



## Profit Meets Purpose

Mutual Benefits for the Palm Oil Sector and Financial Institutions in Scaling Climate Action

21 December 2023

From the Perspective of UOB Asset Management (UOBAM) Malaysia and the Roundtable on Sustainable Palm Oil (RSPO)

- The oil palm is recognised as an efficient crop, with opportunities to enhance agricultural practices through sustainability.
- ESG Integration and Engagement are strategic approaches that address additional risks and opportunities, guiding investment decisions and encourage corporate transitions toward sustainability.

The palm oil industry plays an important economic role in the global food supply, with linkages to various modern consumer goods. In our discussion with the Roundtable on Sustainable Palm Oil (RSPO), both parties agree that while palm oil is an efficient crop, there is room for various producers to enhance agricultural production by adopting sustainable practices. Financial Institutions (FIs) backing the palm oil industry have a unique opportunity to drive more sustainable palm oil industry practices through closer engagement with the companies active in the industry.

Amid the evolving regulatory landscape, UOBAM has embraced ESG Integration and Active Stewardship to align profit with purpose for our clients.



We assess current practices, ongoing efforts, and future plans for improvement as indicators to identify companies that are poised to offer lower risk and higher sustainable returns over long term.

## **Introduction**

This article sheds light on the Environmental and Social challenges of the palm oil industry and proposes sustainably produced palm oil as a potential solution. The stakeholders in focus include industry players, particularly growers, governments, certification bodies, and investors. For investors interested in the commodity sector or food-security trends, a comprehensive understanding of the palm oil sector's complex landscape is essential.

## **Environment and Social Issues in the Industry**

### *Deforestation*

The industry must confront deforestation, a significant environmental challenge. Deforestation results from a variety of activities, including agricultural expansion, new industrial developments, illegal logging and renewable energy projects like solar farms. Effective government intervention is crucial in mitigating deforestation.

### *Slash-and Burn Practices*

The palm oil sector often faces criticism for illegal slash-and-burn methods used to clear land for plantations, contributing to air pollution and regional haze. This issue is particularly acute to Indonesia, where such practices are prevalent despite restricted by law to small-scale farmers under specific conditions.

### *Planting on Peatland*

Cultivation on peatland poses environmental risks due to the necessity of drainage, which leads to carbon emissions and fire hazards. Peatland contains huge amount of water and organic matters underneath the surface. Hence, peatlands have to be drained before planting begins, to protect the roots of crops from excess water, causing the peat to decompose which releases carbon dioxide and be susceptible to fire. Managing peat fires is a complex task due to their tendency to burn underground.



## Thinking Sustainably

### *Labour Rights*

From planting and applying fertiliser to harvesting and other estate operations, manual labour is required for oil palm cultivation and production. Local workers tend to shun these jobs due to tough working conditions and isolated lifestyles (estates are usually located in remote areas), leaving the sector to become dependent on foreign labour.

This leads us to the second issue, which is forced labour. Among the main bases for such allegations is the International Labour Organisation's forced labour indicators. Should an entity be deemed to breach any of the indicators, local and foreign regulators can choose to take action against that entity, regardless of the legality of the matter and norm of the industry practice on a case-by-case basis.

### **UOBAM and RSPO's Perspective**

Despite challenges, stakeholders should not shun the palm oil sector. Palm oil will continue to stay relevant in the market for three reasons:

- **Versatility:** Palm oil's unique properties makes it a preferred choice across industries. Roughly half of supermarket items contain palm oil as an ingredient, underscoring its critical role in modern consumer sectors.
- **Consumption:** Global trends predict a steady demand for palm oil due to population growth, urbanization, and rising incomes.
- **Productivity:** Palm oil has the highest yield per unit of land compared to other vegetable oils. In other words, should the market switch to other non-palm vegetable oil significantly over the long term, more land would need to be converted or deforested to meet the additional demand.



Thinking Sustainably



Source: RSPO Webinar Presentation Slide

Hence, companies that are embracing sustainable practices are positioning themselves as market leaders in relation to sustainable palm oil, offering better potential of sustainable returns to investors.

