AN APPROACH FOR TRANSFORMING THE PALM OIL INDUSTRY:

LESSONS LEARNED AND IDEAS FROM TFT

AS TFT APPROACHES THE END OF THREE INTENSIVE YEARS WORKING TO ACHIEVE TRACEABLE, RESPONSIBLE SUPPLY CHAINS IN THE PALM OIL INDUSTRY, IT'S TIME TO TAKE STOCK OF THE LESSONS WE HAVE LEARNED VISITING DOZENS OF PALM OIL GROWERS, MILLS AND PROCESSORS IN MORE THAN 20 COUNTRIES.

"We're questioning the ability of the commonly adopted certification-driven market transformation strategy to deliver change at the pace necessary for people, for communities, or for companies wanting to protect forests and build responsible supply chains."

As this paper will show, we're questioning the ability of the commonly adopted certification-driven market transformation strategy to deliver change at the pace necessary for people, for communities, or for companies wanting to protect forests and build responsible supply chains.

Our approach suggests that companies should **take full ownership of their sustainability performance,** rather than externalising their responsible sourcing commitments to commodity roundtables. It is an approach that aims to embed the environmental and social quality of the palm oil companies purchase into their brand values, just like other aspects of **product quality**.

Nestlé has done this through its Responsible Sourcing Guidelines (RSGs), and any other company could do the same through its own sourcing policies - call them what they want, 'Responsible Purchasing Principles', 'Sourcing Policy' or other, the important factor is that they are the **company's own policies**. RSGs integrate the environmental and social quality of ingredients into the brand's products and provide deeper brand meaning and values.

The partnership we have started with Nestlé is very much **a human journey** inside a very complex global commodity trade that involves buyers, suppliers, traders, producers, technicians, communities, auditors, activists and many other stakeholders. We have found that market and industry situations around the world are as diverse as forests, and thus we believe it is crucial for us to design solutions that can **adapt** to this diversity locally and embrace complexity, while remaining practical and viable economically. This is also why we question the validity of a centralised "one fits all" model (like market transformation through certification), as it is only by **innovating** at every level of the supply chain that transformation will be scalable and will benefit people, economies, and the environment on a large scale. However, it is important to note that while we do not see current roundtables and certification schemes succeeding as an engine for market transformation, they do have *a* place in stimulating the discussion between stakeholders around good practices and the verification of these good practices at *plantation level*.

OUR APPROACH IS GUIDED BY THREE PRINCIPLES:

1

SETTING KEY VALUES...

...of No Deforestation, respect for workers and their communities, and traditional tenure rights through a proper Free, Prior and Informed Consent (FPIC) process. These are basic environmental and social quality requirements and they have the **biggest impact** on people and the environment - this is what companies should focus on as a priority.

2

SEEKING TRACEABILITY:

Brands should **know where their oil comes from**. Without traceability, how can a company know if its purchasing principles are being effectively implemented by its suppliers, and if they are not, find out what and where the issues are?

3

REMEMBERING THAT PALM OIL IS A COMMODITY:

Because it is a commodity, economies of scale and logistics are underpinning the trade. Solutions that make logistics more complicated and add significant costs (like segregation) are not viable.

This document explains the rationale for the strategy TFT and Nestlé have been implementing over the past three years, and how we believe an approach focused on traceability is the fastest way to ensure the transformation of the palm oil industry whilst building on existing efforts that are being made in certification.

"Brands should know where their oil comes from. Without traceability, how can a company know if its purchasing principles are being effectively implemented by its suppliers?"

WHAT'S WRONG WITH THE CURRENT SYSTEM?

As we started to look into palm oil supply chains in 2008, we identified four main limitations of the RSPO-driven market transformation model for palm oil:

1

CLIMATE CHANGE AND DEFORESTATION IMPACTS ARE LARGELY IGNORED

Clearance of peat and other high carbon stock lands is seldom addressed in the definition of 'sustainable' or 'responsible' palm oil. We must not forget the reason why the whole discussion about sustainable palm oil started ten years ago: it was mostly about deforestation. This issue is still not being tackled adequately in the definition of what is and is not responsible land conversion.

