



A supply chain engagement in the palm oil sector

Reader's guide

This 'lessons learned' document describes the palm oil engagement case conducted under the Dutch Pension Funds Agreement on Responsible Investment. In this case, Dutch pension funds collaborated with NGOs, trade unions and the Dutch government to strengthen their engagement.

Readers who would like background information on the Pension Funds Agreement can scroll to the background section.

Introduction to the case

Palm oil is the second case under the Dutch Pension Funds Agreement on Responsible Investment. The case is formed around engagement involving three companies all playing a different role in the palm oil supply chain: a buyer, a supplier and a subsidiary. The issues in the palm oil sector revolve primarily around labour and human rights, living wages and the necessity to incorporate standards for small farmers, such as access to RSPO (Roundtable on Sustainable Palm Oil) certification.

The working group consists of four parties: pension funds, an NGO, a trade union and the Dutch government. The pension funds played a big role in the initiation of the engagement as they are the asset owners. The collaboration with the NGO and the trade union allowed access to their relevant network of NGO partners and trade unions on the ground. Finally, the Dutch government provided us with on-the-ground knowledge through the contacts with the local Dutch Embassy.

Key insights

Design/creation of the case

- a. The group spent quite some time on getting to know each other and understanding each other's perspective: this is important to build trust between parties.
- b. Selection of target companies should have clear criteria and it is advisable that multiple pension funds are invested in the companies (also to increase leverage).
- c. At the start, it is advised that different scenarios be thought out, including an exit strategy.
- d. It is advisable to set concrete engagement objectives at the beginning of the case, whilst also being aware that additional information could come

in during the case. For that reason, it is important both to keep focused on the main objectives and to keep some flexibility.

- e. The group found it valuable to engage actors along the palm oil supply chain.
- f. Addressing systemic issues in the palm oil supply chain takes time, requires significant capacity and leverage, and is dependent on other factors as well. These were known limitations for the covenant members for driving significant changes on the ground.

Agreements

The group has learnt the importance of the below requirements before starting a similar case. It is advisable to:

- a. Clarify the roles of each party beforehand and discuss the limitations, capacities and responsibilities of the parties.
- b. Create a document with expectations, task division, responsibility and desired outcomes.
- c. Take time to discuss a high-level approach when the engagement doesn't work out as expected, for instance, if the goals are not reached.
- d. Discuss the escalation strategy from the start, to clarify expectations among members but also to be more efficient when limited engagement progress is observed.
- e. Monitor expectations periodically.
- f. It is important to work from a common interest and wider-understood agenda rather than organisation-specific interest.
- g. Ambitions should be adjusted to the time and capacity available.

Salient issues

The group has identified the following salient issues – both prior to and whilst – working on this engagement case. Palm oil sourcing and selling

includes risk related to: deforestation, protection of local communities, free prior and informed consent (FPIC) and workplace health and safety, lack of freedom of association and collective bargaining, lack of freedom of speech, no living wage, gender inequality.

Collaboration

The group found the collaboration to add value to the engagement case. It is important that relevant information and developments to the engagement are shared with all parties in a timely manner, whenever possible. This is a key element for building trust and understanding each other's position. The group has found the following added value from the collaboration:

- a. Pension funds would always ask for input by the labour union and NGO ahead of engagement meetings. The labour union and NGO would also give information in between planned meetings. It helped to debrief engagement meetings within the wider group.
- b. The fact that it's a multi-stakeholder initiative and thereby brings in different perspectives.
- c. Critical insights from the ground (e.g. reports) added value to the collaboration, because it increased the knowledge of pension funds.
- d. Local insight from the labour union on the ground helped put engagement findings in the right local perspective, and would lead to more specific engagement asks to the companies.

Missed opportunities

The working group was supposed to go on a fact-finding and case-building field trip to an important sourcing country of palm oil. Due to COVID-19, this trip has not taken place, which is a missed opportunity for gaining better insights, engaging directly with local stakeholders and building the case.

