and Opportunities*

- ✔ Demonstrated a commitment to manage the human rights risks across its value chain through a stated Human Rights policy informed by local regulations, as well as international instruments and standards, for instance the UN Guiding Principles on Business and Human Rights (UNGPs), the Universal Declaration of Human Rights (UDHR) and International Labour Organization (ILO) conventions
- ✔ A robust Operational Health and Safety (OHS) management system in place, with relevant targets and timely disclosure of the company's performance against said targets

- ✔ A stated commitment to uphold labor standards, protect workers' rights and combat forced labor via a robust Human Capital Management Policy or Labor Policy
- ✔ A stated commitment to respect local communities' right to decide and have a say on projects or plans that may impact their land, livelihoods and environment via a Free, Prior and Informed Consent (FPIC) process
- ✔ Due diligence processes to identify and monitor adverse E&S impacts
- ✔ Audited programs and processes to ensure alignment and compliance to its policies for managing social risks, ideally via third-party assurances and verification
- ✔ Where necessary, enlisted subject matter experts or independent consultants to build the company's and/or board's expertise and knowledge on social-related risks and opportunities in its value chain

#### *Remediation & Grievance Mechanisms*

- ✔ A robust grievance mechanism accessible to workers, communities, civil society organizations and other stakeholders in its supply chain
- ✔ A robust Whistleblowing Policy committing to whistle-blower protection and investigation
- ✔ Demonstrated the processes and governance structures in place to capture, monitor and redress valid grievances and incidents
- ✔ Provided transparent disclosure and updates via a publicly available grievance list
- ✔ Acknowledged and demonstrated active engagement with complainants and other stakeholders to work towards resolution of any captured grievances or incidents, preferably with a time-bound action plan
- ✔ Demonstrated ability to prevent additional grievances, controversies or incidents of a similar nature by identifying areas of improvement, and publishing policy or procedure improvements

#### *Supplier Relations & Supply Chain*

- ✔ A Supplier Code of Conduct that clearly outlines its expectations, monitoring mechanisms, as well as the follow-up actions/consequences in the event of non-compliance
- ✔ Invested in resources and programs to engage, socialize and implement relevant policies mentioned above, for instance NDPE, OHS, Human Rights policies across its supply chain
- ✔ Demonstrated its commitment to full traceability in its supply chain via a robust traceability target and an indication of when this may be realistically achieved in the short-, medium-, and long-term, as well as regular disclosures that demonstrate how the company is progressing towards its target
- ✔ Verified and audited its programs and processes to ensure supplier alignment and compliance to its policies

#### *Governance & Oversight*

- ✔ Demonstrated how its management is integrating sustainability-related issues into its longer-term corporate strategy
- ✔ Demonstrated the board's collective expertise and experience in practicing sufficient oversight over management's sustainability policies and how they are applied
- ✔ Disclosed the governance structures and frameworks in place to implement its sustainability strategy, as well as the key performance indicators (KPIs) used to evaluate the efficacy of its sustainable palm oil program
- ✔ Demonstrated how sustainability KPIs are included in the compensation schemes of key executives

### *Disclosures & Stakeholder Engagement*

- ✔ Used the framework developed by the Task Force on Climate-related Financial Disclosures (TCFD) to disclose their approach to ensuring they have a resilient business model and supplemented that disclosure with industry-specific metrics such as those identified by the Sustainability Accounting Standards Board (SASB).<sup>16</sup> We recognize that some companies may report using different standards, which may be required by regulation, or one of a number of private standards. In such cases, it can assist long-term investors' understanding when companies highlight the metrics that are industry- or company-specific
- ✔ Demonstrated its commitment towards sustainable practices within its operations by participating and/or signing up to sector relevant sustainable palm oil initiatives and standards (e.g. CDP, HSCA etc.)
- ✔ Demonstrated responsiveness to shareholder concerns via a willingness to actively engage

We recognize that the palm oil industry is complex. Companies seeking to appropriately manage the inherent risks and opportunities may require time to implement policies and practices. BIS will continue to engage with palm oil producers, downstream buyers globally and other relevant stakeholders, on behalf of our clients as long-term shareholders, to assess companies' actions and promote adequate disclosures around sustainable palm oil practices and related risks.

