



## **WHITE PAPER ON MUFG FOREST-RISK SECTOR FINANCING**

### **Mitsubishi UFJ Financial Group falls behind banking peers on ESG policies for forest-risk commodities and exempts Indonesian banking arm from its group standards**

March 2021

Mitsubishi UFJ Financial Group (MUFG)(TYO:8306) is one of the world's leading financiers of companies driving rainforest destruction through the production and trade of commodities such as palm oil and pulp & paper. Since 2016, MUFG provided nearly US \$3 billion in forest-risk financing to the production and trade of deforestation-linked commodities in Southeast Asia, Brazil, and parts of Africa.<sup>1</sup> These sectors are major contributors to climate change and biodiversity loss through land use change, with links to human rights abuses and corruption. Addressing them must be a central component of MUFG's climate action plan and broader commitment to sustainability.

Over 60% of MUFG's forest-risk financing goes to Southeast Asia, primarily the palm oil and pulp & paper sectors, with nearly US \$1.2 billion to the palm oil sector alone between 2016-2019.<sup>2</sup> MUFG is the largest financier of the palm oil sector headquartered outside Southeast Asia (see Chart 1), ranking seventh globally, and is expanding its presence in the region through the acquisition of Indonesia's sixth largest bank, PT Bank Danamon Tbk (IDX:BDMN). MUFG is therefore exposed to high levels of Environmental, Social and Governance (ESG) risks connected to clients in these sectors.

These well documented ESG risks include widespread deforestation, bribery, labor abuses and land rights violations (see below). Several of MUFG's clients have, over several years, been implicated in Indonesia's catastrophic fires, estimated to have caused tens of thousands of premature deaths across the region and caused tens of billions in economic loss and damage.<sup>3</sup> These fires, driven by the destruction of Indonesia's carbon rich peatlands and forests, have made Indonesia one of the world's

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<sup>1</sup> Deforestation linked commodities include palm oil, pulp & paper, timber, rubber, soy and beef. <https://forestsandfinance.org/data/> reports \$2.97 billion (2016-2020 April) in financing from bond issuance, bondholding,

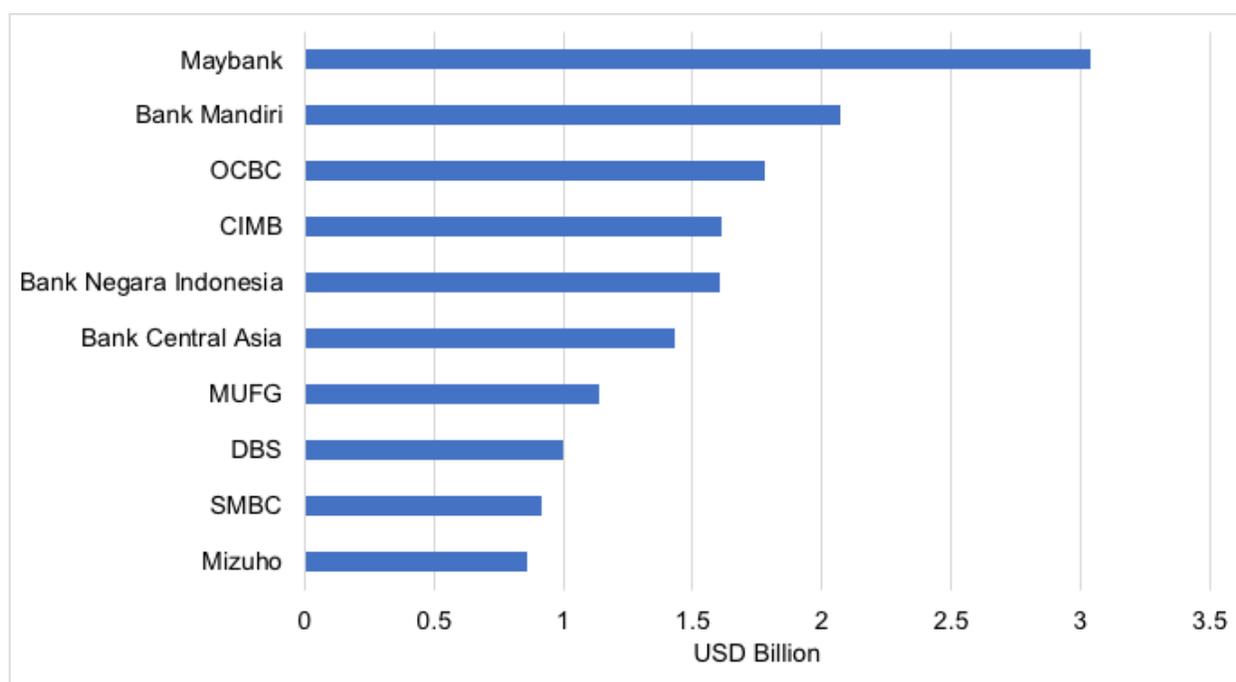
corporate loan, revolving credit facility, shareholding, share issuance.

