

# **VBIAF Sectoral Guide Town Hall**

## ***Palm Oil***



**Value-based Intermediation (VBI)**  
*Strengthening the roles & impact of Islamic Finance*

**10 September 2020**  
**2.30 p.m.**

# Outline of presentation

Slide(s) No.

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# Definition and scope

*The palm oil supply chain can be categorized into four sub-categories*

## 4. RETAILERS / PRINCIPAL BUYERS

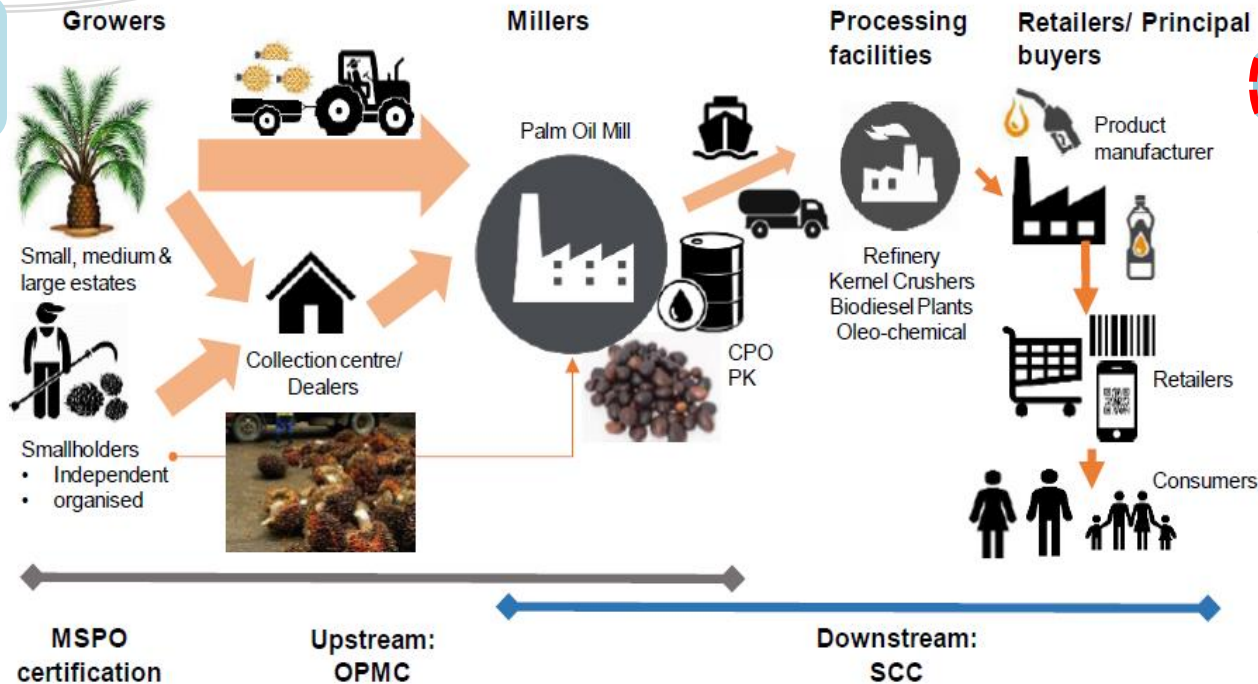
those involved with food production, packaged goods, beverages, retailers and consumer goods manufactures..

## 1. GROWERS

Growers who are involved in the cultivation of oil palm that include nurseries, oil palm estates (including independent and organized smallholders) primarily involved in the production of FFBs

## 2. MILLERS

Millers who are involved in the processing of FFBs to produce CPO and palm kernels (PK) as primary products and biomass as secondary product



## 3. PROCESSING FACILITIES




Processing facilities including palm refines, palm kernel crushers, biodiesel plants, and oleo-chemical plants who manufacture products that are used in diverse end use applications including home and personal care, pharmaceuticals, food and nutrition, flavours and fragrances, biofuel, lubricants and industrial chemicals

