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# A REVIEW OF SINGAPOREAN FINANCIAL INSTITUTIONS' RESPONSIBLE FINANCING POLICIES AS A RESPONSE TO TRANSBOUNDARY HAZE

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**PMHAZE**

a People's Movement to Stop Haze

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## Introduction

The seasonal transboundary haze crisis has been impacting Singapore, Malaysia, and Indonesia as early as 1972, with each poisoning bringing significant adverse impact on public health and the regional economy (Lee 2015). More recently, severe episodes of haze events in 2013, 2014 and 2015 were estimated to have caused 26,300 to 174,300 premature deaths (Koplitz *et al.* 2016). Additionally, these episodes cost USD 16 billion to Indonesia alone (World Bank 2016). The intensifying haze episodes could be attributed to environmental degradation caused by unsustainable land management practices, including peatland drainage and the use of fire for land clearance for agriculture activities, such as palm oil plantation. In addition to causing haze, peat fires also contribute towards destruction of biological diversity and excessive greenhouse gas emissions, which contributes to climate change (Smith *et al.* 2018; Evers *et al.* 2017; Wijedasa *et al.* 2017). As such, transboundary haze is a crisis that requires urgent attention.

Currently, the industrial best practice to manage transboundary haze-inducing forest fires, in addition to other sustainability concerns surrounding the palm oil industry, is for actors across the supply chain to engage in voluntary sustainability certification schemes. The most prominent international certification body of palm oil is the Roundtable on Sustainable Palm Oil (RSPO). Since its establishment in 2004, the RSPO has grown in membership and developed increasingly sophisticated versions of its certification (Nikoloyuk *et al.* 2010). Compared to national sustainable palm oil standards postulated by Indonesia and Malaysia, the RSPO has the most stringent sustainability demands (EFECA 2016). Importantly, the RSPO facilitates information transparency that would allow public scrutiny of the industry. At the same time, it provides a platform for deliberating matters concerning sustainable palm oil (D'Atone and Spencer 2014). The provided a common language and benchmark for industrial stakeholders to initiate a conversation on sustainable palm oil, which facilitates improvement across the board (Tan *et al.* 2009; Richardson 2015).

The RSPO, however, suffers from various shortcomings. First, although its principles and criteria are regularly updated to enhance its stringency, certification still does not completely guarantee against environmental harm. Second, standard setting is a complex and politically charged process that involves negotiation and compromise. Different stakeholders, for example, oil palm farmers, mills, processors,

brands, and NGOs, hold different priorities and expectations to sustainability standards. These differences have at times led to compromises for more lenient requirements (Nikoloyuk *et al.* 2010), or even the breaking down of dialogues (D'Atone and Spencer 2014). Due to their voluntary nature, the effectiveness of these schemes is highly contingent on investor and public awareness of the environmental concerns around the industry to subsequently demand certification and scrutinise both the certification standards and publicly available information provided by actors throughout the supply chain. As membership to the RSPO and certification is often deemed costly, palm oil growers or producers are usually not motivated to participate unless there is external pressure from investors and regulators (Brandi *et al.* 2015). Due to the lack of a legal mandate to adhere to these schemes, the consistent effectiveness of this accountability mechanism is dependent on the availability of resources to track the industry's performance and the willingness to hold industrial players into account if their performance falls short of expectations (Ruyschaert and Salles 2014; Voge & Hutz, 2014).

However, certification standards are not the only solution to the environmental sustainability problems of the industry. Of the myriad of players involved in the palm oil industry, financial institutions (FIs) hold an important lever in pressuring palm oil industrial players to adhere to commit to sustainability, including to certify against voluntary sustainability standards through the strings of their purses (Kusumaningtyas & van Gelder 2017). Historically, FIs have held companies into account for their behavior through divestment, investor activism, investment policies and other informal means of exertion of pressure (Richardson 2009). We argue that in the FIs hold a key position in improving the sustainability performance of the palm oil industry. Existing research suggests that fifteen banks in the world collectively provided 72% of direct loans to sixteen major palm oil companies from 2006 to 2015 (Chain Reaction Research 2017). This high level of concentration of investment in the palm oil industry amongst a handful of banks means their commitment to holding the palm oil industry into account could be a game changer in mitigating transboundary haze.

Singaporean FIs are collectively one of the biggest investors to the palm oil industry. Holding USD 142.69 million worth of investment as of 2018 (Forest and Finance 2018), this working paper argues Singaporean FIs have a key role to play in preventing future episodes of transboundary haze by stepping up their sustainability demands to the industry. Although existing research have observed that FIs in Southeast Asia have failed to hold palm oil companies into account for sustainability due to patronage political interests (Varkkey 2015, 2013), we have observed three significant developments in recent years that may shift the dynamic. First, after the severe haze episodes of 2013 - 2015, there was a rise in awareness in unsustainable agricultural practices among Singaporean FIs (cf. SIIA 2017; 2016; 2015; 2014). Second, the Singaporean government is committed to promoting sustainable and green finance in the coming years. In the G20 meeting in 2017, Singaporean Minister for National Development Lawrence Wong announced that Singapore would take the lead in the region in developing green and sustainable finance (Wong 2017). Furthermore, banks and financial regulators globally are beginning to recognise the financial risks of climate change (TCFD 2017). This means that investments flowing into emission-intensive industries will incur increasingly high financial risks, including risks of physical damage of assets, reputational damage and regulatory burden, all of which would negatively impact the value of the investments (*ibid.*). While environmental credentials are deemed non-financial concerns in the past, investors are beginning to link environmental performance to financial viability after observing several high-profile cases of stock prices diving due to corporate greenwashing and environmental degradation. One notable such instance was the plummeting of the stock price of the palm oil



conglomerate IOI after the suspension of RSPO certification for failing to meet environmental standards in 2016 (Ng 2016).

To elaborate on what role Singaporean FIs could play to holding the palm oil industry into account, this article is organised as follows. The next section of this article explains the rationale of responsible finance and provide an overview of existing strategies in responsible financing and how that could be applicable in the context of sustainable investment in the palm oil industry. This is followed by the methodology section, which explains our evaluation of the progress made by Singaporean FIs on responsible financing in the following section. We then introduce other existing initiatives of sustainable financing of palm oil undertaken by FIs around the world. Based on that discussion, this article concludes with some recommendations for Singaporean FIs and financial stakeholders to further their effort in responsible financing in palm oil. The discussions and recommendations of this paper bear direct policy significance to Singapore, but we believe policy makers, regulators and FIs in the region, especially in palm oil producing countries, would also find relevance in our research.