2

'BOOK & CLAIM' AND 'SEGREGATION' OPTIONS DO NOT DRIVE CHANGE UP THE SUPPLY CHAIN.

In adopting a segregation model, commodity roundtables have copied the supply chain solutions developed for timber certification schemes. In the timber industry segregation and product labelling make sense. Logs cannot be mixed together and wood is the major ingredient of the end consumer product. Palm oil, in comparison, is a liquid and is a minor, near invisible fraction of the final product bought by the consumer. Palm oil is not easily segregated in industrial processes. Companies wanting traceable palm oil from responsible producers have to pay large premiums to refiners and intermediaries for them to isolate/segregate tiny amounts of certified products.

Very few consuming markets in the world can absorb such a cost increase. In emerging economies, which represent the majority of global palm oil by volume, none can pay those premiums.

The system also doesn't reward growers who have made the effort to improve their practices, since most of the premium money is used to pay for logistical costs and does not make it back to the farms. This is why we think that this demand for segregation is **unlikely to scale up** at a level that would generate industry transformation at all, or at a pace that can address the key environmental and social issues.

Due to the costs and impracticality of segregation, many brands simply abandon the effort altogether, or purchase Book & Claim RSPO GreenPalm certificates alongside untraceable palm oil. They are often praised for buying GreenPalm certificates without actually having achieved any transformation. Why would they do more? On the growers' side, the premium received is so low that it is unlikely to incentivise anyone. The end result is that there is very little demand for transformation upstream, the majority of the markets remain opaque, and little change happens on the ground.

3

SMALLHOLDERS ARE BEING ACTIVELY EXCLUDED FROM SUPPLY CHAINS

Smallholders often lack the support and infrastructure to certify their farms with expensive and resource-intensive third-party certification programs. There are some success stories, but they are anecdotal or the result of subsidised aid projects. The truth is that it takes much longer to certify smallholders than it does to certify an industrial plantation. Centralised management and monitoring systems have to be created, farmers trained, auditors have to visit more fields, and many other structural and financial barriers exist, including the cost of certification.

Refiners therefore concentrate their "sustainable" supply base around larger plantations which are able to absorb the certification process – effectively locking smallholder palm oil producers out of international markets and preventing the livelihood benefits they can enjoy through access to trade. This is especially true for independent smallholders who do not benefit from the influence of a plasma (smallholder integration) scheme for certification. Given that 40% of the world's palm oil is produced by smallholders, we are deeply concerned about a certification-driven approach that will result in their exclusion (and the resulting lost opportunity of increasing their yields and reducing overall demand for new planting land).

4

IT'S NOT FAST ENOUGH

It takes time for growers to meet extensive, detailed lists of certification indicators that require large amounts of documentation, and then they must wait in line for their turn to be assessed by a limited number of approved auditors. Meanwhile, No Deforestation, protection of peatlands, respect for workers and local communities' traditional tenures are all issues that do not require extensive documentation and can be quickly checked by many different third parties or NGOs. It can turn bulldozers off quickly.

Additionally, there are entire regions of the world where practices like planting on peat, clearing forest or encroaching on indigenous peoples' lands are very rare, due to the natural topography or rule of law. Companies should be able to recognise 'low risk' sources and not waste time with detailed audits in these regions. Instead, they should focus efforts on areas where practices urgently need to be changed to save forests and people.

40%

"Given that smallholders produce 40% of the world's palm oil, it is deeply troubling that a certification-driven approach results in their exclusion."

THE WAY FORWARD: "100% TRACEABLE NO DEFORESTATION"

TFT believes that responsible palm oil is a key element of our partners' brand value. Brands want values to be represented consistently throughout their supply chains for all their markets, from biscuits in Europe to ice cream in Brazil. **Companies cannot afford expensive segregation** or to switch suppliers entirely. They need technical solutions that will work for moving large volumes of responsible palm oil through supply chains that have already been optimised for their business. It does not make sense to lock smallholders out of meaningful participation in building a sustainable industry.