<sup>2</sup> <https://forestsandfinance.org/data/> reports that 2016-2020 April, \$1.86 billion went to SE Asia and \$1.51 billion to the palm oil and pulp & paper sector in SE Asia

<sup>3</sup> See Harvard Centre for Carbon Brief, 27 March 2019, 'Carbon Brief Profile: Indonesia', <https://bit.ly/2LURXqn>; In 2015 and 2019, Indonesia's fires are estimated to have caused \$16 billion and \$5 billion of economic loss and damage respectively; see World Bank (2015), Cost of Fire, <https://bit.ly/3qHNRRy> and Reuters, 11 Dec 2019, <https://reut.rs/37A06X2>

largest greenhouse gas emitters.<sup>4</sup> In 2019, Indonesia's fires produced more CO2 emissions than the Amazon fires<sup>5</sup> and in 2015, were so intense that they released more greenhouse gases than the annual emissions of the Japanese economy.<sup>6</sup>

**Chart 1 - Largest 10 Creditors of Palm Oil in Southeast Asia (Loans & Underwriting, 2016-2020 April)**



MUFG is one of the world's largest banks, yet its ESG financing is rapidly falling behind its OECD peers. While international banks including HSBC, Standard Chartered, BNP Paribas and DBS have begun to align their financing policies with the internationally recognized standard of "No Deforestation, No Peat, No Exploitation" (NDPE),<sup>7</sup> the policies and risk mitigation strategies of MUFG remain weak and ambiguous. This should be a serious concern to the bank's investors and financial regulators, as MUFG is currently failing to identify material risks to its business and implement mitigation strategies.

MUFG is also falling short of the commitments from its domestic peers Mizuho Financial Group (Mizuho) and Sumitomo Mitsui Financial Group (SMBC Group).<sup>8</sup> Unlike Mizuho, MUFG has failed to incorporate international best practice represented by NDPE policies and failed to enshrine respect for local

<sup>4</sup> World Resources Institute, <https://bit.ly/3uvzbay>

<sup>5</sup> Bloomberg, 26 Nov 2019, 'Forest fire emissions from Indonesia worse than the Amazon, EU says', <https://bloom.bg/2Ns6U42>

<sup>6</sup> Van der Werf. 2015. Global Fire Emissions Database, <https://bit.ly/3qGbkM0>

<sup>7</sup> See, for example, PRI Investor Working Group on Sustainable Palm Oil (IWG), *Investor Expectations on Sustainable Palm Oil*, April 2019, <https://bit.ly/3eEsm0Q>

<sup>8</sup> Rainforest Action Network, 13 May 2020, <https://bit.ly/3boLkVc>

communities' right to Free, Prior and Informed Consent (FPIC). And unlike SMBC, MUFG has made no commitment to protect forests and biodiversity for oil palm plantation development, or prohibit the use of fire to clear land.

In the absence of a clear commitment to NDPE best practice, MUFG's policies are vaguely worded commitments to weak certification mechanisms. In the forestry sector, MUFG accepts the flawed Programme for the Endorsement of Forest Certification (PEFC) standard which has certified companies clearing natural forest and peatlands and with unresolved community conflicts.<sup>9</sup> In the palm oil sector, MUFG's policy requires clients to certify according to a "recognized certification organization". Given several of MUFG's clients are either not RSPO members or have lost RSPO certification, this policy accepts the weak Indonesian Sustainable Palm Oil (ISPO) scheme and likely also accepts the controversial Malaysian Sustainable Palm Oil (MSPO) certification.<sup>10</sup> ISPO is a legal requirement in Indonesia and is not a measure of sustainability or reflection of best practice. MSPO has recently been exposed for certifying palm oil company operations linked to forced labor.<sup>11</sup> A recent comprehensive study has also found forest-risk commodity certification mechanisms often greenwash products linked to deforestation, ecosystem destruction and rights abuses.<sup>12</sup> MUFG has no policies on other forest-risk commodities tied to deforestation, most notably soy, beef, rubber, or cocoa, and does not appear to apply its policies to commodity traders or relevant consumer goods companies.

