

# How Palm Oil Poses Material Risks to Investors

Palm oil is an edible plant oil derived from the fruit of the oil palm tree and used in thousands of consumer products, from cookies to cosmetics to biofuels. **Around 50 percent of the goods we use every day in the United States contain palm oil, as it is currently the cheapest vegetable oil to produce and refine.**<sup>1</sup> However, palm oil development often comes at the expense of tropical forests, biodiversity and local communities' land rights and traditional livelihoods. Today, an area of rainforest the size of 40 football fields will be destroyed every minute<sup>2</sup> – with palm oil plantation expansion among the leading causes of this destruction. This brief outlines the fundamental concerns regarding the palm oil industry – and why these problems pose significant risks to investors.

- **CO2 EMISSIONS FROM DEFORESTATION** – Deforestation is the second largest driver of climate change after the burning of fossil fuels. Globally, roughly 12 percent of total greenhouse gas emissions are caused by deforestation, and some 80 percent of global deforestation is driven by industrial agriculture.<sup>3</sup> Palm oil, alongside soy, cattle, paper, rubber and timber, are the main industrial agricultural commodity contributors to deforestation. In preparing land for palm oil plantations, large swaths of forests are cleared, including dense, ecologically-important rainforests. What remains is cleared by burning. If forests are on peatlands – as is the case in much of Indonesia – the land is drained. Peatlands store vast quantities of carbon, and the conversion of a single hectare of Indonesian peatland rainforest releases up to 6,000 tons of CO<sub>2</sub>.<sup>4</sup> In 2015, burning of Indonesian peatlands for commodity agriculture caused fires responsible for thousands of respiratory illnesses and millions of tons of carbon released into the atmosphere.<sup>5</sup> In Indonesia alone, estimated CO<sub>2</sub> emissions from the palm oil sector are around 250 million tons per year – roughly equivalent to the annual emissions of Spain.<sup>6</sup>

## From Rainforest to Plantation



**Tropical peat soil stores even more carbon than the vegetation that grows above ground (as much as 28 times more).**

Rainforests also serve as habitat for millions of species, including orangutans, elephants, rhinos, tigers, gorillas and chimps. And over a billion people live in rainforests and depend on them for their livelihoods.

Even worse, fires in peat often spread underground—at one point in 2015, active wildfires in Indonesia released more carbon than the entire emissions of the US. And as fires burn, animals and people are killed or displaced.

Most palm oil plantations are inherently unsustainable monocultures that require enormous amounts of water and chemicals. Workers are often trafficked into bonded labor, and abused, overworked and underpaid. Government officials are commonly bribed to look the other way.

- **BIODIVERSITY LOSS** – The destruction of natural habitats deprives species of the basis for their existence, causing an irreversible loss of biological diversity. In Southeast Asia, orangutans are particularly vulnerable because they are dependent on large contiguous forest areas. According to the U.N., there is a risk that no wild orangutans will remain outside of protected areas by 2020.<sup>7</sup> In Africa, recent research shows that if palm oil plantations develop as predicted, it will drive several great ape species to extinction.<sup>8</sup>

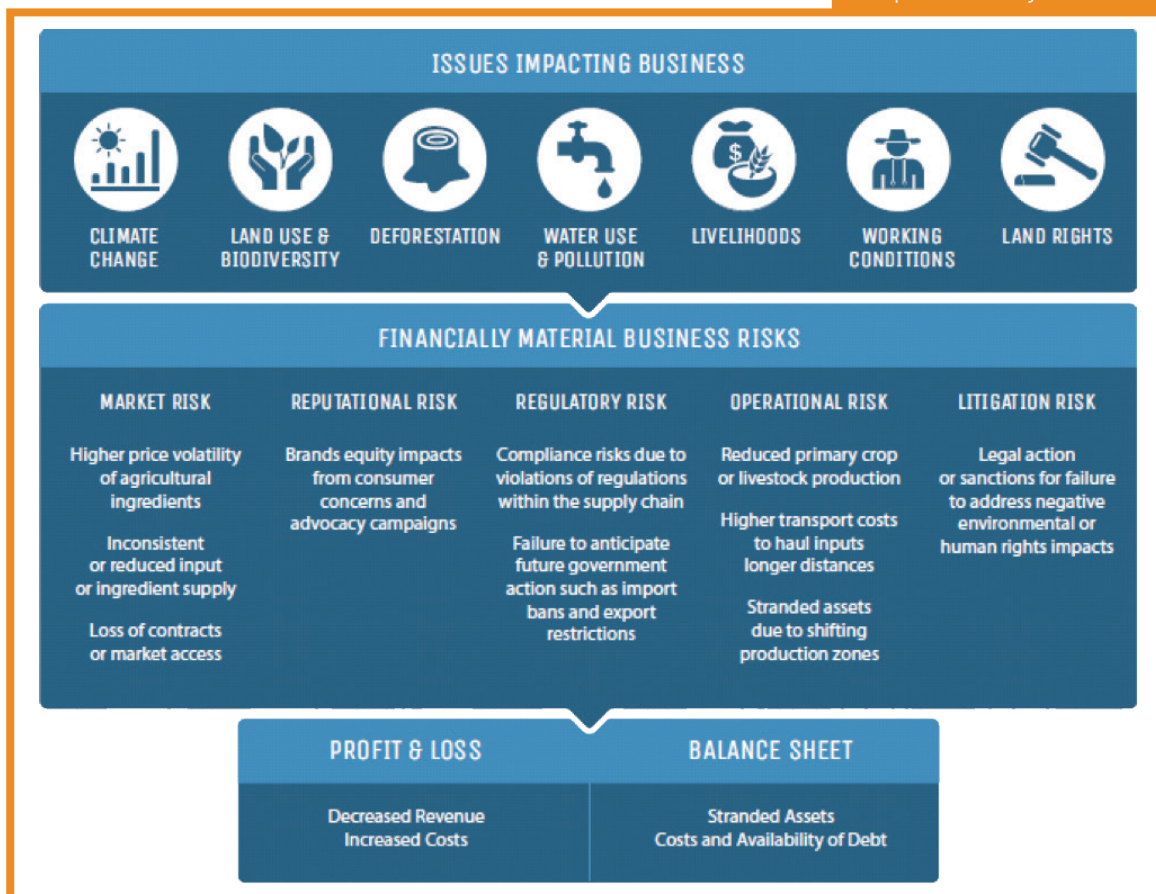
- **SOCIAL CONFLICT** – Illegal acquisition of indigenous and community forests for palm oil plantations is responsible for serious human rights abuses and persistent conflicts between companies and rural communities. Indonesia’s National Lands Agency has registered 3,000 conflicts between palm oil companies and communities, including cases where private armies and paramilitaries have been deployed and people have been killed.<sup>9</sup> In Guatemala, Peru and other frontier areas for palm oil expansion in the Americas, the killing of human rights defenders is clearly linked to plantation expansion.<sup>10</sup>