## The Government initiatives to facilitate compliance of MSPO certification

- 01** Income tax deduction for MSPO certificated premises and CBs to obtain accreditation under Standards Malaysia
- 02** Grant for entrepreneurs who obtain the MSPO certification
- 03** Support for auditing fees and preparation costs
- 04** Provision in financing with lower interest rate for oil palm smallholders
- 05** Allocation to support MPOB efforts to market palm oil internationally and counter anti-palm oil campaigns
- 06** Allocation for research and development to develop higher value added downstream uses of palm oil



## Specialised financing products offered by FIs

-  Landing platform
-  Grant Fund
-  Special pricing

# Impact-based Risk Identification

## - Key impact assessment

- Key impact-based risk categories are classified based on ESG risk aspects.
- The identified categories can typically generate significant risk if not well managed.

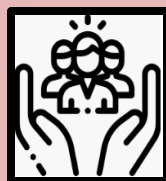


### A. Governance



Governance Mechanism

- Lack of strategic planning on sustainability
- Lack of resources dedicated to sustainability matters



### C. Social Aspect



Human Rights & Community Relations

- Displacement of communities, involuntary resettlement and violation/infringement of rights of indigenous/vulnerable groups without FPIC



Labor Rights & Working Conditions

- Prosecution or fines for human rights abuses and poor working conditions.



OSH

- Failure to comply with OSH regulations and causing injuries/fatalities of workers/contractors.



### B. Environmental Aspect



Land Access, Land-use, Land-use Change & Acquisition

- Land use / land-use change not approved by State Land Office for oil palm cultivation.



Biodiversity Loss & Deforestation

- Damage to biodiversity due to unsustainable production practices.
- Deforestation and encroachment into forest reserves.



Climate / GHG Emissions

- Land degradation and poor productivity particularly cultivation of peatlands.



Pollution Prevention & Resource use efficiency

- Flooding and silt deposits into rivers as a result of soil erosion
- Land clearance through open burning resulting in air pollution and haze



Water

- Destruction of riparian zone
- Inefficient use of water in regions with high water source vulnerability



Supply Chain Management

- Loss of clients or inability to access markets due to concerns over traceability and supply chain sustainability

# Impact-based Risk Identification

## - Customer on-boarding checklist

- FIs need to develop an appropriate customer on-boarding checklist based on the key impact categories and potential risk transmission channels identified.
- FIs should develop an exclusion list which would serve as a baseline.
- The following table suggests the information required for the initial on-boarding assessment to determine the risk level.

### Initial on-boarding checklist.

Category	Estate				Miller
	New		Existing		
	L	S	L	S	
<b>Governance</b>					
Sustainability commitment, strategy and policy including monitoring mechanism, transparency and disclosure	✓	n/a	✓	n/a	✓
Status of MSPO/ RSPO certification (e.g. current, renewal, new application) and time-bound action plan <sup>15,16</sup> ◆	✓	✓	✓	✓	✓
Participation in any government programmes (e.g. FELDA) and/or recipient of government assistance (funding, technical) ◆	✓	✓	✓	✓	✓
Desktop research against global tools (e.g. SCRIPT, SPOTT, GFW, Water Risk Filter*)	✓	n/a	✓	n/a	n/a
<b>Land access, land-use, land-use change and acquisition</b>					
Land description (e.g. size, type of land, proximity to water source, forest reserve, peat, indigenous people and communities) ◆	✓	✓	✓	✓	✓
Valid land-use term (e.g. oil palm/ agriculture) and planning permission ◆	✓	✓	✓	✓	✓
EIA and/or SEIA report ◆	✓	n/a*	✓	n/a*	✓
FPIC* ◆	✓	n/a	✓	n/a	✓
<b>Biodiversity loss and deforestation</b>					
HCV assessment	✓	n/a	✓	n/a	n/a
HCS assessment	✓	n/a	✓	n/a	n/a
Land clearance method ◆	✓	✓	✓	✓	n/a
Desktop biodiversity assessment ◆	✓	n/a	✓	n/a	n/a
<b>Climate/ GHG emissions</b>					
GHG emissions policy, management and monitoring (including best management practices for peat)*	✓	✓	✓	✓	✓
Efficient energy use*	✓	✓	✓	✓	✓
<b>Water</b>					