Further, MUFG has confirmed that compliance with its ESG policies is not enforced through its loan covenants with clients. This is in contrast to best practice, including under the OECD Guidance on Due Diligence for Responsible Corporate Lending and Securities Underwriting<sup>13</sup>. It also differs from its peer SMBC Group, whose loan covenants reflect its ESG criteria in its Credit Policy.

### **MUFG's forest-risk commodity clients**

MUFG's clients include several of Indonesia's largest corporate groups producing palm oil and pulp & paper, including Sinar Mas Group (SMG), Royal Golden Eagle (RGE), Salim Group and Jardine Matheson Group.

- **Sinar Mas Group's** (SMG) palm oil division, Golden Agri Resources (GAR SGX:E5H), is the world's second largest palm oil company and has received US \$508 million in loans and underwriting from MUFG between 2016-April 2020 (see below), with at least 2 active loans at

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<sup>9</sup> WWF, 2015, 'WWF queries IFCC/PEFC certification of Indonesian pulp plantations', <https://bit.ly/3aNrlvG>

<sup>10</sup> Rainforest Action Network, 07 Feb 2019, '<https://bit.ly/3uqEaZO>'

<sup>11</sup> Associated Press, 24 September 2020, *Palm oil labor abuses linked to world's top brands, banks*, <https://apnews.com/article/virus-outbreak-only-on-ap-indonesia-financial-markets-malaysia-7b634596270cc6aa7578a062a30423bb>

<sup>12</sup> Greenpeace, 09 March 2021, *Destruction: Certified*, <https://www.greenpeace.org/international/publication/46812/destruction-certified/>

<sup>13</sup> OECD, '*Due diligence for responsible corporate lending and securities underwriting*', <https://bit.ly/3bJXJFo>

this time.<sup>14</sup> In 2018, GAR employees were convicted of bribing local government officials in an attempt to cover up the alleged illegal plantations inside a forest protection zone.<sup>15</sup> SMG's operations include a litany of land rights, labor rights violations and the criminalization of local dissenting communities.<sup>16</sup> SMG's pulpwood and palm oil supply chains have extensive overlap with flammable peatland, resulting in the strongest links of any corporate group to Indonesia's catastrophic fire and haze crisis.<sup>17</sup>

- **Royal Golden Eagle (RGE) Group's** pulp & paper division APRIL received US \$139 million in loans via MUFG Singapore (2016-April 2020), with at least 5 active loans at this time to the group.<sup>18</sup> Recent investigations show that APRIL has violated its own 'zero-deforestation' policy by sourcing wood fibre from a supplier that has cleared 15,000 ha of natural forest over the last five years.<sup>19</sup> APRIL's pulpwood supply is highly dependent on peatlands and has seen extensive fire alerts in its pulpwood plantations.<sup>20</sup> APRIL group's pulp operations are also involved in unresolved and extensive violations of Indigenous Peoples rights dating back thirty years, and has recently resulted in the criminalization of leaders resisting RGE operations.<sup>21</sup> RGE's palm oil arm has also been caught sourcing from suppliers involved in deforestation of the Leuser Ecosystem.<sup>22</sup> RGE, which was fined \$250 million in 2014 for tax evasion in its palm oil operations, has again been subject to fresh allegations of shifting up to \$168 million of taxable profits out of Indonesia to Macau through its pulp exports.<sup>23</sup>
- **Salim Group's** palm oil operations have received US \$307 million in loans from MUFG (2016-2020 April), with at least 3 active loans to Salim's food processing and palm oil business Indofood Sukses Makmur.<sup>24</sup> Indofood's palm oil plantation subsidiaries were ousted from the RSPO over twenty violations of the certification standards, including ten violations of Indonesian labor law. Following Indofood's decertification, local unions have filed lawsuits alleging continued intimidation, arbitrary dismissal of hundreds of workers and union busting (a criminal offense currently under investigation by the police).<sup>25</sup> Citigroup, Rabobank and Standard Chartered bank all made a conscious decision to end their relationship with the group.