To use an example, imagine palm oil as water: in countries where water treatment is poorly carried out upstream, every household needs to install a filter at tap level. However, if the water treatment is done well, every household can open the tap and drink water safely without worry.

Through our mapping of the supply chain, we identified that in each country there is only a handful of refineries that "treat" palm oil (on average between 3 and 10). Hardly any are currently committed to making sure that 100% of the palm oil they process is responsible. If those refineries were to commit to making sure that **100% of what comes out of their facility is "safe"** in terms of environmental and social quality, there would be no need for anyone to worry about segregation downstream and the huge complexities this generates (see Figure 1, below).

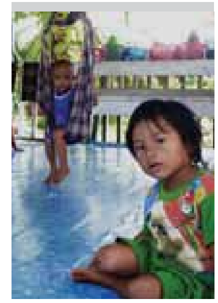
Starting from the assumption that we need to *minimise the cost of segregation as much as possible*, we must aim to have only responsible oil coming out of a mill or a refinery. This means that everything coming into the mill must be *currently implementing or committed to achieving responsible practices*.

Palm oil buyers currently face the risk that their supply chains are associated with unacceptable social and environmental practices.

Typical mills and refineries have a mix of FFB/CPO (Fresh Fruit Bunches /Crude Palm Oil) sourced from:

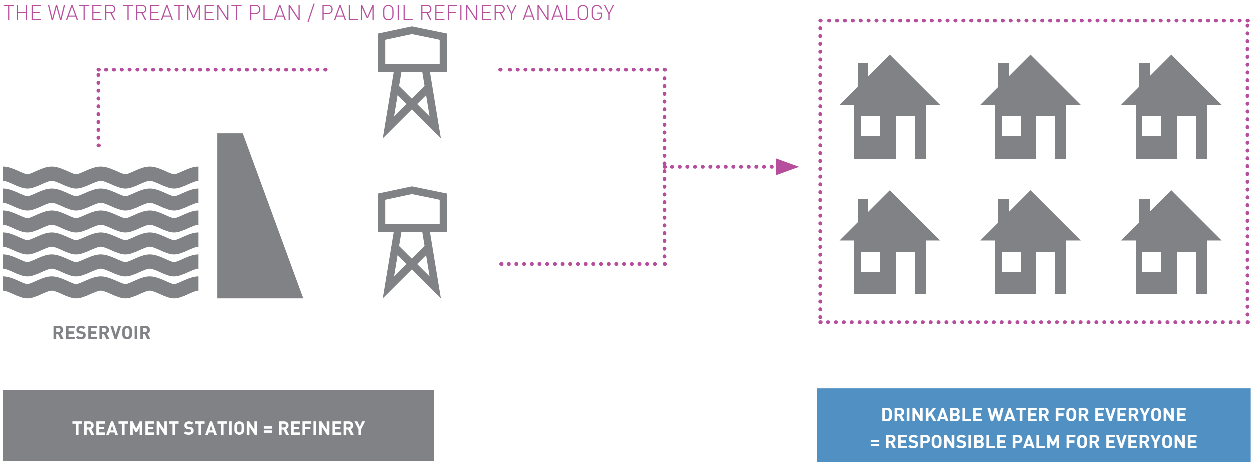
- plantations that are certified RSPO (Roundtable on Responsible Palm Oil)
- plantations that are not yet certified/responsible, but are moving in that direction
- smallholders
- plantations that do not intend to become responsible actors

The output from refineries is in essence a traditional RSPO Mass Balance flow: a blend of certified palm oil with uncertified, usually untraceable oil, presenting a risk to buyers that their supply chains are associated with unacceptable social and environmental practices.