## 1. Financing the haze

### 2.1 The Cause of Haze

Before we embark on a discussion on how and why FIs should hold the palm oil industry accountable for causing transboundary haze, we would first clarify the cause of transboundary haze and the significance of its environmental harm. Transboundary haze is directly attributable to vegetation fires in Southeast Asia. Although fires could be started by natural cause or accidents such as the careless disposal of a cigarette butt, there is growing scientific evidence suggesting that large-scale deforestation and peat drainage has created a fire-prone landscape that has become the most significant contributor to fire risk (Hoijeer *et al.* 2013; Evers *et al.* 2016; Page 2002).

Peat soil is composed mainly of partially decayed plant matter formed over thousands of years. Peat swamps are waterlogged and rich in carbon (Kuwata *et al.* 2016). When peat swamps are cleared and drained, the canopy that was protecting the soil is removed, which dries up the soil and exposes the carbon-rich peat to the tropical heat, increasing the chances of catching fire (Evers *et al.* 2016). Peat fires can smoulder underground for a long time and spread across large areas of land, making it challenging to extinguish (Rein *et al.* 2008). Therefore, to prevent future episodes of transboundary haze, it is more effective to avoid creating environmental conditions that are fire-prone, than to rely on deployment of firefighting services later.



## 2.2 The Palm Oil Investment Chain

One of the key challenges of preventing haze is tracking the origins of fire and holding players accountable accordingly, due the complexity of the palm oil supply chain. Figure 1 depicts the palm oil supply chain.

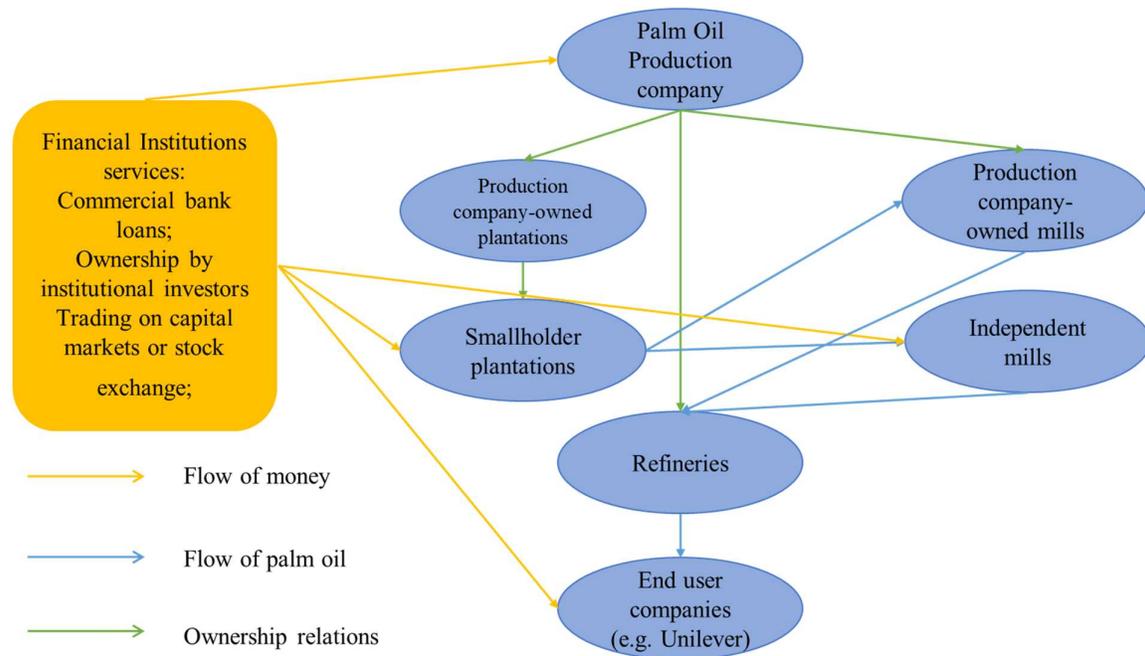


Fig. 1 Palm oil supply chain from plantations to end users, and where financial institutions (indicated in yellow) are involved with different players along the supply chain (Developed from PM Haze 2018)

The variety of ownership models of plantation poses the first challenge of tracing the responsibility of causing of haze. There are three models of ownership of a plantation:

1. Plantations that are owned by an agribusiness companies. This type of plantations constitutes 40% of crude palm oil output (Kusumaningtyas and van Gelder 2017).
2. Smallholders who have working arrangements with agribusiness companies, otherwise known as plasma smallholders. Plasma smallholders typically own plantations and sell all palm fruits directly to the company's mills that they contracted with.
3. Smallholder who have no working arrangements with any companies, otherwise known as independent smallholders. Independent smallholders own plantations and sell the palm fruits to any nearby. It is at the mill's discretion to sell the oil to any palm oil production company for collection, transport and refinery.

According to the RSPO, plasma and independent smallholders combined make up 40% of oil palm plantations. Refined oils produced from the mills are then sold to brands that subsequently use the different types of oils to be used as fuels or to produce food, cosmetics, or lubricant products, as depicted at the bottom of Figure 1.



Due to the lack of reliable maps and information on ownership of plantations (Jelsma *et al.* 2012), there is yet to be evidence determining whether fires happen more frequently at one of the types of plantations outlined above. Notwithstanding, we believe large agribusinesses ought to shoulder the responsibility of ensuring that their supply chains are haze-free. This is because firstly, they have control over the first two categories of plantation ownership. Secondly, most of the oil produced from independent smallholders still end up being sold to large agribusiness companies by the mills (Chain Reaction Research 2017).

There is a further argument of equity. There is an unequal distribution of quality land and technology between large agribusiness companies and smallholders. Large firms tend to occupy large masses of fertile mineral lands and have access to the technology to maximise productivity, leaving smallholder farmers with access only to less fertile peat soils that are also prone to fire (*ibid.*). Smallholders also take back home a small portion of the fruits of their labor due to “rent-seekers”. Research found that farmers who claim land, cut trees, slash and burn land only gain 26 percent of the total value of “ready-to-plant” land per hectare, while farmer organisers, usually politicians or public figures, fetch the majority of 57 percent on comparison (Purnomo *et al.* 2017). Further, large agribusiness firms have access to hotspot-detection technology to determine if their supply chain is involved in causing transboundary haze.

In addition to governments and regulators, two groups of stakeholders could hold large agribusiness companies into account. At the end of the supply chain are consumers who hold the power to ‘vote with their pockets’. Empirical studies have proven that companies whose performance fall short of consumer’s sustainability expectations suffer from reputation damage (Power *et al.* 2009; Walker *et al.* 2014). In recent years, poor management of environmental performance and climate change impact have become a reputation concern for firms (Nikolaou *et al.* 2015). In the context of the palm oil industry where the end of the supply chain leads to individual consumers, reputation risks could become a threat when consumers collectively boycott a brand.