### Implications for Investors

BlackRock – the world’s largest asset manager – recognizes that companies linked to deforestation in their supply chains may face financial risk, and that climate factors, including deforestation, are underpriced because they are “less visible” to investors.<sup>11</sup> But these risks are rapidly beginning to have significant impacts for business. Nonetheless, the leading U.S. investment firms<sup>12</sup> (BlackRock among them) have, in aggregate, billions of dollars invested directly in palm oil companies – without proper due diligence or risk management policies for such a high risk industry.

Land conflicts between companies and local communities also cause operational delays, stranded assets and violations of human rights – all of which pose potential financial, material and reputational risks to investors. The Ceres Investor Network on Climate Risk and Sustainability notes that investors in the palm oil sector face multiple kinds of material risk, including **market risk, reputational risk, regulatory risk, operational risk and litigation risk**.<sup>13</sup> These risks have all resulted in material financial losses for specific companies from Q1 2016 to Q2 2017.<sup>14</sup>

Graphic courtesy of Ceres



A 2017 study into the monetary costs of social conflict on five palm oil plantations in Indonesia found 174 instances of conflict, with the tangible cost of conflict ranging from \$70,000 to \$2.5 million. The study found the largest direct costs due to social conflict were lost income from disrupted plantation operations and diversion of staff time. Additionally, the study found indirect costs of \$60,000 to \$9 million related to social conflict from “conflict recurrence or escalation; reputational loss; and risk of violence to property and people.”<sup>15</sup>

Palm oil is also associated with forest crimes such as illegal logging. The palm oil industry operates in a complex regulatory environment where illegality is almost the norm.<sup>16</sup> Interpol – the International Criminal Police Organization – estimates that illegal logging and related forest and financial crimes siphon off between \$51 billion and \$152 billion dollars from the global economy each year.<sup>17</sup> Exposure to transactions involving forest crimes could subject businesses to litigation under multiple statutes including US anti-money laundering (AML) laws, the **Foreign Corrupt Practices Act (FCPA)**, the **Lacey Act**, the **Global Magnitsky Act** and the set of laws that address **wire and mail fraud**.

The Organisation for Economic Co-operation and Development asserts that financial sector actors are in many cases “directly linked” to adverse impacts caused by their client companies, and are therefore responsible for undertaking due diligence to minimize and mitigate these impacts.<sup>18</sup> In its 2017 guidelines for institutional investors,<sup>19</sup> the OECD argues that:

- Investors, even those with minority shareholdings, may be directly linked to adverse impacts caused or contributed to by investee companies (OECD, 2014)
- Due diligence under the OECD guidelines should be continuous and ongoing, and aimed at avoiding and responding to risks (OECD, 2017)
- Investors should include both active and passive investments in their general risk screening to inform potential actions (OECD, 2017)

As U.S. investors increasingly incorporate Environmental, Social and Governance (ESG) risk management into their portfolios, they should develop thorough due diligence policies to address issues related to the palm oil industry and industrial agro-commodities more broadly, including illegal deforestation and protracted land conflict. Otherwise, investors may be exposing their investments – and the retirement funds of hundreds of millions of Americans – to significant financial and material risks and potential losses.