Fundamentally, it is the *practice* that needs to be addressed, not the crop. Hence, tackling the root cause by adopting sustainable agricultural practices is a good approach. In some countries, a mandatory national sustainable certification for palm oil businesses like the Malaysian Sustainable Palm Oil (MSPO) and Indonesia Sustainable Palm Oil (ISPO) is set up to enhance the overall practice baseline of the industry.

Zooming out from a national lens is the RSPO, a global partnership with voluntary members representing the whole industry, which aims to make palm oil sustainable throughout the supply chain. RSPO operates through consensus, ensuring its stakeholders have a voice and share responsibility to protect its Standards, which are a set of environmental and social criteria that companies must comply with to produce RSPO Certified Sustainable Palm Oil (CSPO).

There are business costs involved such as certification costs, audit costs, and compliance cost among others, and operational challenges such as meeting the requirements of no planting on deforested land after 2018. However, Joseph D’Cruz (JD), RSPO CEO suggests that it is a question of business strategy in relation to market access, product pricing, operations, and customer management.



## Thinking Sustainably

### **UOBAM's Capabilities**

UOBAM generally adopts ESG Integration strategy across our funds. One of the material factors for this sector is carbon emission. However, measuring upstream carbon emissions for the palm oil sector is not straightforward due to structure of the supply chain. Companies may have their own plantation and mills, and still buy fresh fruit bunch, crude palm oil or other raw materials from third party smallholders who lack the capability to measure their carbon footprint. Hence, we consider broad indicators to understand a company's supply chain carbon footprint and whether there are plans for impact reduction, such as policies to embed low carbon operations on a day-to-day basis, traceability to source at different stages of the production cycle (e.g. plantation to mill to refinery), and monitoring systems in place.

We engage companies to encourage the adoption of best practises and monitor their sustainability progress.

### **Conclusion**

Sustainable agricultural practices are vital amidst increasing stakeholder scrutiny and evolving market demands. The palm oil sector has shown improvement over the years, akin to the energy transition from coal to renewables in developed countries.

UOBAM integrates material ESG issues into our investment analysis and believes in engagement over exclusion.

Consumers and investors play a pivotal role in driving demand for sustainable palm oil, although vigilance against greenwashing is essential.



**Important Notice & Disclaimers:**

This publication shall not be copied, or relied upon by any person for whatever purpose. The information herein is given on a general basis without obligation and is strictly for information only. This publication must be viewed in conjunction with the oral presentation provided by UOB Asset Management (Malaysia) Bhd (“UOBAM(M)”). This publication is not an offer, solicitation, recommendation or advice to buy or sell any investment product, including any collective investment schemes or shares of companies mentioned within. The information contained in these publication, including any data, projections and underlying assumptions are based upon certain assumptions, management forecasts and analysis of information available and reflects prevailing conditions and our views as of the date of the document, all of which are subject to change at any time without notice. In preparing this publication, UOBAM(M) has relied upon and assumed, without independent verification, the accuracy and completeness of all information available from public sources or which was otherwise reviewed by UOBAM(M). UOBAM(M) does not warrant the accuracy, adequacy, timeliness or completeness of the information herein for any particular purpose, and expressly disclaims liability for any error, inaccuracy, or omission. UOBAM(M) and its employees shall not be held liable for any decision or action taken based on the views expressed or information contained within this publication. Any opinion, projection and other forward looking statement regarding future events or performance of, including but not limited to, countries, markets or companies is not necessarily indicative of, and may differ from actual events or results. Nothing in this publication constitutes accounting, legal, regulatory, tax, or other advice. The information herein has no regard to the specific objectives, financial situation and particular needs of any specific person. You may wish to seek advice from a professional or an independent financial adviser about the issues discussed herein or before investing in any investment product. Should you choose not to seek such advice, you should consider carefully whether the investment or product is suitable for you or your organization.

UOB Asset Management (Malaysia) Bhd 199101009166 (219478-X).