Companies included in the engagement	Roles	Lessons learned and continuous improvement
<ul style="list-style-type: none"> ▪ Buyer: a global buyer of palm oil, sourcing from several of the supplier's mills. ▪ Objective: to improve the due diligence process and sourcing strategies for palm oil. ▪ Supplier: a large palm oil plantation company, which has taken steps towards traceability, yet is linked to significant human rights and labour rights violations. ▪ Objectives: transparent sourcing, including adherence to and promotion of labour rights, land rights, women's rights, human rights, benefits and capacity-building of smallholders; preventing and mitigating negative impacts; offering remedial measures and mitigation following adverse impacts. ▪ Subsidiary of supplier ▪ Objective: to remedy (land) conflicts with surrounding communities and improve community livelihoods. 	<p>Leverage: pension funds through shareholder relationship</p> <ul style="list-style-type: none"> ▪ Pension funds: use their leverage as shareholders of the companies ▪ Unions (FNV), NGOs (Oxfam Novib) and government (Dutch Ministry of Foreign Affairs) provide information and insights using their network to engage stakeholders locally and internationally. ▪ All delegates will coordinate & exchange information regularly and in good faith with each other. 	<p>Learning objectives:</p> <ul style="list-style-type: none"> ▪ To identify which factors/elements are essential in leverage by PFs on manufacturers and on growers (with whom to engage within company, what measures to apply) ▪ What is added value (if) of multi-stakeholder platforms (RSPO etc.)? ▪ How can national and local government agencies best be involved?

How we started

Focus on palm oil

The production of palm oil has a number of negative social and environmental effects that are well known by the parties who collaborated in this case. Therefore, finding the common importance of working on this topic was easily established. Around 66 million tons of palm oil are produced each year. More than 50% of this comes from Indonesia and more than 30% from Malaysia. The palm oil industry is essential for the economic development of Indonesia and Malaysia. The Netherlands is a big importer and processor of palm oil in Europe.

Palm oil as a commodity

Palm oil has been a long-contested commodity in South-East Asia, leading to labour rights, communities' rights and land conflicts controversies and violations, as well as negative environmental impacts, such as deforestation. Since 2009, there has been significant palm oil development in West Africa as well. While governments have provided legal concessions to the foreign companies that develop the plantations, many companies have not performed sufficient due diligence when entering these new markets and have not fully applied the necessary Free Prior and Informed Consent in relation to local communities. Salient issues are, among others, deforestation, peat, biodiversity loss, human and labour rights violations, including child labour, forced labour, lack of freedom of association & collective bargaining, land rights violations and the non-payment of a living wage, as well as lack of appropriate whistleblower mechanisms and complaints procedures.¹

¹ <https://rspo.org/about>

Palm oil is used in many of the products on supermarket shelves, from margarine and chocolate to ice cream, soaps, cosmetics, and fuel for cars and power plants. The reason why palm oil is so popular is because:

- It has great cooking properties – it maintains its properties even under high temperatures.
- Its smooth and creamy texture and absence of smell make it a perfect ingredient in many recipes, including baked goods (such as biscuits) in particular.
- It has a natural preservative effect which extends the shelf life of food products.
- It is also the highest-yielding vegetable oil crop, which makes it very efficient. It needs less than half the land required by other crops to produce the same amount of oil. This makes palm oil the least expensive vegetable oil in the world.

Why can't we simply replace palm oil with other vegetable oils?

- Replacing palm oil with other types of vegetable oil (such as sunflower, soybean or rapeseed oil) would mean that much larger amounts of land would need to be used, since palm trees produce 4-10 times more oil than other crops per unit of cultivated land. This would result in serious environmental damage, with the risk that more forests would need to be converted into agricultural land.
- In producing countries, millions of farmers and their families work in the palm oil sector. Palm oil plays an important role in the reduction of poverty in these areas. In Indonesia and Malaysia, a total of 4.5 million people earn their living from palm oil production. Stopping the production of palm oil altogether would create significant problems for these people who support their families by working in this industry.

- Replacing palm oil with other types of oil is not always feasible due to palm oil's unique properties as a food ingredient. Using other oils would not give the products the same texture and taste that palm oil offers.