However, achieving the mass mobilization required for successful consumer boycott of brands is extremely challenging. Collective action requires collective awareness, availability of information and willingness to act from a wide universe of population (Paavola 2010). That is, everyone who consumes palm oil must be aware of the issue of haze, understand its causes, how they could contribute to stopping it by voting with their pockets and be willing to act on it. Given some of the countries with the greatest palm oil consumption per capita are developing countries, such as India and Bangladesh, it is not realistic to expect, at least in the near future, that consumers with low income to conduct the necessary research, then subsequently seek alternative oils that could potentially be more costly in replacement of unsustainable palm oil (Corley 2009). Moreover, consumers are only exposed to brands, meaning their influence of their ‘pocket vote’ over plantation and production companies is limited and subjective to the transparency of brands disclosing where they source their palm oil from.

Contrastingly, financial institutions are exposed to the full range of actors throughout the supply chain, including plantation companies, production companies and brands, as well as smaller scale actors such as individual mills and plantations who would also seek bank loans. By taking advantage of their power as shareholders to demand more information and setting improvement targets, FIs have a much stronger and concentrated leverage to influence the operations of palm oil companies than consumers. The next subsection introduces the history, logic and various strategies of responsible financing.



## 2.3 Responsible Financing

Responsible financing takes root in Quaker principle-driven investments, where the investments in 'sin' industries such as pornography, arms, gambling tobacco and alcohol are avoided in order to comply with religious values (Ayling and Gunningham 2017; Richardson 2009). Since then, investors have expressed their ethical, social or political values through their investment. Four different strategies to responsible financing are explored below, namely divestment, environmental, social and governance performance aligned (ESG) investment, impact investment and blended value investment.

Divestment simply refers to the withdrawal of an investment from an entity whose values or performance contradict with that of the investors'. One notable example of these traditional principle-driven investment is the South African apartheid divestment campaign (Kaempfer *et al.* 1987). The withdrawal of investment from companies controlled by the regime effectively drained the regime's financial resources which ultimately led to the regime's downfall.

In recent years, divestment has been adopted by investors as a means of taking climate action (van Durren *et al.* 2016). Like traditional principles-driven divestment, investors would screen their portfolio to remove investments into products and industries that conflict with their environmental values. For example, high net worth individuals or private institutions such as university endowment funds have led the trend of fossil fuel divestment, by way of reflecting their personal or institutional commitment to addressing climate change (Grady-Benson and Sarathy 2016; Nelson 2017). In recent years, pension funds and governments have joined the divestment movement, although the majority of institutions committed to fossil fuel divestment remains to be religious and philanthropic entities (Go Fossil Free *online*). Although the political message that the fossil fuel industry no longer has the support of several institutions might be significant, fragmented divestments efforts is insufficient in restricting financial resources of fossil fuel companies. Furthermore, divestment may lead to 'sustainability leakage', where investors who have little concern over climate change would take advantage of the lowered stock price and buy in at a lower cost after other climate-conscious investors have divested (Richardson 2009). Moreover, divested investors would lose their leverage over investees. As divesting cut all ties between the investor and the investee, any opportunities for a guided and phased approach towards sustainability would be lost. Thus, divestment has increasingly been regarded as a last resort among FIs (Stuart-Smith *et al.* 2018).

Taking a completely opposite strategy to divestment, impacting investing is an investment approach that seeks to create measurable positive outcomes. Impact investing has been developed to intentionally create both financial and social returns (Barman 2016). This investment approach was at first most commonly deployed by family offices and philanthropic funds in the US with a view of employing a market solution to resolve poverty (*ibid*). In recent years, impact investment has gained tractions, tailoring to specific investors mandates such as environmental conservation, gender equality, food security and education, involving a wider range of players including mainstream institutional investors (GIIN 2016; Conservation 2014 Finance Alliance 2014). However, empirical evidence has shown that impact investment does not necessarily yield greater non-financial returns, such as environmental and social impact, compared with their mainstream counterpart (Kish and Fairbairn 2017). The segregation of financial from non-financial returns gives rise to a hierarchy of priorities, and some impact investors choose not to follow up with its social and environmental indicators diligently once the transaction is completed.



Other new investment philosophies such as ‘blended value investment’ are introduced to bridge the divide between traditional investment and responsible investment by putting values at the heart of investment decision making. This approach stems from the understanding that the value of an investment is not limited to financial returns and investees must also consider the environmental and social risks or opportunities of their businesses. Investors take into account the overall performance in aspects of social, environment, governance and financial and have been deployed in a range of financial products to suit various ESG and financial goals. Using this approach, investors can take advantage of their power as shareholders to pressure the board of their investee to report, set targets or reach specific sustainability targets for their sustainability performance (McLaren 2004).

Responsible financing has not been widely deployed in the past as investors fear that the pursuit of environmental and social goals would compromise financial outcomes. However, in recent years, there have been increasing calls for responsible financing to become mainstream to address the increasing concerns of climate change affecting financial performance and the urgency to achieve the United Nations Sustainable Development Goals. Following an outline of our methodology, this article takes stock of the approaches to responsible financing in the agricultural business industry taken by Singaporean FIs.

### 3. Methodology

To determine the progress Singapore has made, we analysed documents on sustainable investment policies of the palm oil industry by major banks and banking associations in Singapore and compared them with the equivalent international practices. Specifically, we focused on the level of detail of the policies, the scope they cover and the stringency of the policies. We also compare these policies with existing international and national sustainable palm oil production, procurement and investment standards. To support our analysis, we also analysed publicly available information provided by banks on their ESG investing and loaning policies. In our analysis process, we realised that some banks claim to have a palm oil or sustainable investment policy but choose not to disclose it publicly. While we appreciate that such policies might be in place and are executed, we had to discount them as we believe the transparent disclosure of such policies is part of good sustainability governance.

### 4. Progress so far: what has worked for Singapore?

According to an investigation conducted by Chain Reaction Research and the Rainforest Alliance Network, the three local Singaporean banks, namely DBS, Overseas Chinese Banking Corporation (OCBC) and United Overseas Bank (UOB) are all directly involved in palm oil financing loans, primarily through providing bank loans (Chain Reaction Research 2017). Furthermore, GIC, Singapore’s sovereign wealth fund, holds shares in at least twelve listed companies in the palm oil supply chain, including palm oil producing companies, consumer goods brands and conglomerate groups (Eikon *online*). Among Singaporean banks, OCBC tops the list with financing close to USD 2.5 billion. DBS comes second with approximately USD 1.25 billion, and UOB comes third, providing approximately USD 600 million (Chain Reaction Research 2017). These figures display the deep involvement of the Singaporean financial institutions in the palm oil industries. Alarming, the same Chain Reaction Research report found that Indonesian palm oil firms financed by DBS and OCBC have been engaging in

environmentally degrading practices (*ibid.*). The following will assess the progress made by Singaporean FIs in recent years, and whether existing progress and policies are sufficiently comprehensive to ensure their investments would be haze-free.