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<sup>14</sup> Data from <https://forestsandfinance.org/data/>

<sup>15</sup> Forest Peoples Programme, 20 March 2020, 'Large scale bribery and illegal land-use violations alleged on large parts of Golden Agri Resources palm oil plantations', <https://bit.ly/3jQDsJM>

<sup>16</sup> Rainforest Action Network, 17 Dec 2020, 'Destroying lives and stealing land', <https://bit.ly/3u1O2cu>

<sup>17</sup> Forests and Finance, 14 Sept 2020, <https://bit.ly/3u0cLxH>

<sup>18</sup> Data from <https://forestsandfinance.org/data/> and PT SMART Financial Statement as of Sept 30 2020, <https://bit.ly/38AhTzF>

<sup>19</sup> Eyes on the Forest, 07 Oct 2020, <https://bit.ly/2Znr7H>

<sup>20</sup> Koalisi Anti-Mafia Hutan, 2019, Perpetual haze, <https://bit.ly/2ZfK6VJ>

<sup>21</sup> See Mongabay, 09 March 2020, <https://bit.ly/3bbV45J> and complaint submitted by Toba Batak community to International Labor Organization (ILO), 12 Aug 2019, <https://bit.ly/2ZmFDSW>

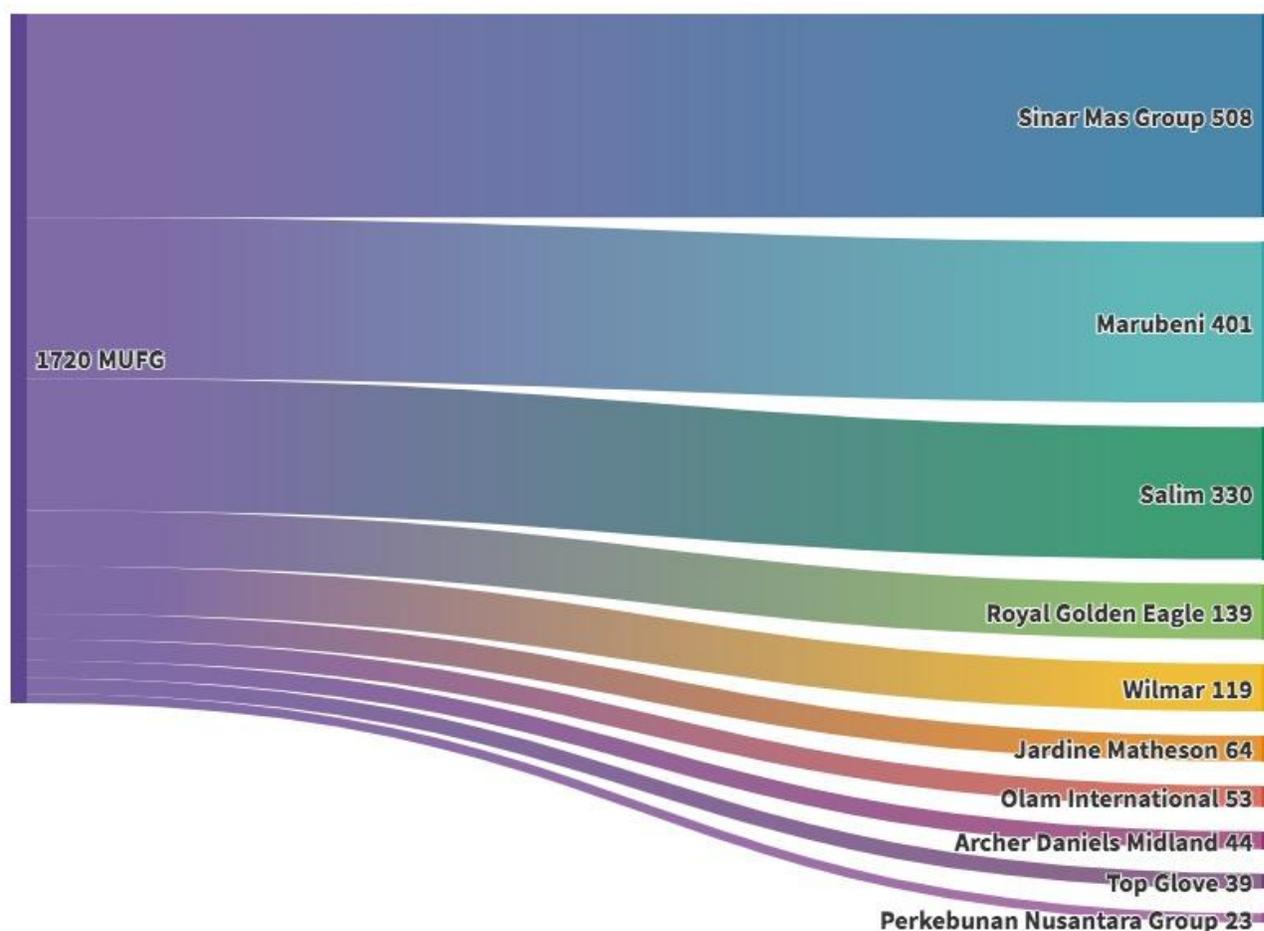
<sup>22</sup> Rainforest Action Network, 21 Sept 2020, <https://bit.ly/3bwxi4z>