Supply chain engagement

This case was set up as a 'supply chain engagement' with three companies that all separately have a crucial role to play in solving critical ESG (Environmental, Social and Governance) issues on the ground. We therefore selected three companies:

1. a supplier
2. a subsidiary of this supplier
3. a buyer of palm oil.

1. The supplier was selected on the basis of these criteria:

- Company size with regard to palm oil production;
- Severity, scale, and irreversibility of the controversies;
- Local presence of NGOs and trade unions around the identified negative impacts; in order to achieve added value;
- Absence of clear collaboration on this case, little success by pension funds/ asset managers in engagement so far.

Moreover, we established that the company was:

- An important, vertically integrated company in the palm oil market;
- Was able to already reach 100% traceability in its own factories, seeking to ensure 100% traceability in its entire supply chain;
- Faced great reputational and operational risk in light of the controversies surrounding their subsidiary.

2. The subsidiary was selected on the basis of the severity of the controversies

We established that the main supplier was mostly at risk because of the activities of its subsidiary. Whilst none of the investors were directly invested in the subsidiary (a private company), the group found the controversies there to be so severe and persistent that it would be worthwhile seeking direct engagement with the subsidiary, whilst simultaneously engaging the main supplier.

- The disputes focus on grievances raised by stakeholders with concern over the application of Free, Prior and Informed Consent procedures.
- This dispute, also played out internationally, provides a significant concern: resulting in reputational risk for the supplier.



3. To select another player in the value chain, the buyer of palm oil, we valued five major palm oil buyers for their market capitalisation, the total volume of crude palm oil and crude palm kernel (CPO and CPK), and their link to the main supplier.

We did this by analysing their palm oil supplier mill list and assessed their general risk exposure to controversies. We evaluated their palm oil policies and assessed their overall sustainability scores with major ESG data providers, and how they were assessed by parties such as Friends of the Earth and Chainreaction research in public reports.

- We identified the buyer we chose to engage with as a so-called 'mover'. This means the buyer is not leading the pack of buyers, but is stepping up its ambitions when it comes to responsible sourcing. However, there is clear room for improvement in its due diligence process. This means that there is potential for successful engagement: the company has raised its capacity and ambition level to better its policy and practices, so engagement could be very timely.
- Hence, engagement with the buyer allowed the group to engage in two objectives:
 1. The company needs to improve its own due diligence practices and should be able to make significant strides on that front.
 2. By buying from the supplier, the buyer is also linked (or 'directly linked' to use the OECD term) to adverse impacts of the suppliers' business practices and those of the subsidiary.

This is also in line with the RSPO Shared Responsibility Recommendations where actors throughout the supply chain are asked to take responsibility.

Joint fact-finding

How did we go about this?

The continuous exchange of knowledge and expert views between the different parties shaped our strategy. This happened at different stages of the process: at the very beginning while setting priorities, as well as throughout the engagement process.

Setting priorities and defining the scope

Case selection steps



The fact-finding for building the case and defining the scope took four months to complete, and the following criteria were taken into account:

- Added value of collaboration in this case compared to other palm oil initiatives
- Significant investments by pension funds;
- Conditions at smallholders versus plantations: labour conditions and human rights issues;
- Availability of information (facts & figures on local situation of workers and communities);
- Focus to be on salient issues (severity of negative impacts);
- Frontrunner vs. 'laggards': the companies chosen had issues to improve, but were not seen as a 'laggards' or frontrunners.

A virtual meeting of the working group with a local labour union leader in March 2020 provided valuable information and strengthened the mutual trust between the different parties in the working group.



Of particular importance was the targeted fact-finding in January 2021, undertaken by the trade union partners regarding the subsidiaries of the supplier in Indonesia, resulting in real-time information on the labour circumstances situation 'on the ground'. This information was used directly in the formulation of engagement asks submitted by the labour union and taken up by the pension funds.

