WILL JAPAN'S MEGABANKS STOP FINANCING RAINFOREST DESTRUCTION?

A call to action to align financing with the SDGs & Paris Climate Agreement

January 2020

RAINFOREST ACTION NETWORK

CONTENTS

PHOTO (ABOVE): A MEMBER OF INDONESIA'S LOCAL DISASTER MANAGEMENT AGENCY (BPBD) MONITORS THE PEAT FIRES FROM THE AIR ABOVE OGAN ILIR DISTRICT. IMAGE BY NOPRI ISMI/MONGABAY INDONESIA. 2019

PHOTO (COVER): A HELICOPTER DUMPS WATER ON BURNING PEATLAND IN CENGAL, OGAN KOMERING ILIR DISTRICT. IMAGE BY NOPRI ISMI/MONGABAY INDONESIA. 2019

INTRODUCTION

In 2019, Indonesia was again scarred by widespread fires that blanketed the country and its neighbors in a toxic haze. The fires ravaged over 850,000 hectares of land and forest; an area ten times larger than Singapore. An estimated 709 million tons of greenhouse gas emissions were released by Indonesia's fires from January 1- November 15 2019, far exceeding the CO2 released by fires in the Amazon rainforest in the same year.[1] These fires alone made Indonesia the sixth largest carbon-emitting country in the world, just behind the US, China, India, Russia and Japan.

A major cause of these fires has been the clearance of tropical forests and carbon-intensive peatlands for plantation development. Indonesia's National Agency for Disaster Management (BNPB) estimated that 80% of the fires were deliberately started to clear land for oil palm plantations, while existing pulp plantations have resulted in hundreds of fires due to their heavy reliance on fire-prone peatlands.[2] In an attempt to mitigate the damage, the Government of Indonesia sealed off plantations owned by 83 palm oil, pulpwood and rubber plantation companies,[3] many belonging to large corporate groups. Unfortunately, the financial sector continues to fuel Indonesia's plantation and forestry sectors with vast sums of credit. **Financing behind some of the culprits of this year's fires, such as the Sinar Mas Group, Royal Golden Eagle Group, and Salim Group, is traceable back to the Japanese megabanks - most notably Mitsubishi UFJ Financial Group (MUFG) and Mizuho Financial Group (Mizuho)** (See Graphic 1).

Deforestation and fires are not the only problems in Indonesia's commodity sectors driving deforestation ("forest-risk commodity sectors"). A 2016 audit into the palm oil sector by Indonesia's Anti-Corruption Commission (KPK) found corruption rife in the plantation permit-issuance process, resulting in social conflicts, state fiscal losses and illegal deforestation.[4] The country's National Audit Agency (BKP) report in 2019 found that 81% of oil palm plantations are in breach of a range of regulations. This included companies operating without Cultivation Use Rights (HGU) and planting in protected and conservation areas such as carbon-rich peatlands which are highly combustible and drive the annual fire and haze during the dry season.[5] MUFG and Mizuho, as well as Sumitomo Mitsui Financial Group (SMBC Group) are also linked to such companies.

The three megabanks have significant exposure to some of the largest palm oil and pulp & paper companies operating in Southeast Asia, as well as companies engaged in the natural rubber and timber sectors. Given all three banks are aggressively expanding their business in Southeast Asia, particularly Indonesia, their exposure to Environmental, Social and Governance (ESG) risks in these forest-risk commodity sectors will most likely increase unless accompanied by more robust due diligence in their financing activities.

Unfortunately, the financing practices by the megabanks show that finance to these high risk sectors are being provided without credible checks on client compliance with legality or sustainability standards, nor without adequate sustainability performance criteria - like no deforestation, fire prevention or peatland restoration - built into loan agreements. This is clearly demonstrated by the case studies that follow, detailing activities by clients that include illegal plantation development, land rights violations, fires, destruction of tropical forests and peatlands, and violations of labor laws.