<sup>23</sup> Forum Pajak Berkeadilan (Tax Justice Forum), 03 Nov 2020, <https://bit.ly/3dkUSUg>

<sup>24</sup> Data from <https://forestsandfinance.org/data/>

<sup>25</sup> See Rainforest Action Network, 23 Nov 2020, <https://bit.ly/37GoyYB>

Chart 2- MUFG's 10 Largest forest-risk clients by credit in Southeast Asia 2016-2020 (April) USD Millions



- Jardine Matherson's** palm oil operations have received US \$64 million in loans from MUFG (2016-2020 April), with at least 4 active loans at this time to Jardine's palm oil subsidiary Astra Agro Lestari (AAL).<sup>26</sup> Jardine's director until January 2020, Lord James Sassoon sits on MUFG's Global Advisory Board.<sup>27</sup> AAL faces serious social conflict and legality issues in its Central Sulawesi operations. A report by the provincial government concluded that an AAL subsidiary had occupied and planted without legal land acquisition or mandatory permits. It destroyed rice padi farms and inflicted environmental and economic damage on communities. A report by the Presidential Staff's Office (KSP) into this protracted agrarian conflict states that the conflict covers over 5,000 hectares and infringed the constitutional rights of 2,893 households.<sup>28</sup>

<sup>26</sup> Data from <https://forestsandfinance.org/data/> and Indofood Sukses Makmur Financial Statement, Sept 30 2020

<sup>27</sup> MUFG, *Global Advisory Board as of 01 April 2020*, <https://bit.ly/3r8xLk2>

<sup>28</sup> See Forest & Finance (2019), 'A review of sustainable finance reforms in Indonesia', p42, <https://bit.ly/3pOXNXW>

## MUFG's Sustainability Reporting in Indonesia

MUFG's financing of forest-risk commodities is routed through its banking, securities and asset management divisions. MUFG has expanded its business in Indonesia through its phased acquisition of Indonesia's sixth largest bank, Bank Danamon (IDX:BDMN) which began in 2017 and now owns 94% of shares.<sup>29</sup> However, MUFG's forest-risk commodity policies are not applied to its asset management division or its Southeast Asian subsidiaries, including Bank Danamon, creating a double standard for its financing.