Category	Estate				Miller
	New		Existing		
	L	S	L	S	
Water management – policy, source of water, usage monitor*	✓	✓	✓	✓	✓
Riparian management <sup>17</sup> – policy, mitigation plan*	✓	n/a	✓	n/a	n/a
<b>Pollution prevention and resource use efficiency</b>					
Waste/ effluents management plan (JAS)* ◆	✓	✓	✓	✓	✓
Permit of purchasing and storage of diesel (KPDNHEP)* ◆	✓	✓	✓	✓	✓
On-site assessment – waste/ effluent/ chemical storage, handling and disposal	✓	✓	✓	✓	✓
Air quality measurement and management*	✓	✓	✓	✓	✓
<b>Supply chain management</b>					
Status of MSPO/ RSPO certification (e.g. current, renewal, new application)	✓	✓	✓	✓	✓
Desktop/ on-site assessment	✓	✓	✓	✓	✓
<b>Labour rights and working conditions</b>					
Use of migrant and vulnerable workers ◆	✓	✓	✓	✓	✓
Labour management – policy, formal contracts, training, grievance/ complaints mechanism*	✓	✓	✓	✓	✓
Desktop/ On-site assessment – working condition scanning, living arrangements	✓	✓	✓	✓	✓
Issues reported and how they were resolved	✓	n/a	✓	n/a	✓
<b>OSH</b>					
OSH management – policy, training, monitoring, audits	✓	✓	✓	✓	✓
Certification of Fitness for machinery in plant (JKKP) ◆	n/a	n/a	n/a	n/a	✓
Steam Engineer's Certificate of Competency (JKKP) ◆	n/a	n/a	n/a	n/a	✓
Sufficient protection – coverage, compensation ◆	✓	✓	✓	✓	✓
On-site assessment – working condition, safety/ protection gears	✓	✓	✓	✓	✓
Issues reported and how they were resolved	✓	n/a	✓	n/a	✓
<b>Human rights and community relations</b>					
Stakeholder management – policy including FPIC, grievance/complaints mechanism*	✓	n/a	✓	n/a	✓
Engagement programmes including awareness, supporting community events*	✓	n/a	✓	n/a	✓

# Impact-based Risk Measurement

## - Transaction-level risk metrics and risk score (1/5)

- To develop different impact metrics/ indicators for different counterparties (e.g. medium and large estates, smallholders and millers).
- To assign appropriate risk score/ level for each of the impact metric/ indicator.
- To consider factors such as the likelihood and materiality of the impact-based risks, consideration of stakeholders' interest and national priorities/ targets.
- To include, where relevant, an analysis of the severity of the environmental risk, as well as capacity, commitment and track record of the client in managing such risk
- Transactions with higher environmental risk should be subject to in-depth due diligence.
- To determine a decision-making rule based on the aggregate risk score/ level of the impact based metrics/ indicator and their respective risk appetite statement.



### Governance

Category	Inherent risk level	Metric	Mitigation	Risk score/ level <sup>21</sup>
<b>Governance</b>				
Valid certification (L, S, M) ◆	High	<ul style="list-style-type: none"> <li>• % of area (ha) which are MSPO or other sustainability schemes certified</li> <li>• % of mills which are MSPO/ RSPO certified</li> <li>• Progress to MSPO/ RSPO certification</li> </ul>	<ul style="list-style-type: none"> <li>• Time-bound action plan with effective monitoring</li> </ul>	Example % of area (ha) which are MSPO/ RSPO certified– <ul style="list-style-type: none"> <li>- High – 0-50%</li> <li>- Medium – 51-99%</li> <li>- Low – 100%, clean audit and surveillance report, additional certification e.g. RSPO, ISCC</li> </ul>

Applicability ( ) : L = medium and large estates, 40.46 ha and more, S = smallholders, estates less than 40.46 ha, M = millers