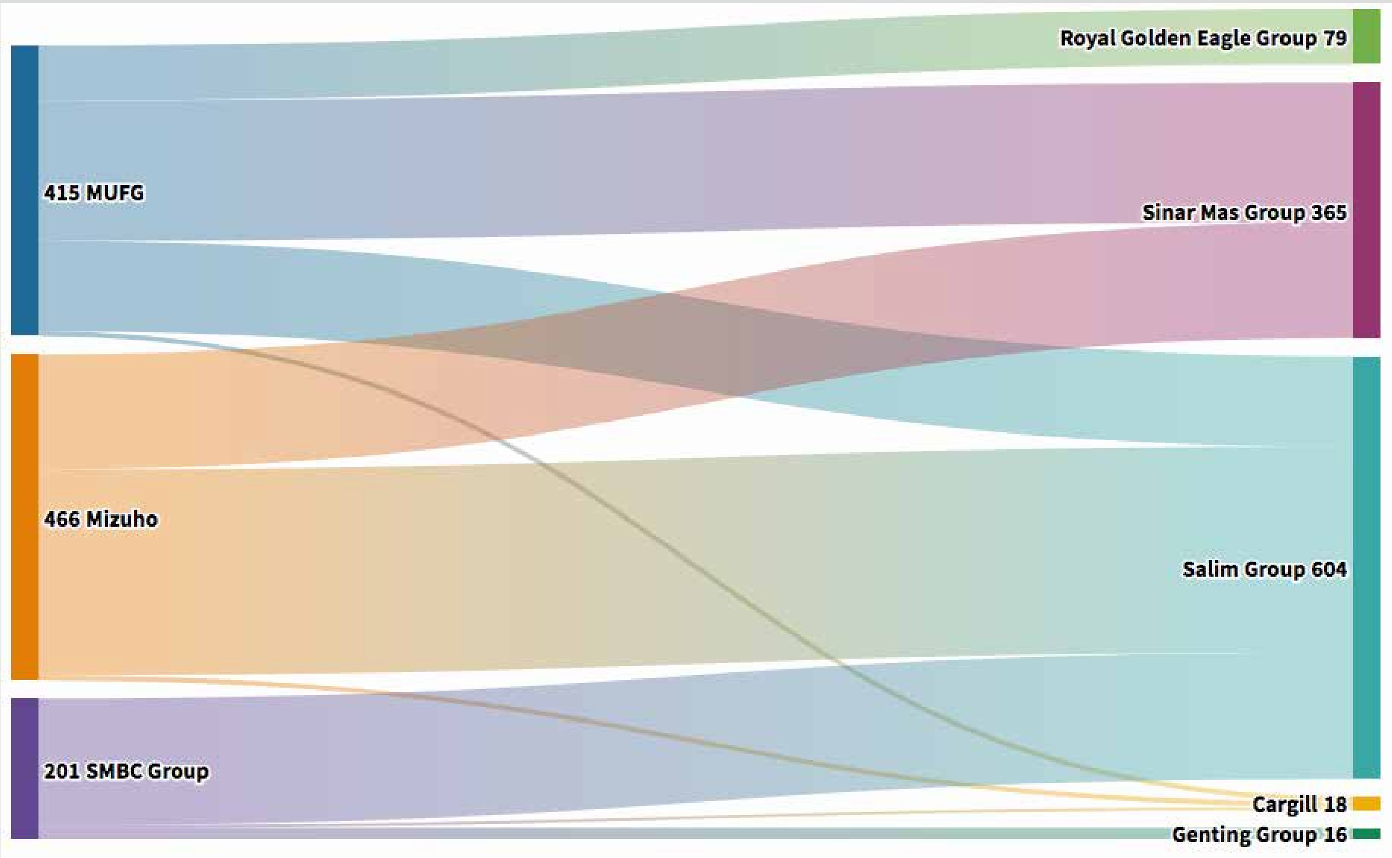
While all three megabanks adopted their very first forestry and palm oil sector financing policies over the past year and a half, their due diligence is highly reliant on weak certification systems, and they are failing to even uphold minimal commitments to not finance illegal activities. The megabanks' policies are in stark contrast to global best practice in the agribusiness and financial sectors that is embodied in a No Deforestation, No Peatland, and No Exploitation (NDPE) policy and use of the High Carbon Stock Approach (HCSA).[6] In April 2019, 56 investors affiliated with the Principles for Responsible Investment, with US$7.9 trillion in assets under management, issued a strong statement calling on companies operating across the palm oil value chain, including banks, to adopt and implement a publicly available NDPE policy. NDPE is not exclusive to palm oil, but also applicable to a wide range of agricultural commodities including pulp, soy, beef, rubber, cocoa, and others.[7]

The megabanks' irresponsible financing is undermining key international initiatives, namely the Sustainable Development Goals (SDGs) and the Paris Climate Agreement, both of which the megabanks have committed to align business strategies with by endorsing the UN Principles for Responsible Banking (PRB). SDG 15: Life on Land calls for halting deforestation and restoring degraded forests by 2020. The IPCC's Special Report on Climate Change and Land (2019) found that an estimated 23% of total anthropogenic greenhouse gas emissions (2007-2016) derived from Agriculture, Forestry and Other Land Use, with a significant proportion driven by the degradation and loss of tropical forests and peatlands. Yet, these same tropical forests and peatlands remain some of the best natural carbon sinks on the planet, and can contribute much more to the climate solution if kept intact.

Financial institutions, regulators and central banks around the world, including Japan's Financial Services Agency, are increasingly recognizing that the management of ESG risks in credit decision-making is not only important to sustainability, but also in ensuring wider macroeconomic and financial stability. Properly measuring, disclosing and integrating ESG risks reduces reputational and regulatory risks, and evidence shows that it also offers improved financial returns. This consensus is reflected in the Recommendations by the Task Force on Climate-related Financial Disclosures (TCFD), the above-mentioned PRB that has been endorsed by 152 banks including the three megabanks and Sumitomo Mitsui Trust Bank, as well as various regional and country-based initiatives. Under Indonesia's Roadmap for Sustainable Finance (2015-2019), for example, the government is increasingly demanding better disclosure of ESG risks and improved client due diligence by banks doing business in the country; megabanks risk being excluded from this market if they fail to reform.

By improving ESG risk management processes and sustainability disclosures, megabanks can not only reduce their reputational, regulatory and financial risks, but also help to ensure a sustainable future for people and the environment in forested countries such as Indonesia. It is a win-win solution that the megabanks should immediately embrace.

GRAPHIC 1: FINANCIAL FLOWS FROM JAPANESE MEGABANKS TO SELECT CORPORATE GROUPS IMPLICATED IN 2019 INDONESIAN FIRES
(LOANS & UNDERWRITING 2017-2019 AUGUST, USD MILLION) SOURCE: FORESTSANDFINANCE.ORG