#### 4.1 Investee Engagement

The severe haze episode in 2015 prompted Singaporean banks to adopt responsible financing policies targeted at the palm oil industry, with DBS leading the way in announcing a palm oil policy in 2017, followed by OCBC and UOB (PM Haze 2018). Sector-specific responsible investment guidelines signifies the bank's acknowledge of sustainability concerns in the palm oil and agricultural sector more generally. By disclosing their responsible financing policies, banks are on one hand communicating their expectations with their clients, on the other signaling to the public of their commitment (or the lack of) to the issue. The policies adopted by the Singaporean banks have improved over the years. According to the scorecard published by the Forests & Finance which assesses the environmental and social policies of major banks, both DBS and OCBC scored 1 mark out of 30 points in 2016 (Forest and Finance 2016). In 2018, DBS scored 15 out of 50 points (Forest and Finance 2018; see more details on the scorecards in Section 5.2.1).

To track the progress of Singaporean banks in greater detail, we have compared the policy framework published by the three major Singaporean banks with HSBC and Rabobank, who has been scored by Forest and Finance as the best performing bank in sustainable investment in the palm oil sector (Forest and Finance 2018; see comparison analysed in Table 1). We found that all three Singaporean banks have referenced the ABS Guidelines on responsible financing and the haze-free diagnostic tool kit (See Section 4.2.2). All three banks also have commodity- or sector-specific guidelines for financing palm oil or the agriculture industry, but the extent to which the banks have disclosed their policy differs. Amongst Singaporean banks, DBS's policy makes the closest references to industry best practices, for example the updates made by RSPO in its 2019 Principles and Criteria. This includes no conversion of High Conservation Value and High Carbon Stock Forests, no plantation on peat, no plantation without securing both the legal right and community support to use all the land involved via a 'free, prior, informed, consent' process, no open burning for land clearance (DBS 2019). UOB is the only of the three banks to suggest that a lending relationship would be terminated if the borrower is deemed unwilling or unable to meet the bank's sustainability requirements, however the requirements or the timeframe for which a client could revise their practices before UOB terminates the relationship unspecified. Of the three banks, OCBC has disclosed the least amount of information regarding their responsible financing policy in the agriculture-fishery industry.

However, there is still a significant gap in the stringency of policies between the Singaporean banks and HSBC and Rabobank. In comparison, Rabobank and HSBC have more specific and stringent requirements. For example, Rabobank specifies that their responsible financing policy in palm oil is applicable to clients involved in the entire palm oil production chain that might be seeking any of their banking services. Both banks have also warned of a timeframe for clients to comply by their requirements, with HSBC being the most transparent about an exact date by which clients must comply with the RSPO. The lack of specificity weakens the stringency of the policy. For instance, the DBS policy does not distinguish the Indonesian and Malaysian national certification scheme with the



more stringent RSPO scheme, which gives companies a significant leeway to settle for lower sustainability performance. DBS also does not require palm oil investees to become a member of the RSPO. In comparison, the HSBC policy requires specific compliance with RSPO certification. It also does not address palm oil supply chain companies other than the growers specifically. In comparison, Rabobank specifies that their policy for palm oil is applicable to clients involved in the entire palm oil production chain that might be seeking any of their banking services. Further, the policy falls short of addressing how the bank would support existing clients to achieve certification or set timeframes to act against non-compliant borrowers. According to DBS, any lending policies only apply to new lending relationships and there is no time-bound action plan for improving the sustainable practice of existing clients. UOB is the only one of the three banks to suggest that a lending relationship may be terminated if the borrower is deemed unwilling or unable to meet the bank’s sustainability requirements, however the timeframe to do so was not specified. In comparison, both Rabobank and HSBC put forward a timeframe within which the borrowers must comply with the respective palm oil policies, with HSBC being the most transparent about the deadline by which clients must comply with the RSPO P&C.

DBS	<p>References ABS guidelines.</p> <p>Recognises the Indonesian Sustainable Palm Oil (ISPO), Malaysian Sustainable Palm Oil (MSPO) or Roundtable on Sustainable Palm Oil (RSPO). But does not exclusively lend to clients certified by these standards.</p> <p>New lending relationships must comply with “no Deforestation, no Peat, no exploitation” policies. These clients also need to disclose that they are not involved in High Conservation Value (“HCV”) and High Carbon Stock (“HCS”) forests, peatland plantation, plantation without securing legal rights and community support under the free, prior, informed, consent process, and open burning for land clearance in according to the ABS Guide</p> <p>Policy towards existing lending relationships is not addressed.</p>
OCBC	<p>References ABS guidelines.</p> <p>Has agriculture and forestry sector-specific policy in place that references International Finance Company (IFC) industry sector guidelines, as well as the RSPO and Equator Principles Association.</p> <p>The policy is periodically reviewed and updated, but the details of the policy are not publicly available.</p>



UOB	<p>Reference ABS guidelines.</p> <p>Has agriculture sector-specific policy in place.</p> <p>Prohibits financing of companies that do not have measures to manage or to mitigate the risk of air, soil and water pollution, involved in the exploitation of labour, including forced labour and child labour, based on the International Labour Organisation (ILO) standards; in violation of the rights of local or indigenous communities; and involved in open burning for land clearance.</p> <p>Borrowers are notified of any updates of the Responsible Financing Policy and the bank proactively engages with borrowers to adhere to compliance if not best practice, including compliance with RSPO.</p> <p>In the event of a known ESG-breach, an immediate review could be triggered and borrowers would be required to rectify any breach within a stipulated time frame. The relationship could be terminated if the borrower is deemed unwilling or unable to respond adequately.</p>
Rabobank	<p>Code of conduct and Palm Oil Supply Chain policy in place, which applies to all services provided by the bank and throughout the entire palm oil supply chain. Companies are required to get certified, failing that, they must disclose issues regarding legality, human rights, prior consultation, land rights, open burning, planting area, and social and environmental impact assessment. The bank would engage and set a timeframe for clients that are showing insufficient progress.</p> <p>Encourages clients downstream in the palm oil supply chain to have a purchasing policy in place.</p>
HSBC	<p>The follow categories of palm oil supply chain companies must meet all requirements by the dates specified:</p> <p>A. Growers and Mills: [To become] member of RSPO by 31 December 2018 and [to adopt] a time-bound plan for 100% certification by December 2014; [to announce] public commitment on the protection of HCS and peat (NDPE policy); [to publish] due diligence on HCS and peat for new plantation by 30 June 2017; [to obtain] 100% RSPO certification of all management units; [to obtain] evidence of independent verification of HCS and peat commitments by 31 December 2018</p> <p>B. Refiners and Traders: [To become] member of RSPO and a time-bound plan for 100% certification by 31 December 2018; [to adopt] a plan to exclude palm oil from controversial sources, by providing “traceability”, within a set timeline by December 2014; [to announce] public commitment on the protection of HCS and peat (NDPE policy) by 30 June 2017; [to obtain] 100% RSPO certification of owned facilities; [to obtain] evidence of (own or suppliers’) independent verification of HCS and peat commitments by 31 December 2018</p>