---

1. “Food and agriculture data,” Food and Agriculture Organization of the United Nations, FAO, accessed on August 27, 2018, <http://faostat.fao.org>.  
2. IFL Science, In 2017, We Lost 40 Football Fields Of Trees Every Minute, <https://www.iflscience.com/environment/in-2017-we-lost-40-football-fields-of-trees-every-minute/>  
3. “National Greenhouse Gas Inventory Data for the Period of 1990-2013,” accessed on August 24, 2018. <http://unfccc.int/resource/docs/2015/sbi/eng/21.pdf>.  
4. Morgan Erickson-Davis, “Recent plantation expansions on peatlands came with huge carbon costs,” Mongabay, April 27, 2016, <https://news.mongabay.com/2016/04/recent-plantation-expansions-peatlands-came-huge-carbon-cost/>  
5. Oliver Balch, “Indonesia’s forest fires: everything you need to know,” The Guardian, November 11, 2015, <https://www.theguardian.com/sustainable-business/2015/nov/11/indonesia-forest-fires-explained-haze-palm-oil-timber-burning>.  
6. “National Greenhouse Gas Inventory Data for the Period of 1990-2013,” accessed on August 24, 2018. <http://unfccc.int/resource/docs/2015/sbi/eng/21.pdf>.  
7. “The Last Stand of the Orangutan State of Emergency: Illegal Logging, Fire and Palm Oil in Indonesia’s National Parks. UNEP, accessed on August 27, 2018. [http://www.orangutanssp.org/uploads/2/4/9/9/24992309/laststand-of-orangutan-report\\_2007.pdf](http://www.orangutanssp.org/uploads/2/4/9/9/24992309/laststand-of-orangutan-report_2007.pdf).  
8. Giovanni Strona et al. “Small room for compromise between oil palm cultivation and primate conservation in Africa,” PNAS, August 13, 2018. <http://www.pnas.org/content/early/2018/08/07/1804775115>.  
9. Christopher Achobang et al., “The oil palm sector at a crossroads,” Forest Peoples Programme, Sawit Watch and TUK Indonesia.  
10. [https://www.oxfam.org/sites/www.oxfam.org/files/file\\_attachments/bp-land-power-inequality-latin-america-301116-en.pdf](https://www.oxfam.org/sites/www.oxfam.org/files/file_attachments/bp-land-power-inequality-latin-america-301116-en.pdf)  
11. Hildebrand, P., Winshel, D. (2016). Adapting portfolios to climate change: Implications and strategies for all investors. N.p.: Black Rock Investment Institute. <https://www.blackrock.com/investing/literature/whitepaper/bii-climate-change-2016-us.pdf>

12. “Are You Invested in Exploitation? Why US Investment Firms Should Quit Financing Conflict Palm Oil and Commit to Human Rights,” Friends of the Earth United States. June 2016. <https://foe.org/resources/are-you-invested-in-exploitation/>  
13. “Engage the Chain: Financial Risks in Agricultural Supply Chains. Ceres. June 2017. <https://www.engagethechain.org>.  
14. Barbara Kuepper et al. “Palm oil frontiers: Lessons learned from SE Asian corporate expansion to Africa,” Chain Reaction Research, October 2016, <https://chainreactionresearch.files.wordpress.com/2014/02/palm-oil-frontiers.pdf>.  
15. Barrerio, Virginia et al. “The Cost of Conflict in Oil Palm in Indonesia.” November 2016. [http://daemeter.org/new/uploads/20170121193336.The\\_Cost\\_of\\_Conflict\\_in\\_Oil\\_Palm\\_Indonesia\\_.pdf](http://daemeter.org/new/uploads/20170121193336.The_Cost_of_Conflict_in_Oil_Palm_Indonesia_.pdf).  
16. “Permitting Crime: How palm oil expansion drives illegal logging in Indonesia,” EIA. December 2014. <https://eia-international.org/report/permitting-crime-how-palm-oil-expansion-drives-illegal-logging-in-indonesia>.  
17. “Uncovering the Risks of Corruption in the Forestry Sector,” Interpol, December 9, 2016. [https://globaltimbertrackingnetwork.org/wp-content/uploads/2017/12/INTERPOL\\_2016\\_Uncovering-the-Risks-of-Corruption-in-the-Forestry-Sector.pdf](https://globaltimbertrackingnetwork.org/wp-content/uploads/2017/12/INTERPOL_2016_Uncovering-the-Risks-of-Corruption-in-the-Forestry-Sector.pdf)  
18. “Global Forum on Responsible Business Conduct Due diligence in the financial sector: adverse impacts directly linked to financial sector operations, products or services by a business relationship,” OECD, accessed on August 27, 2018, <https://mneguidelines.oecd.org/global-forum/GFRBC-2014-financial-sector-document-1.pdf>  
19. “Responsible business conduct in the financial sector,” OECD Guidelines for Multinational Enterprises, OECD, accessed May 10, 2018. <http://mneguidelines.oecd.org/rbc-financial-sector.htm>.