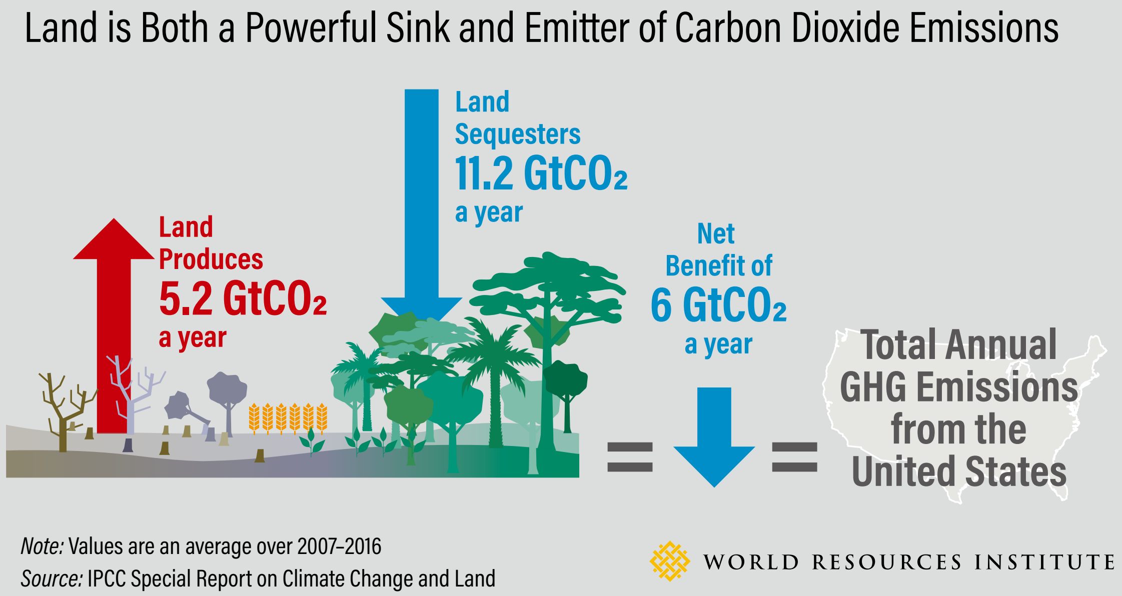


MEGABANKS' ESG POLICIES ON FORESTS

While all three Japanese megabanks have forest-risk commodity sector policies that provide various levels of social and environmental protection as well as commit to not finance illegal activities, the standards fall short of NDPE best practice and what is necessary to achieve SDG 15 and the Paris Agreement goals. The absence of an explicit commitment to protect tropical forests and peatlands and respect tenure rights is concerning, as well as the heavy reliance on voluntary certification schemes given evidence of how many of these schemes do not guarantee sustainability or even legality.[8] Moreover, none of the banks have provided clear explanations of how they will ensure compliance with their newly established policies, nor have they disclosed what progress has been made in policy implementation or present ESG impacts, including climate impacts, resulting from their financing to the forest-risk commodity sectors. The three megabanks were given an opportunity to comment, but they declined to respond.

TABLE 1: ASSESSMENT OF JAPANESE MEGABANKS' FINANCING POLICIES FOR FOREST-RISK COMMODITY SECTORS

Bank (policy year)	**Relevant Policy Components** (corporate lending & underwriting)	**Key Pros & Cons**
[9] MUFG Bank of Tokyo-Mitsubishi UFJ (2019)	*Prohibits transactions that are illegal or for illegal purposes, "violate public order & good morals," negatively impact Ramsar wetlands or UNESCO designated World Heritage Sites, violate CITES, or involve use of child labor or forced labor. *Restricted Transactions are subject to enhanced due diligence and include impacts on Indigneous Peoples and HCV areas as well as land expropriation leading to involuntary settlement, and any transactions to Forestry & Palm Oil Sector clients. *Forestry clients in non-high income OECD countries are requested to have FSC or PEFC certification, or an action plan to obtain it. *Palm oil clients are encouraged to be RSPO members and requested to have certification such as RSPO, or have an action plan to obtain it. *Expects clients to respect human rights and avoid human rights violations, and seeks to respect international standards in the case of conflict with local laws. *ESG assessment includes client interviews and "constructive dialogue with various stakeholders."	*Dedicated forestry & palm oil sector policies *Clear prohibition on certain transactions *No explicit protection of tropical forests or peatlands *No prohibition on use of fire for land clearance *Reliance on weak certification mechanisms *No clear commitment to respect tenure rights, especially of Indigenous Peoples *No requirement to respect Free, Prior, and Informed Consent (FPIC) *No requirement for supply chain traceability and transparency. *inadequate explanation of how client policy compliance is assured.
[10] MIZUHO Mizuho Financial Group (2018)	* Prohibits transactions that are illegal, related to organized crime, or directed to "entities whose business operations defy public morals, are ethically problematic, or otherwise contravene social norms, or who have high potential to be the subject of public criticism." *Decisions on transactions in palm oil and lumber sectors involve a "thorough examination" of whether there are any potential conflicts with Indigenous Peoples or local communities and whether client operations are certified. *Financing decision is based on "the degree to which the client has taken steps to avoid or mitigate risk." *Committed to give rights holders access to remedy, and if discrepancies exist between internationally recognized human rights standards and domestic laws, higher standard is followed.	
[11] SMBC (2018)	*Prohibits "financial support to borrowers engaged in businesses contrary to public responsibility, or which may have a significant negative impact on the global environment" *Prohibits financing to businesses involved in illegal logging or illegal land clearing. *Palm oil clients are additionally proibited from engaging in human rights violations such as child labor, and must have internationally accepted external certifications such as RSPO or the equivalent. *"Seeks to avoid doing any business where such business may conflict with SMBC's human rights responsibilities."	



GRAPHIC 2: FORESTS AND PEATLANDS ARE CRITICAL TO THE CLIMATE.
AGRICULTURE, FORESTRY AND OTHER LAND USE ACTIVITIES ACCOUNTED FOR 23% OF TOTAL NET ANTHROPOGENIC EMISSIONS OF GHGS BETWEEN 2007-2016, MAKING IT THE 2ND LARGEST SOURCE OF GHG EMISSIONS. AT THE SAME TIME, NATURAL LAND PROCESSES, ESPECIALLY TROPICAL FORESTS AND PEATLANDS, ABSORB ONE THIRD OF GHG EMISSIONS FROM FOSSIL FUELS & INDUSTRY.
SOURCE: IPCC SPECIAL REPORT ON CLIMATE CHANGE AND LAND, 2019

RECOMMENDATIONS *JAPANESE MEGABANKS SHOULD:*

1. Strengthen ESG financing policies to align with SDG 15: Life on Land & Paris Agreement

- Banks must strengthen environmental and social safeguard policies by requiring compliance with NDPE standards and the High Carbon Stock Approach for all forest-risk commodities, particularly in tropical forest countries. This should include no deforestation or degradation of High Conservation Value (HCV) Areas, High Carbon Stock (HCS) forests, or peatlands regardless of depth, as well as respect for local communities' and Indigenous Peoples' customary tenure rights and ILO core labor rights;
- The policy scope must apply to all financial services and require compliance across all corporate group client entities;
- Client compliance with policies should be mandated through specific covenants in financing agreements, with clear thresholds and timelines for mandating corrective actions and terminating financing in the case of non-compliance.