Table 1 Comparison of palm oil policies between Singaporean banks (DBS, OCBC and UOB) and selected international banks (Rabobank and HSBC)

In addition to introducing sustainable financing policies, a reward-based approach has been introduced in recent years. In November 2017, Wilmar became the first palm oil company to work with the Singaporean branch of ING, a bank headquartered in the Netherlands, to couple the company’s sustainability performance to loan terms (ING 2017). The principle for the sustainability performance-linked loan was to provide a financial incentive for companies to enhance their ESG performance. The bank and company would agree to a set of performance indicators and the progress will be measured by a third party expert in ESG research and ratings. Following Wilmar’s first loan, Olam entered



a similar arrangement with fifteen banks (Olam 2018). Since the first sustainability-linked loan, Wilmar has entered into similar loan arrangements with OCBC (June 2018) and DBS (August 2018), both unconditioned upon the company's environment, social and governance performance rating according to independent sustainability consultancy firm, Sustainalytics (OCBC 2018; DBS 2018).

Though undoubtedly innovative, the effectiveness of this approach in encouraging more sustainable performance is questionable. This is not least because there is a lack of transparency of the loan terms involved, making it challenging to assess whether the targets set were meaningful, and whether they were met fully. It is also questionable whether the reduction of interest gives companies enough motivation to improve, as the worst-case scenario would be paying the same interest without any other forms of losses.

## 4.2 Commitment to Industrial Standards

Industrial standards provide a benchmark for performance for both palm oil companies and FIs investing in the industry, providing a standard of performance expectation, as well as a platform for comparison and accountability. Compliance to industrial standards also signals the sustainability commitment of the party. On the contrary, non-compliance may lead to reputational or even punitive consequences. Finally, commitment to industrial standards concurrently provides a knowledge community and a deliberation platform of best practices and common challenges, which may provide a resolution to certain obstacles in committing to sustainability. This section would examine the commitment to industrial standards by Singaporean FIs.

### 4.2.1 The Roundtable on Sustainable Palm Oil (RSPO)

The RSPO P&C is the most well-known international sustainability standards for palm oil producers, refineries and buyers. It provides a sustainability certification scheme for different stakeholders in the palm oil supply chain, including palm oil processing and trade companies, FIs, NGOs and consumer brands, as well as other deliberation platforms and resource pool for capacity-building (Nikoloyuk *et al.* 2010). For its FI members, RSPO requires the publication of an internal palm oil policy and specify a time-bound plan for providing financial services and products to clients that are RSPO members.

The RSPO is supported by and is in active collaboration with high profile responsible investment networks, such as the United Nations Principles for Responsible Investment (*ibid.*). There are several benefits to FIs becoming members of the RSPO. First, it signifies their commitment to financing sustainable business and reduce the reputation risk associated with the palm oil sector. Second, the RSPO P&C provides a set of off-the-shelf standards for FIs to screen its portfolio, which could simplify the FIs' engagement with their investees on. The community of the Roundtable also provides knowledge transfer and peer support in achieving sustainability best practice. In addition, as a member of RSPO, FIs gain the right to compel the RSPO secretariat to take corrective actions against non-compliant RSPO members through the grievance procedure. FIs can file formal complaints against RSPO member companies which could prompt the RSPO secretariat to investigate alleged non-compliant conduct. If the complaint is found to be true, RSPO can suspend or revoke the company's membership, which could lead to commercial and reputational consequences. For instance, HSBC, an RSPO member, instigated an investigation into Noble Plantations following allegations that the company was preparing to clear thousands of hectares of rainforest in Papua for palm oil (Paddison 2017). Though



HSBC did not file a formal complaint, it triggered the RSPO to issue a stop-work order until full independent investigation and assessment is completed.

The work of RSPO is internationally recognised and there is a strong case for Singaporean FIs to become members. Prof Tommy Koh, a former Singaporean diplomat and a prominent figure in Singaporean society, has called for all the financial institutions in Singapore to join the roundtable in the wake of the 2013-2015 haze episodes (Jayakumar & Koh 2015). However, as yet, none of the Singaporean banks are members of the Roundtable. The table below provides a list of FIs who are members of the RSPO. Although the majority on the list are European banks, two Indonesian banks have committed to the Roundtable. It thus appears that Singaporean FIs are lagging behind some of their Indonesian counterparts.

<b>Name</b>	<b>Country/Origin</b>	<b>Member Since</b>
HSBC Holdings Plc	United Kingdom	2004
Cooperative Rabobank U.A.	Netherlands	2004
International Finance Corporation (IFC)	United States	2005
Standard Chartered Bank	United Kingdom	2006
ANZ Banking Group Limited	Australia	2008
Credit Suisse AG	Switzerland	2010
Citi	Indonesia	2010
BNP Paribas	France	2011
UBS AG	Switzerland	2012
Koperasi Kredit Keling Kumang	Indonesia	2014
ABN AMRO Bank N.V.	Netherlands	2014
Commerzbank AG	Germany	2014
ING Bank N.V.	Netherlands	2015
African Agriculture Fund LLC	Mauritius	2015

Table 2: RSPO members in the “banks and investors” category (Source: [www.rspo.org](http://www.rspo.org))



#### 4.2.2 The Singaporean Standard on Responsible Financing

Alongside international industrial standards, countries have established national standards to provide more targeted guidance to issues specific to their countries. National standards are important in engaging FIs domestically as they signal the relevance of the issue at hand. In cases where domestic banks are not confident in committing to international standards, national standards could pave a way to harmonization by gradually levelling up the playing field.