"Our mapping of the supply chain identified in each country has found that only a handful of refineries "treat" palm oil. Hardly any are currently committed to making sure that 100% of the palm oil they process is responsible"

FIGURE 1:
THE WATER TREATMENT PLAN / PALM OIL REFINERY ANALOGY



TFT'S APPROACH BEGINS WITH THESE NATURAL FLOWS AND ASKS THE FOLLOWING ADDITIONAL EFFORT FROM THE REFINERY / MILL:

- Achieve full traceability back to the farm, plantation or group of smallholders
- Assess and monitor its suppliers' current practices but also their willingness to improve, and support them to achieve real change.
- Eliminate from the supply chain those plantations and growers who are not performing well in terms of sustainability and who are not interested in changing.

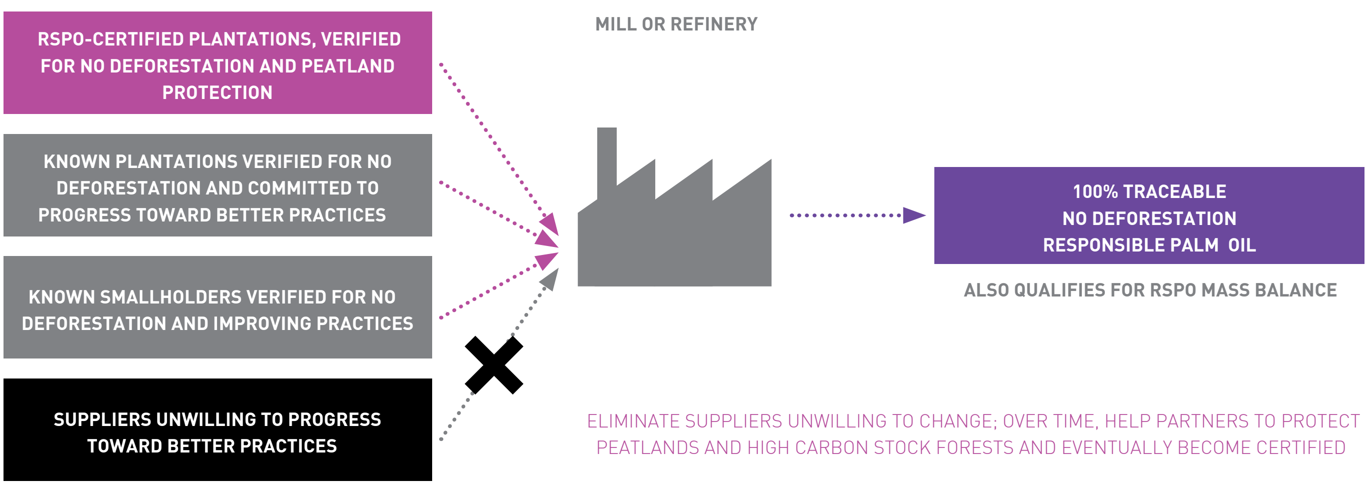
As a result, and relatively quickly, 100% of the palm oil flowing out of a refinery can be:

- **100% traceable**
- **a mix of "responsible" and "moving towards responsible"** (with the entry level of responsibility being a commitment to implement a **No Deforestation** policy and a credible and transparent action plan that can be monitored by second and third parties)

This is illustrated in Figure 2, below.

Also, and because there will naturally be a mix of RSPO with non RSPO, this flow will naturally qualify as RSPO Mass Balance, allowing those companies who have made RSPO commitments to show progress on those.

FIGURE 2:
100% TRACEABLE NO DEFORESTATION



WHAT DOES IT TAKE TO PUT ONE FLOW OF 100% TRACEABLE NO DEFORESTATION OIL INTO PRACTICE?

TFT takes a supply chain approach to implementing change. Changes come from the combined effort of supply chain actors sharing the same values and the same ambition:

RETAILERS AND MANUFACTURERS MUST:

demand **traceability** as a first step, and, forming a critical mass, make suppliers understand that GreenPalm certificates will only ever be a short-term solution for mainstream markets. If the right signals are not sent to suppliers, how can we expect them to transform? TFT is working with dozens of buyers in the US, UK, France, Switzerland, Philippines and Singapore to coordinate their requests for fully traceable, responsible, No Deforestation palm oil.
We have found that **involving the supplier's procurement teams, not just sales or sustainability teams**, is crucial.