2. Improve client due diligence

- Banks must screen and monitor potential and existing clients for bank policy and legal compliance through enhanced due diligence processes on client operations, in line with the OECD Guidelines for Multinational Enterprises.[12] If risks are identified, banks should engage with additional stakeholders including NGOs and communities affected by client activities;
- For forestry and plantation industries, due diligence should include verification of supply chain traceability and legal compliance, especially a client's 'proof of good title' by obtaining full documentation of all required social and environmental analyses and permits and documented evidence of respecting community member rights to give or withhold consent, as fully consistent with the principles and practice of Free, Prior and Informed Consent (FPIC) as set out under the UN Declaration on the Rights of Indigenous Peoples;
- Full Board-level accountability for sustainability issues should be required, with bank-wide staff training on effective social and environmental risk management (including Business Relationship Managers). Remuneration for relevant bank staff and executives should be linked to the achievement of sustainability targets.

3. Enhance disclosure and grievance procedures

- Banks must dramatically improve reporting on their exposure to client ESG risks, using the internationally accepted Global Reporting Initiative (GRI) G4 Financial Services Sector Disclosure Framework. Banks must also require forest sector clients to submit TCFD reports that disclose land use emissions resulting from their operations and supply chains.
- Access must be granted to communities, NGOs and other stakeholders to file grievances with banks where clients are implicated in activities in violation of bank policies and obligations, with clear and accountable procedures in place that protect complainants, consistent with the UN Guiding Principles on Business and Human Rights.

CASE STUDY 1: SINAR MAS GROUP

Sinar Mas Group (SMG) controls the world's second largest palm oil producer Golden Agri Resources (GAR) (SGX: E5H)[13] and one of the world's largest pulp and paper producers Asia Pulp & Paper (APP). In 2001, the group defaulted on USD 14 billion in bonds and loans, the largest emerging markets corporate default in history.[14] Despite its risky track record, SMG continues to receive more finance than any other forest-risk commodity group in Indonesia, estimated to amount to $1.2 billion and $3.4 billion for its palm oil and pulp and paper operations respectively (2017-2019 August). While international financial markets appear to have regained some confidence in the group, there are fundamental sustainability concerns regarding its operations, which are compounded by its culture of corporate secrecy.

MEGABANK FINANCING OF SMG'S FOREST-RISK SECTOR OPERATIONS (SOURCE: FORESTSANDFINANCE.ORG)

Bank	Total adjusted loans & underwriting (2017-2019.8)	Global Financier Ranking	Borrower / Adjusted Maximum Facility Value (issuance ~ maturity date)	Adjusted Outstanding Value (2019.9)	Bank policy violation?
MUFG Bank of Tokyo-Mitsubishi UFJ	$200M (palm oil)	7	PT Sinar Mas Agro Resources and Technology Tbk, $50M Revolving Credit Facility (3/14/18~3/14/19) Golden Agri-Resources, $100M Revolving Credit Facility (4/18/2018 ~ ?) PT Sinar Mas Agro Resources and Technology Tbk, $50M Revolving Credit Facility (7/2/18~6/30/19)	0	YES
MIZUHO Mizuho Financial Group	$165M (pulp)	8	Indah Kiat Pulp & Paper (APP), $165M Revolving Credit Facility (9/28/18~9/28/19)	0	YES
SMBC	0	-	None	0	N/A

MAJOR ESG RISKS:

- **Corporate secrecy / shadow companies**
- **Peat development**
- **Fires and haze**
- **Deforestation**
- **Tax avoidance / state fiscal losses**
- **Community land rights conflicts**
- **Illegality**
- **Corruption**[15]

Extensive market pressure from international customers prompted SMG's palm oil and pulp and paper divisions - GAR and APP - to adopt NDPE policies in 2011 and 2013, respectively, that apply across their operations and those of its third party suppliers. However, there have been repeated evidence of noncompliance.

An investigation in 2018 found that two SMG 'shadow companies' had deforested 8,000 ha of forest and peatland in West Kalimantan.[16] SMG had taken deliberate measures to disguise its ownership of these companies, including using employees as nominee shareholders.[17] Such efforts to create cosmetic separations between SMG and its subsidiaries is a systemic corporate governance issue. A 2017 study also revealed that many of its major wood fiber suppliers - described as 'independent' pulpwood plantation companies - have extensive ownership links with SMG.[18] The Forest Stewardship Council (FSC) stated that SMG's "pattern of using corporate proxies to control operations without legal ownership is very alarming", and later suspended their roadmap to re-associate SMG's pulp and paper division (APP) with the certification body, illustrating the market risks of SMG's corporate secrecy.[19]

PHOTO: BURNED PEATLAND IN FORMER SMG AFFILIATE THAT HAD LICENSE REVOKED IN 2016. IMAGE BY EYES ON THE FOREST, AUG 2018

Such nominee structures are prohibited under Indonesian laws on Capital Investment, and failure to disclose ultimate control may also violate new beneficial ownership regulations.[20] This continued lack of transparency should be a major concern to financiers and regulators given SMG's recent history of default. It highlights material liquidity risks, given one such SMG shadow company is being pursued by Indonesia's Ministry of Environment and Forestry for IDR 7.8 trillion (USD 5.9 billion) in damages for lighting land fires in its concessions.[21] SMG has acknowledged links to many of these controversial suppliers and committed to engage an independent auditor to investigate the allegations, but has failed to publish the findings of this audit. [22]