In the aftermath of the 2015 haze episode, the Association of Banks in Singapore (ABS), a membership-based non-profit organisation that represents the interests of the Singaporean banking community issued its first Guidelines on Responsible Financing. Importantly, the Haze Diagnostic Kit was attached to the guidelines which detailed how banks should require all their palm oil, pulp and paper clients to manage haze and fire risks (ABS Haze Diagnostic Kit 2018).

The ABS Haze Diagnostic Kit suggested that banks should assess all existing and new clients and monitor them on an ongoing basis. The kit has since seen a new iteration coming as 'version 1.1'. In Table 3, we compared the kit with the latest RSPO P&C 2018 to test its stringency (See Table 3 for summary). The guideline prohibits open burning on own peatlands and requires companies not to accept suppliers that use open burning to clear the land. This requirement is consistent with RPSO P&C 2018, Indonesia Sustainable Palm Oil standards (ISPO) and ASEAN Policy on Zero Burning guidelines. Further, the guidelines require companies to implement comprehensive fire prevention, monitoring and suppression measures. The Kit prohibits new development on peat, regardless of depth after 16 Nov 2015, a cut-off date three years earlier than that of RSPO P&C 2018. As for the management of existing plantations on peat, the guideline requires the companies to adhere to RSPO NEXT guidelines and encourages companies to adopt the "RSPO manual on Best Management practices for Existing Oil Palm Cultivation on Peat." The RSPO NEXT standards were published in 2015 and incorporated additional requirements to the RSPO P&C. It is noteworthy that the RSPO NEXT requirements on management of existing plantations on peat are largely identical with that of the RSPO P&C 2018. The guideline also requires adequate infrastructure and manpower capacity to combat fire, as well as real time monitoring of fire hotspots via satellites, e.g. use of the World Resource Institute's Global Forest Watch Tool.

In general, the ABS Haze Diagnostic Kit emphasizes on better fire prevention and peatland management in order to reduce risks of transboundary haze that affects Singapore. To this end, the Kit references the most progressive industrial standards on peatland management. However, the Kit lacks conviction in preventing deforestation by new plantations, which was a significant addition to the new RSPO P&C 2018. Further despite a great emphasis on fire prevention and peatland management, the ABS Haze-Diagnostic Kit does not address land clearing causing deforestation nor the protection of High Conservation Value (HCV) or High Carbon Stock (HCS) forests. This omission may be due to the perception that deforestation does not directly cause fire, thus it is unnecessary to address deforestation for the purpose of reducing risks of transboundary haze. It is unfortunate that the Kit missed the opportunity to stress the importance of forest conservation and instead takes a "Nimby" attitude towards deforestation when Southeast Asia is among the world's major deforestation hotspots mostly due to land clearance for palm oil plantations.



In addition, the ABS Haze Diagnostic Kit is not as strict as it could have been on water management. Water management is an essential part of fire prevention measures. In order to prevent fire, the water table should be maintained as high as possible. The Kit adopts the standard of the Indonesia National Interpretation of Principles and Criteria of RSPO, which requires maintenance of water tables at an average of 60 cm below ground surface. While this level is within the required water table specified in the Guidelines for the Implementation of the ASEAN Policy on Zero Burning (which is between 50 and 75cm), it falls short of the requirement in RSPO Manual on Best Management Practices (BMPs) for Existing Oil Palm Cultivation on Peat 2018 Draft (which is 40-50cm). The lack of a complementary water policy with that of peat and deforestation hinders the effectiveness of the standard in preventing peatland fires.

In terms of compliance and implementation, the Kit does not require companies to get thirdparty assurance. The absence of such requirements weakens the strength of the guideline as it reduces the accountability of the companies and restricts public scrutiny on companies that are potentially involved in haze-causing activities. Further, the Kit does not require banks to verify the accuracy of the concession maps that the companies provide. Due to the complexity of land ownership issues, banks need to verify companies' own maps with official maps, maps possessed by NGOs and even via ground truthing to accurately establish the operational boundaries of plantations. Without independent verification of the maps, it may be difficult for banks to hold their clients liable for fires when discrepancies exist between companies' own maps on paper and the operations on the ground.

Most importantly, like RSPO, the ABS standards are not legally binding. ABS have commented that based on experience, banks would improve under peer pressure and ABS was confident that the banks would comply with the guidelines (Lee, 2018). While the ABS Haze Diagnostic Kit may be considered "soft law" or a quasi-legal instrument that serves as the *de facto* Singapore national standard on the forestry and palm oil industry, its effectiveness is highly dependent on the level of importance the industry attributes towards haze prevention and environmental sustainability in the palm oil industry in general.



<b>Requirements</b>	<b>ABS Haze Diagnostic Toolkit</b>	<b>RSPO (P&amp;C 2018) Equivalent</b>
No Open Burning		
No open burning on own plantation and associated smallholder land	<ol style="list-style-type: none"> <li>1. SOPs to ensure no open burning in line with best practices: Indonesia National Interpretation Guidelines for the Implementation of the ASEAN Policy on zero burning (this guideline provides technical guidance for zero burning plantation)</li> <li>2. Land use map requirement, referencing ISPO</li> <li>3. Records of no burning to clear land, referencing Indonesian National Interpretation of the Principles and Criteria of RSPO.</li> </ol>	7.11 Fire is not used for preparing land and is prevented in the managed area.
Peat		
Comply with regulations in each country regarding the planting on peat and new peat area	Policy documents and SOPs to prohibit new development on peat, regardless of depth after 16 Nov 2015.	No new planting on peat, regardless of depth after 15 Nov 2018 and all peatland are managed responsibly
Water Management	<ol style="list-style-type: none"> <li>1. Policy documents and SOPs on management, retirement, and restoration of planting on existing peat (RSPO NEXT)</li> <li>2. Records of maintenance of the water table at an average of 60 cm below ground surface, referencing Indonesian National Interpretation of the Principles and Criteria of RSPO.</li> <li>3. Records of drainability assessments prior to planting on peat with reference to Indonesian National Interpretation of the Principles and Criteria of RSPO.</li> </ol>	<ol style="list-style-type: none"> <li>1. RSPO Manual on Best Management Practices (BMPs) for Existing Oil Palm Cultivation on Peat 2018 Draft and RSPO NEXT: in-field water level should be maintained at an average of 40-50 cm</li> <li>2. RSPO drainability assessment procedure</li> </ol>

Table 3. Comparison of ABS Haze-free toolkit Version 1.1 to RSPO Principles and Criteria 2018



### 4.3 Divestment

As previously discussed, the adoption of the divestment strategy may directly avoid the negative impacts of an undesirable investment. However, compared to investor engagement and target setting strategies, the impact of divestment may be undermined by the effect of “sustainability leakage” when a less environmentally conscious FI takes advantage of the situation and continue to fund companies with poor sustainability practices.