Confidentiality

Confidentiality was well observed by all covenant parties. Confidentiality is especially important for the protection of local labour union leaders and human rights defenders and was taken into account. When the voices of trade union leaders or human rights defenders – who are aiming to improve their labour and livelihood standards and freedom for unions to operate – are becoming too loud or too organised for the companies involved, they often face harassment, improper dismissals or even personal threats. That is why they are careful to speak up, to avoid negative consequences. Confidentiality needs to be assured for them to be able to tell their story.

Informing the company engagement

While only the pension funds were involved in the direct company dialogues, the parties jointly drafted the engagement asks and discussed interim engagement outcomes.

The expertise of NGOs and trade unions was helpful in this regard. They supported the pension funds to better understand the issues at hand, including the local context, as well as informed the pension funds about relevant sector developments. In continuous consultation with local trade union partners in Indonesia, the labour union was able to provide an informed perspective, taking into account the actual situation on the ground in the palm oil value chain.

The Ministry of Foreign Affairs contacted the local Dutch Embassy. Two virtual meetings were organised to exchange information and obtain more background

information on palm oil developments. The meetings focused on exchanging information on the political and legal framework developments in the country, such as the Omnibus law and the moratorium. The objective was to gain a better understanding of sensitivities of these issues and the diplomatic efforts of the government. The government's focus is on sustainable palm oil consumption (like RSPO) in the Netherlands.

Key findings

- NGOs and labour unions provided the pension funds with relevant resources and information from the ground to inform and strengthen the company engagement. This information was useful. At times, the information had no direct link with the engagement asks and objectives as set out by the group. Nevertheless, the information would be relevant to the business practices of the company and at times, could also be labelled as a possible severe controversy. In those instances, it was hard to establish as a group what to do with this information: especially if the information was not yet verified. In the engagement, the group would then ask the company about their perspective and possible remedial actions taken, and follow up on this as well. However, the group also noticed that this could take away from the main engagement objectives. It is good to be explicit about these possible trade-offs, since time with companies is often limited in engagement meetings.
- The pension funds debriefed the other members on the engagement conversations and all members jointly reflected on the outcomes.
- The engagement objectives were ambitious from the start. Part of the selection criteria of the case was to seek engagement cases that proved hard to solve for parties alone. Addressing systemic issues in the palm oil supply chain takes time, requires significant capacity and leverage, and is dependent on other factors as well. These were known limitations for the covenant members for driving significant changes on the ground.

The engagement

Supply chain management engagement

In short, the engagement was designed to:

- Adopt a value chain approach: engaging throughout the supply chain simultaneously;
- Adopt a multi-focus approach: engaging on human rights (with the focus on community rights and especially FPIC) and labour rights, especially freedom of association;
- Sharing information from trade unions, NGOs and the government:
 - Helped to share insights from the ground, different perspectives, understanding local context and relevant regulations. There were limitations as a result of COVID-19 for fact-finding and research on the ground. Without these limitations, there might have been even more benefits from the information shared.
 - Aimed to overcome knowledge constraints. NGOs and trade unions can help investors better understand the issues at hand, including root causes and what adequate solutions may look like.

Outcomes and tracking process

Before starting our engagement, the group conducted an in-depth analysis of the palm oil sector and the selected companies to identify what the most pressing issues were. This helped us to determine our course of direction and set our engagement objectives. Over time, we followed an iterative process whereby objectives were adjusted throughout the process based on new insights from the company dialogues and sector developments to ensure that the objectives reflected reality on the ground. In 2020, one of the pension funds in this case had sold its shares in the company due to regular portfolio management; and in 2021, the pension fund decided to exclude the company from investment strategies for not meeting the RSPO Principles and Criteria for Sustainable Palm Oil Production.