PHOTO: FARMING COMMUNITY IN DISPUTE WITH SMG, JAMBI PROVINCE
IMAGE BY AGUSRIADY SAPUTRA / RAN

SMG has been embroiled in other corporate scandals. In early 2019, three executives from Sinar Mas, one of GAR's major subsidiaries, were convicted of bribery and sentenced to prison by an Indonesian court over bribing government officials to cover up extensive water pollution and alleged irregularities in plantation permitting in the province of Central Kalimantan.[23] This resulted in GAR being removed from the Dow Jones Sustainability Index.[24] In 2015, a special committee commissioned by the Riau Provincial Assembly (DPRD) found "massive collusion" between government officials and APP to manipulate production statistics to reduce its taxes.[25]

SMG is also failing to remedy the ongoing social conflicts in its operations. Research in 2019 found that APP had hundreds of active social conflicts such as land ownership disputes, forced evictions, violence and criminalization. It has so far ignored calls for a transparent process of conflict mapping and resolution, which according to independent research, risks escalating such conflicts fivefold.[26] This represents ongoing reputational and operational risks to SMG.

A similar pattern emerges regarding its impact on peatlands, which release substantial greenhouse gasses into the atmosphere and become highly combustible when drained for plantations. APP was identified as one of the largest culprits in the Indonesian fires and haze this year, primarily in Sumatra,[27] and recent analysis confirmed that it was responsible for a total burned area of over 257,000 ha between 2015-2018, the largest burned area of any plantation group in Indonesia and equivalent to an area three and a half times the size of Singapore. APP's operations are particularly susceptible to fires given up to 60% of APP's concession area is on peat.[28] Oxidation of drained peatlands in SMG/APP concession areas contributes 25~33 million tons of CO_2e to the atmosphere each year.[29] Following the devastating peat fires in 2015, SMG committed to restore critical peat ecosystems located inside their industrial tree plantations. However, since 2015, APP has made large capital investments in new processing capacity, specifically the Oki Pulp Mill in South Sumatra, that increase land-use pressure on drained peatlands.[30] Field surveys undertaken in 2018 revealed four SMG affiliates had failed to implement restorative measures and had continued to replant these peat domes with industrial acacia, in violation of government regulation and increasing the risk of new peat fire disasters.[31] As for its palm oil division, in December 2019, GAR admitted to trading palm oil illegally grown in a protected peatland from an area in the Leuser Ecosystem well known as the Orangutan capital of the world.[32]

The above statements and allegations were put to SMG for comment, but the group chose not to respond. However, SMG has previously stated that they are "committed to use only responsible woods from 100 percent sustainable plantations across [their] supply chain," and that they follow Indonesian government regulations where peatlands are concerned.[33] On the issue of social conflicts, SMG has stated that the 2019 assessment referenced above "does not illustrate the whole and complex problem of land disputes in Indonesia." [34]

CASE STUDY 2: JARDINE MATHESON GROUP

Astra Agro Lestari (AAL) (IDX: AALI) is Indonesia's third largest palm oil grower by landbank, controlling 291,000 ha of developed plantations in Sumatra, Kalimantan and Sulawesi. AAL forms part of Astra International (IDX: ALII), an Indonesian conglomerate often considered a bell-weather for the Indonesian economy as a whole.[35] Astra International is majority owned by Bermuda-registered Jardine Matheson Group (Jardine), controlled by the UK-based Keswick family, and has been described as Jardine's 'crown jewel'. Apart from the Jardine family, banks are the most important financial stakeholders of Astra Agro Lestari, financing 18% of its expansion capital at the end of 2017.[36] The Director of Jardine Matheson Holdings, Lord (James) Sassoon, currently sits on the Global Advisory Board of MUFG.[37]

PHOTO: COMMUNITY PROTEST OUTSIDE AAL OFFICE, CENTRAL SULAWESI, MAY 2018
IMAGE BY FORUM MASYARAKAT LINGKAR SAWIT PETASIA TIMUR

MEGABANK FINANCING OF JARDINE'S FOREST-RISK SECTOR OPERATIONS (SOURCE: FORESTSANDFINANCE.ORG)

Bank	Total adjusted loans & underwriting (2017-2019.8)	Global Financier Ranking	Borrower/ Adjusted Maximum Facility Value (issuance ~ maturity date)	Adjusted Outstanding Value (2019.9)	Bank policy violation?
MUFG Bank of Tokyo-Mitsubishi UFJ	$57M (palm oil)	7	Astra International, $3M Revolving Credit Facility (5/17/19~7/19/22) Astra Agro Lestari, $24M Revolving Credit Facility (4/23/18~4/23/19) Astra Agro Lestari, $30M Revolving Credit Facility (9/28/17~?)	$25M	YES
MIZUHO Mizuho Financial Group	$141M (palm oil)	4	Astra Agro Lestari, $17M Revolving Credit Facility (8/23/19~8/23/24) Astra Agro Lestari, $50M Corporate Loan, 8/23/19~8/23/24 Astra International, $5M Revolving Credit Facility (5/17/19~7/19/22) Astra Agro Lestari, $14M Revolving Credit Facility (6/29/18~6/29/19) Astra Agro Lestari, $15M Revolving Credit Facility (9/28/17~?) Astra Agro Lestari, $40M Revolving Credit Facility (6/22/17~?)	$100M	YES
SMBC	$171M (palm oil)	1	Astra Agro Lestari, $17M Revolving Credit Facility (8/23/19~8/23/24) Astra Agro Lestari, $50M Corporate Loan (8/23/19~8/23/24) Astra International, $5M Revolving Credit Facility, (5/17/19~7/19/22) Astra Agro Lestari, $59M Revolving Credit Facility (12/28/17~?) Astra Agro Lestari, $40M Revolving Credit Facility (9/28/17~?)	$100M	YES

MAJOR ESG RISKS:

- **Community land rights conflicts**
- **Illegal operations**
- **Tax avoidance / state fiscal losses**
- **No RSPO certification**

Based on plantation permits, Astra Agro Lestari is estimated to control a landbank of around 455,534 ha, of which 164,573 ha were unplanted as of 2017, primarily in Kalimantan and Sulawesi. While AAL has adopted NDPE policies, it is not a member of the RSPO and therefore none of their mills are RSPO certified.