Notwithstanding its shortcomings, this approach has been taken by the Norwegian Government Pension Fund Global (GPFG), managed by the Norges Bank Investment Management (NBIM), in dealing with deforestation in the forestry commodity industry. A “risk-based divestment” strategy was pursued which actively divest from companies that are linked to deforestation. In 2012, GPFG sold its stakes in 23 of the world’s largest palm oil companies, reducing its investment in Malaysian and Indonesian palm oil industry by 40% (Gnych 2013). Later in 2015, GPFG was reported to divest from 43 corporations due to deforestation risks, more than half of which were palm oil companies (Hence 2015). Further in 2016, CPFG divested from six palm oil companies and revealed their names, sending a clear signal to the palm oil industry that it must stop deforestation (Gaworecki 2016). In 2016, NBIM reportedly carried out a thorough review on the performance of the palm oil sector, in order to assess whether the sector had improved. Eventually GPFG decided to stay out of the palm oil sector, citing specific challenges such as lack of traceability in the palm oil supply chain, and lack of faith in palm oil certification systems (Rainforest Foundation Norway 2017).

NBIM’s action may have inspired other investors to divest from palm oil companies. In 2014, Deutsche Bank, a German banking giant sold its share in Bumitama, an Indonesian palm oil company (Mongabay, 2014). In 2016, Dimensional Fund Advisors, a US-based asset manager, removed shares of palm oil producers, including Wilmar International, Olam International, Sipef SA and Indofood Agri Resources, from its two US and international sustainability investment portfolios (Chasan, 2016). Recently, Aegon Netherland, a Dutch insurance company, sold its interests in palm oil companies, stating that the sector was unable to improve (Aegon Asset Management 2018).

As yet, no Singaporean FIs have engaged in divestment. Owing to its abrupt nature, it is not necessarily a suitable option for Singaporean FIs to take either. It is however worth bearing in mind that divestment, especially by more environmentally conscious European FIs may continue if the palm oil industry could not prove to drastically improve their sustainability performance. This approach is consistent with the trend of rejection of palm oil in Europe. In the short term, divestment may affect the palm oil industry and the millions of workers in the palm oil industry negatively. It may also bear a negative impact on other FIs currently invested in the industry as share prices drop. As previous sections have detailed, there are a variety of viable strategies to engage with the palm oil industry to improve their sustainability performance other than divestment. This means the FIs currently engaged with the palm oil industry may have a heavier burden in pushing for rapid improvement in sustainability to avoid damages caused by divestment.



## 5. Discussion and Recommendations

While FIs may improve the sustainability performance of regional forestry and palm oil companies through their lending and investment activities, they have not done so with the vigor required to eliminate the transboundary haze crisis. Based on the discussion above, gaps exist between the actions taken by Singaporean FIs and the best international practices. The Singaporean standard as established by the ABS Haze Diagnostic Kit is less comprehensive than international industrial standard. Due to the lack of transparency, it is difficult to assess the actual impact made by FIs beyond the stringency of their palm oil policies.

FIs do not operate in silos. Regulators, governments and the civil society all play a role in the broader financial ecosystem in holding them into account. The section below explores what the Singapore regulators and civil society may do so that the FIs rapidly improve their lending and investment practices and halt financial flows into companies that continue to practice environmentally unsustainable agricultural practices, such as peatland drainage and slash and burn.

By drawing on the case study of Singapore with its unique legal and penal system, this article has demonstrated that certain civil society strategies that were typically used in western societies to hold FIs into account would not be applicable. As such, governments and regulators must step in to play a firmer and stronger role.

### 5.1 Regulatory Action

We encourage regulators and industrial bodies to continue to drive change through their close relationship with the industry. We recommend ABS to update their Haze Diagnostic Kit and close the gap with industry sustainable best practices, such as the latest RSPO P&C, in line with the practical need and technical capacity of Singaporean FIs.

Additionally, we would recommend ABS and Monetary Authority Singapore (MAS) to engage in sector-focused capacity building workshops to raise awareness and technical capacity among Singaporean FIs to engage in responsible financing in their investment approach in the palm oil industry. As the first step of its Green Finance Action Plan, the MAS recently published Proposed Guidelines on Environmental Risk Management (Guidelines) for banks, insurers and asset managers. The Guidelines require the FIs to implement robust environmental risk management policies and processes, and effectively monitor, manage and disclose their exposure to environmental risks. The Guidelines purports to serve as “call to action” for FIs to acts as a “force for good” in driving the transition towards an environmentally sustainable economy (MAS *online*). While it is certainly a progressive step by the government to nudge the FIs in the right direction, the Guidelines’ efficacy remains to be seen, especially considering the potentially lack of enforceability. As the proposed Guidelines is currently under public consultation, its evaluation will only be appropriate upon finalization.

Finally, we believe the Singapore Exchange (SGX) could build upon their existing efforts in mandating sustainability reporting for their listed firms to make sector-specific disclosure recommendations



to encourage listed palm oil companies to make meaningful assessment and disclosures of their sustainability performance.

## 5.2 Civil Society Action

Due to the rising public awareness on environmental damages caused by irresponsible and unsustainable financing by FIs, many NGOs and the public, increasingly demand FIs to improve their sustainability practices. For example, civil society groups in Europe and North America have been demanding the disclosure of information on the FIs exposure to environmentally damaging projects, thereby providing basis for public pressure and scrutiny. This final section discusses the various strategies taken by NGOs and research bodies to pressure FIs to improve their practices in the palm oil industry and recommends relevant strategies to the Singaporean context to accelerate the transition to responsible financing.

### 5.2.1 Scorecards

The most popular method of monitoring the performance of various FIs involved in the palm oil industry comes in the form of scorecards. An independent assessor, usually an NGO, scores the performance of FIs according to its own scoring criteria. Scorecards facilitate comparison and benchmarking between industrial actors, and track progress of any individual actor overtime. They equip the general public with the information that would allow them to instigate conversations, stage campaigns and make investment decisions according to their commitment to forestry sustainability.

There are two prominent scorecards that assess the sustainability performance of Singaporean banks, namely the ESG Integration Disclosure Results of ASEAN Banks (2019 update) by WWF, and Policy Assessment scorecard (2018 update) by the Forests & Finance, a collaborative effort between the Rainforest Action Network, TuK Indonesia and consultancy firm Profundo. While the WWF assessment focused on the overall integration of the ESG considerations into the banks' processes and products, the Forest & Finance assessment was targeted at the banks' specific investment exposure in the palm oil, pulp & paper, rubber and tropical timber ("forest-risk sector") supply chains.