PROCESSORS AND INTERMEDIARIES MUST:

cooperate with buyers to open up supply chains transparently and share information about sources, performance and risks.

TFT is increasingly seeing willingness on the part of some traders and mills to provide traceability and a deeper understanding of sustainability risk to their clients, even after years of thriving on opacity in commodity supply chains. They are coming to terms with the fact that NGO and consumer pressure on brands to be responsible actors will only increase, and that traceability could actually be a tool to make their business sustainable by better controlling access to raw material and avoid time and energy lost in crisis management when bad practices are discovered in their supply chains.

not talk to suppliers about price only: Where does the oil I buy come from? Who are the growers? What are the conditions there? Are my suppliers deforesting?

take ownership of the process of building verification systems upstream to provide concrete evidence to any interested party that the oil is traceable and meets certain responsibility criteria. For this to occur, **innovation** needs to happen among the growers, the mills, the refiners and the traders.

TFT (OR OTHER ORGANISATIONS) HELP TO:

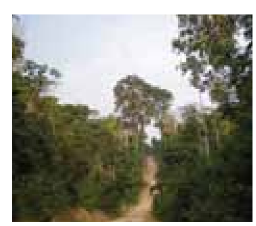
assess risk throughout the supply chain, including individual suppliers, through field visits. Because the 100% Traceable No Deforestation approach does not rely solely on certification to assess supplier performance but rather depends on more flexible assessments of producers' and suppliers' willingness to improve, it is essential for companies to partner with field experts who have strong ties to local watchdog groups in order to have a full understanding of sustainability performance.

Bring supply chain actors together to innovate and find solutions. In our view there are many ways to provide evidence of traceability and responsible practices in order to build a 100% Traceable No Deforestation flow of oil. That is why we don't suggest a one-size-fits-all solution, but guide partners to let solutions emerge naturally among industry actors, who, after all, know best what can and cannot work. We can provide tools like traceability software and performance tracking, but ultimately we feel that true transformation can happen only if it is driven by the supply chain actors themselves.

THIRD PARTIES SUCH AS LOCAL NGOs OR CERTIFIERS CAN:

provide an external verification of the quality of the traceability systems in place, and how responsibly a producer is acting on the ground.

"If the right signals are not sent to suppliers, how can we expect them to transform? In our experience, involving suppliers' procurement teams, not just sales or sustainability teams, is crucial."



100% TRACEABLE NO DEFORESTATION:
A TOOL FOR SCALING UP INDUSTRY TRANSFORMATION

Nestlé's approach has been accused of being "niche". It is anything but. It is already bringing traceable, responsible palm oil at a decent cost to emerging markets that use a lot of palm oil, including the Philippines and Indonesia. Eliminating logistical complexity is freeing up money to invest in supporting transformation on the ground: at plantation and smallholder level. **Nestlé's approach can easily be reproduced by any brand, with or without TFT. It is driven by the brand and can be implemented by anyone**.

It is true, though, that it is a very demanding approach:

First, the brand needs to look inside and question itself internally. In Nestlé's case, the Greenpeace campaign accelerated this process. But it is nevertheless challenging to set ambitious targets in terms of environmental and social quality and discuss values in what is perceived as a price-driven commodity market. It takes **courage** to make these requirements a true part of how business is done on a daily basis, including deploying it throughout the organisation and providing adequate resources to be able to make it happen.

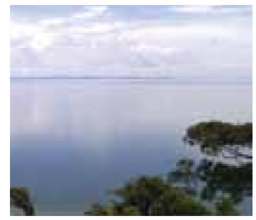
Once it has defined its values and translated them into Responsible Sourcing Principles, the brand needs to **take a genuine interest** in its supply chain. Rather than waiting for suppliers to come with a cheap, ready solution or taking the shortcut of buying GreenPalm certificates, the procurement teams need to **engage** with suppliers to better understand their constraints and ask for traceable, responsible flows. This transparency phase is essential but takes time, energy and a lot of **trust-building** between individuals.