Astra prides itself as one of the most professionally managed corporations in Indonesia,[38] but its plantation business in Central Sulawesi faces social conflict and legality issues, which represent compliance, reputational and financial risks for financiers. A report from the Central Sulawesi Ombudsman in 2019 concluded that an AAL subsidiary had occupied and planted without legal land acquisition and without mandatory business permits (IUP-B) or Land Cultivation Rights (HGU).[39]

This subsidiary destroyed rice padi farms and inflicted serious environmental and economic damage on communities, who have been prevented from entering and cultivating their land. A report by the Presidential Staff's Office (KSP) into this protracted agrarian conflict states that the conflict covers 5,467 hectares and infringed the constitutional rights of 2,893 households in six villages.[40] This includes settler communities with certificates to the land issued under Indonesia's Transmigration Programme.

AAL's illegal plantation operations have also resulted in significant losses of state revenue, as companies without HGU cannot be subject to Property and Land Taxes.[41] Such practices represent compounded governance risks to AAL.

Another AAL subsidiary in Central Sulawesi has also been linked to land conflict with local communities. Activist groups have expressed concern over company collusion with police in criminalizing dissenting communities.[42]

The above statements and allegations were put to AAL for comment, but the group chose not to respond.

CASE STUDY 3: SALIM GROUP

The Salim Group is a complex web of listed and unlisted entities in Indonesia and other jurisdictions, controlled by Anthoni Salim, the fourth richest person in Indonesia. It controls the second largest planted oil palm land bank in Indonesia and is the country's fifth largest producer of Crude Palm Oil.[43] Its main listed plantation entity is Indofood Agri Resources (IndoAgri, IAR) (SGX: 5JS), which is a subsidiary of Indofood Sukses Makmur (Indofood) (IDX: INDF). Anthoni Salim serves as the CEO of Indofood and Chairman of Indofood's parent company First Pacific. At the end of 2017, banks financed 18% of IAR's palm oil expansion capital.[44]

MEGABANK FINANCING OF SALIM GROUP'S FOREST-RISK SECTOR OPERATIONS*

Bank	Total adjusted loans & underwriting (2017-2019.8)	Global Financier Ranking**	Borrower / Adjusted Maximum Facility Value (issuance ~ maturity date)	Adjusted Outstanding Value (2019.9)	Bank policy violation?
MUFG Bank of Tokyo-Mitsubishi UFJ	$130M (palm oil, rubber)	5	Indofood, $43M Revolving Credit Facility (Dec 2018~Dec 2019) Indofood, $87M Revolving Credit Facility (Dec 2017~Dec 2018)	$10M	YES
MIZUHO Mizuho Financial Group	$294M (palm oil, rubber)	3	Indofood, $77M Revolving Credit Facility (Mar 2019~Mar 2020) Indofood, $67M Revolving Credit Facility (Mar 2018-Mar 2019) Indofood, $139M Revolving Credit Facility (Mar 2017-Mar 2018) First Pacific, $4M Bond Issuance (5/23/2018~?) FP Treasury (2018), $7M Corporate Loan (7/24/18~9/13/24)	$51M	YES
SMBC	$181M (palm oil, rubber)	4	Indofood, $8M Revolving Credit Facility (Aug 2019~Aug 2020) Indofood, $8M Revolving Credit Facility (Aug 2018-Aug 2019) Indofood, $16M Revolving Credit Facility (Aug 2017-Aug 2018) IAR, $69M Revolving Credit Facility (5/1/18-5/1/19) IAR, $21M Corporate Loan (2017~3/1/19) Salim Ivomas Pratama, $60M Credit Facility (Nov 2017~Nov 2019)	0	YES

*FINANCING FIGURES ARE BASED ON FORESTSANDFINANCE.ORG (2017-2019.8) AND FINANCIAL STATEMENTS OF INDOFOOD AND ITS SUBSIDIARIES INDOAGRI AND SALIM IVOMAS PRATAMA.

**ANALYSIS IS BASED ON LOANS TO INDOFOOD AND SUBSIDIARIES AS OF 2019.9.30.

MAJOR ESG RISKS:

- **Illegality**
- **Labor rights violations**
- **Peat development**
- **Corporate secrecy / shadow companies**
- **Deforestation**
- **No RSPO Certification**

Indofood has significant ESG risks in its palm oil operations. A 2017 analysis by Chain Reaction Research suggested that up to 42% of IAR's landbank could be contested due to factors including community and labor conflict, peatland and forest development restrictions or failure to publish concession maps.[45]

A 2016 investigation revealed illegal and exploitative labor practices in two IAR plantations, including use of child labor.[46] The associated complaint filed with the Roundtable on Sustainable Palm Oil (RSPO) grievance mechanism prompted an independent audit of one palm oil mill and three palm oil estates that confirmed 20 violations of the RSPO standards and ten violations of Indonesian labor laws, including gender discrimination, hazardous working conditions, and payment below minimum wage.[47] The RSPO concluded that the "grave and methodical nature of the breaches" required immediate suspension of its sustainability certificate. In early 2019, IAR's RSPO certificates and membership were terminated as IAR refused to implement the corrective action plan required to meet RSPO standards.[48] Since then, the independent union representing IAR's workers have brought several grievances to the District and Provincial Manpower Agency in Indonesia, including incidents of intimidation against workers who joined the independent union, unfair dismissal of casual workers, and misrepresentation of an independent union's participation in a collective bargaining agreement; only the bargaining agreement dispute has been resolved.