## Endnotes

1. According to the Roundtable on Sustainable Palm Oil (RSPO), smallholders are usually family-based enterprises producing palm oil from less than 50 ha of land. In Malaysia and Indonesia, smallholder production represents approximately 40% of the total oil palm plantation area. For additional information, please see: <https://rspo.org/smallholders>.
2. We firmly believe in the value of engaging with companies. Encouraging responsible business operations serves the interests of long-term investors in both equity and fixed income securities issued by public companies. BIS engages companies on behalf of BlackRock's index funds and accounts and coordinates with portfolio managers with active positions in a company. When BIS engages a company, we do so from the perspective of a long-term investor. Engagement enables us to have ongoing dialogue with companies and build our understanding of the challenges they face. This is particularly important for our clients invested in indexed funds, which represent a significant majority of BlackRock's equity assets under management, as they do not have the option to sell holdings in companies that are not performing as expected.
3. The Guardian, "[How the world got hooked on palm oil](#)", February 2019.
4. United States Department of Agriculture, Foreign Agricultural Service, "[Palm Oil Explorer](#)", as of January 2022.
5. Ibid, as of January 2022.
6. However, we do note that these sustainable palm oil certification schemes are not without criticisms. For instance, RSPO have been accused by NGOs and other stakeholders for not adequately auditing member companies, being slow to investigate allegations and penalize non-compliant members, as well as having inadequate standards for suppliers, amongst others.
7. United Nations Environment Programme, Law and Enforcement Assistance Platform, "[Regulation of the President of the R.I. No. 44 of 2020 on the Certification System for Sustainable Palm Oil Plantation in Indonesia](#)" 13 March 2020.
8. Originally a voluntary scheme, the MSPO was made mandatory for plantations, independent and organized small holdings and palm oil processing facilities in Malaysia in 2019. For additional information, please see: <https://www.mpoc.org.my/about-mspo>.
9. The Jakarta Post, "[Palm oil: More than 750 ISPO certificates issued for producers as of last year](#)", 7 June 2021.
10. The Edge Markets, "[86.4% of Malaysia's total licensed oil palm planted area MSPO-certified, says MPOB](#)", 9 March 2021.
11. Please note that some companies did not respond to our repeated requests for engagements.
12. BIS also engages with companies in the Americas where we discuss the use of palm oil and their palm oil supply chain management. These companies in developed markets are important to ensuring demand for sustainably sourced palm oil. As part of our engagement with companies that use natural resources, including palm oil, in their products we seek to understand how they engage on and hold their suppliers responsible to sustainable and responsible sourcing and production. We also seek to understand the monitoring and mitigation processes, as well as any targets for increasing the proportion of inputs that are sustainably sourced. For an example, please see our [2020 Vote Bulletin](#) on Proctor and Gamble.
13. According to [RSPO](#), smallholders are usually family-based enterprises producing palm oil from less than 50 ha of land.
14. Roundtable on Responsible Palm Oil, "[RSPO smallholders](#)".
15. BlackRock Investment Stewardship, "[Our approach to engagement on natural capital](#)", Published February 2022.
16. While the TCFD framework was developed to support climate-related risk disclosure, the four pillars of the TCFD, Governance, Strategy, Risk Management, and Metrics and Targets are a useful way for companies to disclose how they identify, assess, manage, and oversee a variety of sustainability-related risks and opportunities. SASB's industry-specific guidance (as identified in its materiality map) is beneficial in helping companies identify key performance indicators (KPIs) across various dimensions of sustainability that are considered to be financially material and decision-useful within their industry.

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