For traders and intermediaries, this demand is an opportunity to differentiate. But it is also hard work to untangle the complexities of an operation that has for years been optimised to keep prices down, not bring traceability and responsibility.

For upstream actors (processors, mills, growers), the challenge is in **innovating** to provide buyers with **evidence and verification** of good practices and traceability.

These are clearly investments worth making to ensure the long-term sustainability of such a key product, as well as providing jobs, income and nutrition to billions of people worldwide.

TFT doesn't pretend to have all the answers; we keep an open mind and want to learn from others' experience. However, we believe that the approach described in this paper and currently being implemented by Nestlé and other companies is a powerful way forward for responsible palm oil. It is ambitious, it is economically viable, it is inclusive, and it is quickly scalable, anywhere in the world. Moreover - and this is a very important point - this approach does not rely on one single organisation. Values like traceability and No Deforestation do not belong to anyone. It is an ***open source*** approach that anyone can adopt at any time. The more brands willing to adopt such an approach, the faster the industry will transform, and the faster people and forests will be respected.



"For traders and intermediaries, this demand is an opportunity to differentiate. But it is also hard work to untangle the complexities of an operation that has been for years optimised to keep prices down, not bring traceability and responsibility."

CONTACT US

For more information on TFT's palm oil approach or any aspect of our work, please contact:

Bastien Sachet, Director, TFT
T: +41 (0) 22 367 94 40
E: b.sachet@tft-forests.org

ABOUT TFT

Established in 1999, TFT is a global non-profit that helps businesses bring responsible products to market. TFT helps its more than 90 members worldwide build responsible supply chains by identifying and addressing embedded social and environmental issues. Having established a strong record of achievement in timber supply chains, TFT has expanded its work into palm oil, leather and stone.

GLOBAL OFFICES

FIELD SUPPORT OFFICES:

SWITZERLAND (HEAD OFFICE)
The Forest Trust
Chemin des Brumes 4
1263 Crassier
T: +41 (0) 22 367 94 40

UK
The Forest Trust
Innovation Centre
2 Venture Road
Chilworth
Southampton SO16 7NP
T: +44 (0) 2380 111220

FRANCE
The Forest Trust
Centre Tolède
51-53 rue de l'Alcazar
59000 Lille
T: +33 (0)3 20 31 63 39

NORTH AMERICA (US & CANADA)
TFT
3417 Evanston Ave N, STE 421
Seattle, WA, 98103
T: +1 206 414 0758

FIELD OFFICES:

INDONESIA
Dr.Wahidin no.42
Semarang 50255 – Indonesia
T: +62 24 8509798

CHINA
Room 1202, Block A
Ocean Express
No.66 Xiaguangli
North Road East Third Ring
Chaoyang District, Beijing
100027
T: +86(0)10 8446 7353

VIET NAM
Room 702, Number 341 - 343
Dien Bien Phu Street
Binh Thanh District, Ho Chi Minh City
T: +84 (0)8 351 22538

CAMEROON
Rue du Foyer Bandjoun
Quartier Etoa Meki
Yaoundé
T: + 237 94 97 96 24 / +237 97 49 84 48

BRAZIL (MAIN OFFICE)
Rua Orlando Fagnani, 470, sala 212.
Nova Campinas
CEP 13083-200
Campinas, São Paulo.
T: +55 (0) 19 3395 0712
+55 (0) 19 3291 4867

BRAZIL (SUPPORT OFFICE)
Travessa Quintino Bocaiuva 1588,
3º andar, bloco A.
Bairro Nazaré.
CEP 66035-190
Belém, Pará
T: +55 (0) 91 3242 0859

INDIA
608 Kirtimahal Building
19 Rajendra Place
New Delhi 110008
T: +91 (0) 11450 09389