In response to evidence of labor violations found by RSPO auditors, IAR stated that they hired a law firm to conduct a review of the findings and found them unsubstantiated. However, the methodology for the assessment does not detail who and how many were interviewed, what questions were asked, or if confidentiality and non-reprisal were guaranteed. None of the workers in the independent union were interviewed as part of this assessment, and it is unknown if any other plantation laborers were interviewed, raising serious questions about the assessment's reliability.

The opaque corporate structure of the Salim Group also contains 'shadow companies' that violate Indonesian laws and sustainability commitments of IAR. A 2018 investigation revealed that two "shadow companies" operating in West Kalimantan had illegally cleared over 10,000 ha of peat forest to make way for future oil palm plantations. These companies were allegedly controlled by Anthoni Salim through complex corporate ownership structures. Their operations were in clear violation of regulations and company commitments prohibiting further peat clearance and deforestation.[49] In response to this allegation, IAR stated that neither of these companies are affiliates or subsidiaries of the group.

IAR's failure to reform its plantation business has resulted in the loss of many major international business relationships - with brands, traders and refiners - who have committed to sustainability standards, underlining how ESG issues relate to market and reputational risks. In the last two years, Indofood lost 15 buyers, including prominent companies such as Nestle, Unilever, and Fuji Oil. International banks including Citigroup, Standard Chartered and Rabobank have also severed credit lines to Indofood.[50] IAR's share price has dropped 38% since the start of 2017.[51]

PHOTO (ABOVE): ILLEGAL PEAT CLEARANCE BY SALIM GROUP SHADOW COMPANY PT DUTA RENDRA MULYA, 2017
IMAGE BY AIDENVIRONMENT
PHOTO (RIGHT): PROTESTORS CALL ON MUFG TO CUT ITS TIES TO COMPANIES LIKE SALIM GROUP THAT ARE ASSOCIATED WITH CONFLICT PALM OIL. IMAGE BY AYSE GÜRSÖZ / RAN

REFERENCES

1 https://www.bloomberg.com/news/articles/2019-11-26/forest-fire-emissions-from-indonesia-worse-than-amazon-eu-says

2 New York Times, 17/09/19, 'As Amazon Smolders, Indonesia Fires Choke the Other Side of the World', https://nyti.ms/2CzN4dV; https://www.aljazeera.com/ajimpact/forest-fires-burn-indonesias-peatlands-191121094638576.html

3 Presentation by Indonesian Ministry of Environment and Forestry, 07 November 2019

4 KPK, 2016, 'Kajian Sistem Pengelolaan Komoditas Kelapa Sawit', https://bit.ly/2FBwgHP

5 Mongabay, 25 August 2019, '81% of Indonesia's oil palm plantations flouting regulations, audit finds', http://bit.ly/32EFdXf

6 http://highcarbonstock.org/the-high-carbon-stock-approach/

7 PRI, 2 April 2019, Fifty-six investors sign statement on sustainable palm oil, https://www.unpri.org/news-and-press/fifty-six-investors-sign-statement-on-sustainable-palm-oil-/4266.article

8 See, for example, https://www.greenpeace.org/malaysia/press/2676/joint-ngo-statement-on-failure-of-rspo-to-meet-the-demands-of-global-climate-crisis/; https://e360.yale.edu/features/greenwashed-timber-how-sustainable-forest-certification-has-failed; https://changingmarkets.org/wp-content/uploads/2018/05/False-promise_full-report-ENG.pdf

9 https://www.mufg.jp/english/csr/policy/

10 https://www.mizuho-fg.com/csr/index.html

11 https://www.smfg.co.jp/english/responsibility/smfgcsr/policy/

12 See OECD, 29 October 2019, Due Diligence for Responsible Corporate Lending and Securities Underwriting, https://mneguidelines.oecd.org/due-diligence-for-responsible-corporate-lending-and-securities-underwriting.htm

13 TuK-Indonesia, Profundo, 2018, Tycoons in the Indonesian Palm Oil Sector', p6, https://bit.ly/2U6VOQG

14 Euromoney, 06/01/2016, 'The Untouchables: Indonesia's Widjajas', https://bit.ly/2KYSOD0

15 In 2018, KPK arrested Sinar Mas executives in connection with a bribery investigation, see Reuters, 28 Oct 2018, 'Indonesia arrests executives of palm firms in bribery probe', https://reut.rs/32G9qoP

16 Greenpeace, 21 May 2018, 'This company promised to stop deforestation. But we caught them out.' http://bit.ly/2Kezzoc

17 Mongabay, 10 July 2018, 'Revealed: Paper giant's ex-staff say it used their names for secret company in Borneo', http://bit.ly/2KiM6qD

18 AP News, 20 December 2017, 'AP Exclusive: Pulp giant tied to companies accused of fires', http://bit.ly/2rGwKWD

19 AP News, 30 May 2018, 'Forests watchdog sends ultimatum to Indonesian paper giant', http://bit.ly/34V2bL9

20 Nominee shareholding structures are legally declared null and void in Law 25 (2007) on Capital Investment; Re new beneficial ownership regulation, see http://bit.ly/2NIHdt0

21 On 12 August 2016, the Palembang High Court, South Sumatra overturned the lower courts acquittal of PT Bumi Mekar Hijau for unlawful acts, and ordered it to repay 78.5 billion rupiah. This is a fraction of the 7.8 trillion damages sought by the Ministry of Environment and Forestry. Both sides are appealing the ruling. See Jakarta Post, 31/08/2016, http://bit.ly/2NHke1y

22 Koalisi Anti Mafia Hutan, May 2019, 'APP acknowledges links to controversial suppliers but fails to release an auditors report', https://bit.ly/2ITSVFN

23 https://www.cnnindonesia.com/nasional/20190328195540-12-381615/kpk-eksekusi-tiga-pejabat-sinar-mas-ke-lapas-tangerang

24 https://foe.org/news/palm-oil-giant-golden-agri-resources-removed-dow-jones-sustainability-index-bribery-corruption-scandal/

25 Report of Special Committee of Riau Parliament, 2015, 'Results of Monitoring and Evaluation Analysis...in efforts to maximize tax acceptance and licensing in Riau Province'.