Engagement objectives	Engagement outcomes / observations / lessons learned / results (Did we achieve something? And did we learn something from this?)
Traceability: To achieve full traceability across the palm oil supply chain, down to the plantation level and provide evidence of this by publishing a complete supplier map by 2022.	<p>The buyer acknowledges the importance of being able to trace back where the palm oil originates from, however was not able to successfully exert influence over the supplier to publish concession maps.</p> <p>“While nearly stagnant on its RSPO certification level and failing to meet its 100% traceability target for 2020 due to the pandemic, the supplier nevertheless significantly increased the share of suppliers <u>traceable to the plantation level since 2018.</u>”</p> <p>Concerns around supplier privacy, competition and local regulation, however, kept the supplier from publishing all of its concession maps. The underlined challenges highlight the importance of independent third parties, such as certification bodies etc. in the verification of traceability claims without jeopardising the company’s supplier relationships.</p>

Engagement objectives	Engagement outcomes / observations / lessons learned / results (Did we achieve something? And did we learn something from this?)
Controversies: To resolve and remediate labour and community rights controversy at subsidiary level.	<p>To resolve and remediate an RSPO complaint around community and labour rights violations filed against the subsidiary, we took a multi-level engagement approach to ensure adequate prioritisation and support from the parent company.</p> <p>At subsidiary level, we asked for concrete and timebound action plans and to research the possibilities for the development of an adequate smallholder – or community-based harvesting model – that would allow for a sustainable and inclusive sourcing process.</p> <p>Meanwhile, we engaged the supplier (i.e. parent company), to ensure not only adequate pressure from the top, but also to provide the financial and technical support needed to swiftly implement changes.</p> <p>While the RSPO complaint was not resolved within the given timeframe, mainly due to the lacking financial accountability from the parent company and the slow progress from both the subsidiary and the RSPO complaints panel, we continue to believe that the two-layer engagement process used provides a unique insight and leverage necessary to align priorities across the supply chain.</p>

Engagement objectives	Engagement outcomes / observations / lessons learned / results (Did we achieve something? And did we learn something from this?)
<p>Freedom of association: To establish the importance of unionisation by making collective bargaining and unionisation part of systematic supplier assessments, and publicly disclosing resources allocated to suppliers with low unionisation rates.</p>	<p>While the buyer and supplier have recognised the importance of social dialogue, reflected in their policies, grievance mechanisms and supplier requirements, both continued to face industry-wide barriers to social dialogue.</p> <p>The supplier identified workers' limited understanding of their rights and a capacity gap among both third-party suppliers and labour unions as the most notable obstacles. While the supplier implemented some capacity building among its third-party suppliers, it failed to set up systematic ways to ensure workers' voices were strengthened across its supply chain, such as:</p> <ul style="list-style-type: none"> ■ Integrating social dialogue within supplier assessments. ■ Providing evidence of effective collective bargaining agreements being reached. ■ Industry-wide collaboration to improve knowledge around workers' rights.

Engagement objectives	Engagement outcomes / observations / lessons learned / results (Did we achieve something? And did we learn something from this?)
<p>Leveraging influence: In general, we asked the palm oil buyer to improve its human rights due diligence and to use its leverage to influence suppliers. The supplier, in turn, should use its leverage to improve human and labour rights at subsidiary level.</p>	<p>Both buyer and supplier acknowledged the importance of conducting their due diligence and did so to a certain extent. While both recognised their ability to exert influence over their upstream business partners, there was little evidence of meaningful pressure from the palm oil buyer and supplier over the supplier and subsidiary respectively.</p> <p>Our layered engagement approach enabled us to gain a more in-depth understanding of companies' levels of accountability in practice. Insights from our conversations with upstream companies strengthened our dialogue with downstream counterparts.</p>