**Table 1 - Examples of MUFG forest-risk financing routes**

MUFG Entity	Types of financing	Sample Clients	ESG Policy Applicable
Bank Danamon	Corporate loans, revolving credit facility	Sinar Mas Group (GAR/PT SMART)	No
MUFG Bank (Jakarta)	Corporate loans, revolving credit facilities	Jardine Matheson Group (Astra Agro Lestari Tbk) Sinar Mas Group (PT Smart/GAR)	Yes
MUFG Bank (Singapore)	Corporate loans	Royal Golden Eagle Group (APRIL) Sinar Mas Group (Golden Agri Resources)	Yes
MUFG Bank (Tokyo)	Corporate loans	Salim Group (First Pacific)	Yes
MUFG Securities	Bond issuance	Sinar Mas Group (Golden Agri Resources), Marubeni, Louis Dreyfus	Yes
Mitsubishi UFJ Asset Management	Shareholding, bondholding	Jardine Matheson (investment holding companies in Hong Kong), Salim Group (investment holding companies in British Virgin Islands)	No

Under existing Indonesian financial regulations, both Bank Danamon and MUFG must manage eight types of risk, such as reputational risk and compliance risk, that are strongly correlated to ESG issues.<sup>30</sup>

<sup>29</sup> NikkeiAsia, 03 June 2019, <https://s.nikkei.com/3ba0bU3>

<sup>30</sup> See POJK nr. 18/POJK.03.2016. Eight types of risk are: credit, market, liquidity, operational, legal, reputational, strategic, compliance risk

Indonesia’s Financial Regulator (OJK) plans to integrate ESG into bank risk management systems as part of its Roadmap on Sustainable Finance (2021-2025).<sup>31</sup> Additional Sustainable Finance regulations introduced by OJK require banks to produce annual Sustainability Reports and Sustainable Finance Action Plans, which provide reporting banks an opportunity to demonstrate their progress on ESG issues.<sup>32</sup>

However, as noted above, the disclosures and policies of MUFG do not adequately address ESG risks prevalent in the forest-risk commodities sector. MUFG’s 2020 Sustainability Report only references MUFG’s adoption of palm oil and forestry policies and lacks any explanation of the bank’s exposure or management of such risks.<sup>33</sup> Moreover, Bank Danamon’s sustainability report discloses no ESG risks or mitigation measures. MUFG has also confirmed that it exempts Danamon from its global financing policies. This fundamentally undermines MUFG’s group level reporting on its exposure to risk, as regional loopholes can be exploited to execute transactions in restricted, risky sectors. By contrast MUFG’s Japanese peer SMBC Group confirmed that their ESG policies on forestry and palm oil also apply to their Indonesian subsidiary Bank Tabungan Pensiunan Nasional Tbk (BTPN). In failing to align Bank Danamon with MUFG’s group level ESG reports and policies, MUFG is allowing weaker standards for Indonesian banking, and obscuring risks from Indonesia’s financial regulator.

**Table 2 - Comparison of MUFG and Bank Danamon identified Risks and Policies on commodities linked to deforestation**

Sector	MUFG	Bank Danamon
All loans & underwriting	Transactions to which financing is prohibited: A) Illegal transactions and transactions for illegal purposes B) Transactions which violate public order and good morals C) Transactions that negatively impact wetlands designated under the Ramsar Convention D) Transactions that negatively impact UNESCO designated World Heritage Sites E) Transactions violating the Convention on International Trade in Endangered Species of Wild Fauna and Flora (Washington Convention) F) Transactions involving the use of child labor or forced labor	No policies disclosed
	‘Restricted transaction’ sector due to ESG risks including a) Impact on Indigenous Peoples Communities, b) Land expropriation leading to involuntary resettlement, c) Impact on High Conservation Value areas	No risks or policies disclosed

<sup>31</sup> See OJK, Roadmap on Sustainable Finance (2021-2025), <https://bit.ly/2NSqhDs>, p13 and p26

<sup>32</sup> See Forests&Finance, 2017, <https://bit.ly/3qaCOzb>

<sup>33</sup> MUFG, MUFG Sustainability Report 2020, [https://www.mufg.jp/english/csr/pickup/202012\\_01/index.html](https://www.mufg.jp/english/csr/pickup/202012_01/index.html)

Palm oil	Clients “encouraged” to become members of RSPO and request them to certify relevant operations according to “recognized certification organizations such as RSPO”. Action plans to achieve certification required if relevant operations are not certified.	
Forestry	‘Restricted transaction’ sector due to the same ESG risks outlined above under ‘palm oil’.  Certification required under Forest Stewardship Council (FSC) or Programme for Endorsement of Forest Certification Schemes (PEFC). Action plans to achieve certification required if relevant operations are not certified.	No risks or policies disclosed
Coal Mining	‘Restricted transaction’ sector due to ESG risks outlined above, together with occupational hazards and climate risk.  MUFG considers the client's consideration for environmental and social impacts, including local ecosystems, relationship with local residents and occupational safety and health issues. Prohibition on Mountaintop Removal Mining.	No risks or policies disclosed