26 Environmental Paper Network, October 23 2019, Conflict Plantations, https://bit.ly/2B9Xe4b

27 https://www.greenpeace.org/southeastasia/press/3221/asean-haze-2019-the-battle-of-liability/

28 https://www.eco-business.com/news/healthy-forests-zero-burningprosperous-economy-can-indonesia-have-it-all/, APP 2018 Sustainability Report

29 Wetlands International, Koalisi Anti Mafia Hutan, Woods & Wayside International, Hutan Kita Institute, WWF, WALHI, Eyes on the Forest, Auriga, Forest Peoples Program, Jikalahari, Elsam, Rainforest Action Network, 2016, Will Asia Pulp & Paper default on its "zero deforestation" commitment? https://www.wetlands.org/publications/will-asia-pulp-paper-default-on-its-zero-deforestation-commitment/

30 Perpetual Haze: Pulp Production, Peatlands, And The Future Of Fire Risk In Indonesia, 2019, https://auriga.or.id/wp-content/uploads/2019/11/Perpetual-Haze.pdf

31 Eyes on the Forest, August 2019, 'Peat fires raging as Indonesian Government turns back the clock on restoration', https://bit.ly/2oKAhCb

32 https://goldenagri.com.sg/sustainability-dashboard/grievance-data. For details on the illegal trade, see https://www.ran.org/wp-content/uploads/2019/09/Leuser_Watch_Singkil-Bengkung_2019.pdf

33 https://www.aljazeera.com/ajimpact/forest-fires-burn-indonesias-peatlands-191121094638576.html

34 https://www.business-humanrights.org/en/indonesia-report-alleges-that-companies-controlled-by-app-and-sinar-mas-are-involved-in-community-conflicts

35 Financial Times, 11 April 2014, 'Jardines still marches to its own beat', https://on.ft.com/2IzRFHF

36 TuK-Indonesia & Profundo, 2018, 'Tycoons in Indonesian Palm Oil', http://bit.ly/2O72X0X

37 https://www.mufg.jp/english/profile/overview/advisory_board/index.html

38 The Economist, 31/05/2014, 'Avoiding the dinosaur trap', https://www.economist.com/news/special-report/21602829-state-firms-and-family-conglomerates-are-asias-favourite-kinds-companies-both-must

39 Central Sulawesi Ombudsman, 2019, 'Maladminstration in Palm Oil Plantations in Buol, Tolitoli and North Morowali Regencies'

40 TPPKA-KSP, Field Verification Report (April 2019) states that this consists of Molino Village 500 Ha (Transmigrant land 365 Ha), Towara Village 1047 Ha, Bungintimbe Village 2,100 Ha, Tompira Village 1,300 Ha, Bunta Village 440 Ha (Transmigrant land 140 Ha), Perbooa Village 80 Ha

41 Walhi Central Sulawesi summary of findings from Agrarian Conflict Team of Presidential Staff Office (TPPKA), 2019. Field Verification with TPPKA-KSP was held on 9-11 April 2019 in the North Morowali Regency Government Office.

42 PT Mamuang has been implicated in a number of incidents, see Mongabay, 05 June 2018, 'When palm oil meets politics, Indonesian farmers pay the price', https://bit.ly/2nMbOvF

43 'Tycoons in Indonesian Palm Oil', pp 9, 13

44 Id.

45 Chain Reaction Research, 06 Feb 2017, 'Indofood Agri Resources: Material risks from Contested Land and Labor Issues', https://bit.ly/2k5RJie

46 OPPUK, Rainforest Action Network, International Labor Rights Forum, 2016, 'The Human Cost of Conflict Palm Oil', https://bit.ly/32jAivg

47 https://rspo.my.salesforce.com/sfc/p/#90000000YoJi/a/90000000PYaf/6mJ.T1HSMNHdkSdhiOT8z3ldAHk8eJ6fHGUelpz9jB0

48 RSPO, 01 March 2019, 'RSPO SECRETARIAT'S STATEMENT ON COMPLAINTS PANEL DECISION', http://bit.ly/2qOtiJ1

49 AidEnvironment, 19 April 2018, 'New Report Uncovers One of the Largest Cases of Illegal Rainforest Clearance in Borneo for Palm Oil Development', https://bit.ly/2Hh8xc8; Chain Reaction Research, 21 June 2018, https://chainreactionresearch.com/report/shadow-companies-present-palm-oil-investor-risks-and-undermine-ndpe-efforts/

50 https://forestsandfinance.org/blog/asian-banks-increase-financing-of-rogue-palm-oil-company-indofood/

51 Bloomberg, Indofood company profile, https://www.bloomberg.com/quote/IFAR:SP

METHODOLOGICAL NOTE:

Forestsandfinance.org assesses the financial services received by over 190 companies directly involved in the palm oil, pulp and paper, rubber and tropical timber ("forest-risk sector") supply chains, whose operations impact natural tropical forests in the Southeast Asia region. Financial databases Thomson EIKON, Bloomberg IJGlobal, TradeFinanceAnalytics, company register filings, as well as publicly available company reports, were used to identify corporate loans, credit and underwriting facilities provided to the selected companies. This data provides a deal-level dataset of specific relationships between selected companies and any linked financial institution.

Companies with business activities outside of the forest-risk sector had recorded amounts reduced (adjusted) to more accurately present the proportion of financing that can be reasonably attributed to the forest-risk sector operations of the selected company. Where available financial information did not specify the purpose of investment or receiving division within the parent company group, reduction factors were individually calculated by comparing a company's forest-risk sector activities relative to its parent group total activities.

PHOTO: PAUL HILTON / RAN

Publication Date: January 2020

RAINFOREST ACTION NETWORK

425 Bush Street, Suite 300 | San Francisco, CA 94108
RAN.org