According to the WWF scorecard, which assessed DBS, OCBC and UOB, the three Singaporean banks on average obtained full marks on formulating sustainability strategy and stakeholder engagement, assessing ESG risks in client & transaction approvals, and client monitoring and engagement. However, all three Singaporean banks lacked in disclosure of ESG risk exposure and targets, as well as ESG integration in products and services. The WWF recommended the regulators to strengthen mandatory requirements around disclosure of ESG information, and the banks to develop and strengthen climate-related and natural capital risk strategies, and to use science-based standards, asset-level data and geo-spatial tools to manage climate-related and natural capital risks (WWF 2019). Overall, the WWF assessment provides valuable insights of the progress of sustainable finance among ASEAN banks. However, due to its emphasis on policy recommendations and the high-level discussions on all sectors, this assessment is more suitable for policy makers to improve the governing measures rather than for the public to hold the banks accountable.

The Forest & Finance scorecard, on the other hand, provides the specific environmental risk exposure of the banks to the forestry sector. The scorecard not only assesses the policies based on scope of commitments by financier and the ESG standards for their clients, but also provides a database on the banks'

total credit to the forestry sector so that the public can understand how much each bank is involved (Forest & Finance 2019). The additional information on the banks' exposure to the forestry sector is helpful for the public to understand quickly the level of involvement of their domestic banks in the sector. The three Singaporean banks are among the top financiers to the forestry sector and the result of their assessment, as well as their involvement in the forestry sector are listed in table 4.

Bank	Bank Policy Assessment 2018 (full mark is 50)	Total Credit (2010 – 2019 USD million)	Ranking based on Total Credit among banks assessed
DBS	15	1064	#7
OCBC	9	504	#19
UOB	11	299	#26

Table 4 Forest & Finance assessment of Singaporean banks, i.e. DBS, OCBC and UOB

The scoring criteria of the Forest & Finance assessment are specific to the forestry sector. For example, the environmental standards for clients comprise of the following sub-criteria: (1) operations that convert/degrade natural habitat prohibited; (2) operations that drain/ degrade peatland prohibited; (3) operations that convert/ degrade HCS forests prohibited; (4) operations in/impacting protected areas prohibited; (5) companies must identify and protect HCV areas; (6) use of fire for land clearing prohibited; (7) trading in or harvesting International Union for Conservation of Nature (IUCN) Red List or the Convention on International Trade in Endangered Species of Wild Fauna and Flora) species prohibited; (8) introduction or use of genetically-modified and/ or alien species or harmful pesticides prohibited. The three Singaporean banks scored poorly according to the environmental sub-criteria as they either had no policy on deforestation related criteria ((1) and (4)) and wildlife protection ((7) and (8)) and only implied by certification requirements without explicitly formulating the policies on the rest of the sub-criteria ((2), (3), (5) and (6)). Furthermore, the three Singaporean banks were judged to lack significantly in social and governance standards for their clients. The highest scores according to the 2018 update were given to ABN Amro and Rabobank, both scored 39 out of 50. This shows the significant gap between the sustainability performance of the Singaporean banks with the best performance by international banks.

Scorecards are limited by information availability as banks may not always be forthcoming with their responses to surveys or requests. Furthermore, in the absence of a universal scoring criteria, some may argue that the assessments by international NGOs are harsh on the Singaporean banks and fails to consider the economic context and the banks' needs. However, the comparison on an international scale unveils the gap between Singaporean banks with the international counterparts. Particularly, the Forest & Finance assessment is a readily available tool for the Singaporean civil society to hold their financial institutions into account. Likewise, FIs that wish to align their investment with forestry sustainability could refer to the scorecard to aid their decision making. Therefore, the continuous updates to the scorecards should be maintained and the results should be communicated to the Singaporean public.

### 5.2.2 Information depository



Like scorecards, an information depository provides publicly available information on the sustainability performance of FIs to aid the decision making of consumers and investors. Banktrack, for example, keeps a continuous record of the banks, both domestic and international, that have invested in deforestation. They also track the deals and transactions made between banks and companies, as well as the projects that result from it.

The long-term objective of information depositories is to track sustainability progress overtime for the sake of informing investment decision-making. In the shorter term, the availability of such information has provoked protests, public demonstrations, and marches which were organised to hold banks responsible. While it is not convenient for Singaporeans to participate public protests as a means of holding FIs into account, public awareness and information availability should be encouraged in maintaining accountability in the industry.

### 5.2.3 Reputational Risks Exposé

Investigation and exposés are getting increasingly popular in recent times due to the advent of social media. In an exposé, an FI is targeted, investigated and the findings are reported. Often, these FIs are singled out for its links to specific environmental or social injustices and non-compliance to its ESG policies or the lack thereof. For highly influential NGOs, FIs might directly engage with them to reduce further fallout. However, FIs might sideline or ignore smaller organisations to prevent them from gaining legitimacy through direct engagement.

NGOs make use of this highly visible marketing strategies with the objective of prompting immediate and proportionate reaction from the public and the target FI. While it is the *modus operandi* of international organisations such as Greenpeace and Market Forces, other NGOs have used this as a last resort after multiple failed attempts via other means. Exposés are useful for ad-hoc and high impact reporting, capable of rapidly thrusting a particular issue into the limelight. They are also useful in bringing attention to less relatable issues, where the general public might not be directly affected by the consequences of the problem.

However, it is difficult and indeed risky to carry out field investigation, not least because plantation locations are often remote and local governments are not receptive of foreign NGOs or academic institutions to carry out research. Alternative approaches, such as publications of public letters urging banks to take certain sustainability action, have been better received. For example, in 2018, PM Haze published a public letter urging DBS to change their investment policy in coal. This approach that achieves both the objectives of engaging with FIs and increasing public awareness could be scaled up and applied to other FIs in Singapore and in the region.

## 6. Conclusion

Singapore, as Southeast Asia's financial hub and as one of the biggest investors in the Southeast Asian palm oil industry, has both business and moral reasons to lead the adoption of responsible investment principles. We therefore recommend that Singaporean FIs should begin to disclose fully their palm oil investment policy to make it available for public assessment and scrutiny. As Singaporean FIs



contribute a significant proportion of financing flowing into the palm oil industry, they ought to take the lead in demanding the adoption of international best practices, including requiring existing and new clients to obtain the most stringent certification, RSPO, within a given time period. Finally, like many banks that are serious about working with their clients to improve their sustainability performance, Singaporean banks should participate in discussions at RSPO or equivalent platforms, join RSPO membership and contribute to its standard setting.

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