Lessons learned from collaboration

Investments and investment decisions	
<p>Investors can use their leverage over investee companies. Yet investors are most likely to be minority shareholders. The below considerations should be taken into account when engaging:</p> <ul style="list-style-type: none"> ■ Selecting engagement companies with substantial holdings can increase the leverage, thus selecting companies with majority shareholders who are not involved in this process decreases the chance of success. ■ Working together increases the shareholding and the assumed leverage. ■ In reality, investor engagement does not happen in a vacuum and is only one sphere of influence over the company. Success is also dependent upon the company's financial considerations, available capacity, board oversight and priorities, and other stakeholders exerting influence over the company. ■ Divestment or other escalation strategies such as shareholder proposals are thought to be the 'stick'; whilst investors who are not 	<p>currently invested could be the 'carrot', incentivising the company to make progression on issues, and in return investors could make favourable financial decisions by buying shares from the company. In reality, when this concerns smallholdings, the incentive could be minor or non-existent.</p> <ul style="list-style-type: none"> ■ No longer investing in a company could be an active investment decision from an investor (for instance, after unsuccessful engagement), but could also be the results of other types of investment decisions, such as risk-return considerations or the company no longer meeting the criteria for being included in the portfolio or benchmark. <p>From this case, the group concluded that having leverage as a shareholder does not guarantee success: the investors were generally unhappy with the progress made by the supplier.</p>

Lessons learned from collaboration

Working together in a multi-stakeholder group	
<ul style="list-style-type: none"> ■ It is important that the different parties understand each other's interests and each other's limitations. Managing expectations, and knowing each other's capabilities and constraints is important ■ They should also understand each other's responsibilities and limitations under the OECD guidelines. It is important to be open and transparent from the start of and throughout the collaboration about one's own limitations and constraints, and to discuss together potential mitigating strategies when appropriate ■ Once all parties agree to collaborate, it is important for all parties to stay committed to the common interest and wider-understood agenda. It is crucial not to treat each other as 'engagement candidates' within 	<p>the multi-stakeholder group or to use the leverage of the direct relationship of the investor with the investee to achieve the agenda of the other multi-stakeholder group participants.</p> <ul style="list-style-type: none"> ■ Renegotiating the engagement asks is counter-productive and will lead to an erosion of trust among the other participants in the multi-stakeholder group. <p>From this case, the group concluded that the common understanding of each other's role was limited, although a lot of time and effort went into this. If there is no understanding of each other's perspectives and knowledge about each other's sphere of influence at the outset, a multistakeholder approach is not likely to succeed.</p>

Key factors for a successful collaboration are:

- 1) openness and transparency, about your own role and your own goals;
- 2) a clear and joint understanding of the common agenda and the common interest; and
- 3) clear agreements about the commitment to the case by all parties.



Background information about the Agreement (SER)

About the Agreement: The Dutch Pension Funds Agreement on Responsible Investment was signed on 20 December 2018 by 73 pension funds, the Federation of the Dutch Pension Funds, six NGOs, three trade unions and three government ministries. The objective of the Agreement is for the Parties to prevent and tackle the adverse social and environmental impact of investments by pension funds. The number of signatory pension funds is 84 with EUR 1600 BLM AUM. This is 94% percent of the total assets invested by Dutch pension funds.

In this agreement, the signatory pension funds have chosen an approach to identifying, prioritising and addressing risks for society and the environment based on the OECD Guidelines for Multinational Enterprises and the UN Guiding Principles on Business and Human Rights (UNGPs).

Under the agreement, the funds cooperate with the Dutch government, NGOs and trade unions, which in turn share their knowledge and experience and the knowledge and experience of the parties' local partners. This gives the pension funds a better understanding of where risks may occur – for example, human rights violations or environmental damage – and enables them to use their leverage to solve problems and mitigate risks. The ultimate aim is to have a positive impact on the practices of the companies in which they invest. For more information on the Agreement, please visit the [website](#).

Collaboration in cases

The agreement has a 'Wide Track' and a 'Deep Track'. The Wide Track concerns all signatories. Its aim is for all the Dutch pension funds to adopt an approach that will speed up implementation of the OECD Guidelines and the UNGPs in their investment policy and practice.

In the Deep Track, the pension funds work with the Dutch government, trade unions and NGOs on specific cases. They select cases on the basis of the selection criteria specified in advance in the Agreement:

- The adverse impact of the case must be severe.
- The joint investigation should provide added value for the case and allow different parties to contribute their specific expertise.
- The case must address actual and potential adverse impacts on fundamental labour rights and human rights, such as freedom of association, forced labour and children's rights. Cases must act as examples and be instructive, so that the investigation has a broader relevance for the entire pension sector and other Delegations.

Working group members

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