Indonesia has recently introduced sweeping deregulatory laws that affect most aspects of its economy. Many observers, academics and civil society groups see these measures as significantly lowering standards in areas like labor rights, public participation, environmental protections and corporate liability for fires & haze. The deregulation also waters down the investigatory powers of Indonesia’s anti-corruption agency.<sup>34</sup> Such changes will likely *increase* the likelihood of companies and their financiers being exposed to ESG risks such as exploitative labor conditions, deforestation, or bribery and compliance risks.<sup>35</sup> This argument was expressed to the Indonesian government by both international garment manufacturers and investor groups with US \$4.1 trillion assets under management.<sup>36</sup> For banks operating in this space, risks posed by weaker regulation in sectors like mining or plantations can only be mitigated through robust ESG policies.

<sup>34</sup> Asia Times, Jan 2020, <https://bit.ly/3kyM6E2>

<sup>35</sup> Mongabay, 13 Jan 2021 <https://bit.ly/3u1YznZ> and 04 Nov 2020, <https://bit.ly/3dh2asd>

<sup>36</sup> Letter from major international garment manufacturers to President Joko Widodo, 30 Sept 2020, “Re: Fundamental Worker Rights and the Proposed Omnibus Law on Job Creation”; See “*Open letter on the Omnibus Bill on Job Creation. The statement is endorsed by 36 investors representing approximately USD \$4.1 trillion in AUM*”

## Recommendations

### For MUFG and Bank Danamon

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

ESG safeguard policies must require compliance with 'No Deforestation, No Peatland and No Exploitation' (NDPE) standards and the High Carbon Stock Approach for all financing of forest-risk commodities. This should include no deforestation or degradation of High Conservation Value (HCV) Areas, High Carbon Stock (HCS) forests, Intact Forest Landscapes, or peatlands regardless of depth. It should also stipulate respect for local communities' and Indigenous Peoples' customary tenure rights and ILO core labor rights, as well as zero tolerance procedures to prevent violence, criminalization, intimidation, and killing of human rights, land, and environmental defenders.

2. **Broaden the scope of MUFG's Global Financing Policies**

MUFG's global ESG financing policies must apply to the entire banking group, including Bank Danamon, and all financial services as well as investments. Clients should be expected to comply with the bank's policies across all entities in the client's corporate group. MUFG should aim for a cross-commodity policy that goes beyond palm oil and forestry to include other drivers of deforestation, most notably soy, beef, rubber, and cocoa. MUFG should also apply its policies not only to forest-risk commodity producers and processors but also end users, such as retailers, consumer goods manufacturing companies and downstream processors and traders.

3. **Improve client due diligence and non-compliance protocols**

MUFG 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. 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;

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. MUFG should publish a clear protocol on non-compliance, which includes time-bound commitments to ensure clients transparently implement corrective actions and remedy negative impacts.

A bank director should be accountable for sustainability issues, adequate resources should be allocated for sustainability risk management, and bank-wide staff training on effective social and environmental risk management should be mandated, including for Business Relationship Managers. Remuneration for relevant bank staff and executives should be linked to the achievement of sustainability targets.

**4. Enhance disclosure and grievance procedures**

MUFG and Bank Danamon must improve their reporting on exposure to ESG risks, using internationally accepted standards such as the Global Reporting Initiative (GRI) G4 Financial Services Sector Disclosure Framework. MUFG must also require forest sector clients to disclose land use emissions resulting from their operations and supply chains, and disclose its financed emissions associated with the land use sector. MUFG should also disclose its “forest footprint” - namely the area of forests and peatlands impacted by its investments and financial services, including the impact on Indigenous Peoples and local communities’ rights, when forest and peatland areas are on traditionally managed lands.

MUFG grievance procedures must allow communities, NGOs and other stakeholders to file reports where client activities violate bank policies and obligations. This protocol must be clear and accountable, and protect complainants, consistent with the UN Guiding Principles on Business and Human Rights.