◆ Indicates minimum scoring criteria

# Impact-based Risk Measurement

## - Transaction-level risk metrics and risk score (2/5)



### Land Access, Land-Use, Land-Use change and Acquisition

Category	Inherent risk level	Metric	Mitigation	Risk score/ level <sup>21</sup>
<b>Land access, land-use, land-use change and acquisition</b>				
HCV and HCS forests, primary forests, forest reserves and peatland (L) ◆	<ul style="list-style-type: none"> <li>Unacceptable risk for new estate</li> <li>High for existing estate</li> </ul>	<ul style="list-style-type: none"> <li>Amount of peatland ecosystem restored</li> <li>Amount of trees replanted</li> <li>Funding towards biodiversity conservation activities</li> </ul>	<ul style="list-style-type: none"> <li>Effective commitment to conservation/ reforestation†</li> </ul>	Example for existing estate, % of peatland area restored– <ul style="list-style-type: none"> <li>High – 0-50%</li> <li>Medium – 51-99%</li> <li>Low – 100%</li> </ul>
Valid land term (palm oil/ agriculture) and planning permission (L, S, M) ◆	High	<ul style="list-style-type: none"> <li>Valid land term and planning permission</li> </ul>	<ul style="list-style-type: none"> <li>Disbursement subject to obtaining valid documents</li> </ul>	Example– <ul style="list-style-type: none"> <li>Unacceptable/ High – No valid documents</li> <li>Moderate – Credible evidence of preliminary approval/ in progress status from relevant authorities</li> <li>Low – Valid documents from relevant authorities</li> </ul>
EIA and/or SEIA report <sup>22</sup> (L,S) ◆ FPIC (L) ◆	High	<ul style="list-style-type: none"> <li>Satisfactory report</li> </ul>	<ul style="list-style-type: none"> <li>Disbursement subject to effective mitigation</li> </ul>	Example– <ul style="list-style-type: none"> <li>Unacceptable/ High – Unsatisfactory report</li> <li>Medium – Sufficient evidence that effective mitigation measures are in place to address issues identified</li> <li>Low – Satisfactory report</li> </ul>

Applicability ( ) : L = medium and large estates, 40.46 ha and more, S = smallholders, estates less than 40.46 ha, M = millers

◆ Indicates minimum scoring criteria



# Impact-based Risk Measurement

## - Transaction-level risk metrics and risk score (3/5)



Biodiversity Loss & Deforestation



Climate/ GHG Emissions



Water

Category	Inherent risk level	Metric	Mitigation	Risk score/ level <sup>21</sup>
<b>Biodiversity loss and deforestation</b>				
HCV and/or HBV/ HCS assessment (L) ◆	Unacceptable/ High	<ul style="list-style-type: none"> <li>Satisfactory report</li> </ul>	<ul style="list-style-type: none"> <li>Disbursement subject to effective mitigation</li> </ul>	Example– <ul style="list-style-type: none"> <li>Unacceptable/ High – Unsatisfactory report</li> <li>Medium – Sufficient evidence that effective mitigation measures are in place to address issues identified</li> <li>Low – Satisfactory report</li> </ul>
Land clearance method (L, S) ◆	Unacceptable/ High	<ul style="list-style-type: none"> <li>Number of hotspots/ fires in estates<sup>23</sup></li> </ul>	<ul style="list-style-type: none"> <li>Effective no burning policy<sup>†</sup></li> </ul>	Example– <ul style="list-style-type: none"> <li>Unacceptable/ High – Persistent history of reports on burning practices</li> <li>Medium – Rare reports of burning practices and sufficient evidence that effective mitigation measures are in place</li> <li>Low – No incidents</li> </ul>
<b>Climate/ GHG emissions</b>				
GHG emissions (L, S, M)	High/ Medium	<ul style="list-style-type: none"> <li>GHG emissions per tonne reduced (scope 1,2, 3)</li> <li>% of renewable energy use</li> <li>% of biogas capture or CH<sub>4</sub> avoidance<sup>24</sup></li> </ul>	<ul style="list-style-type: none"> <li>Effective GHG management<sup>†</sup></li> </ul>	Example of metric: GHG per tonne– <ul style="list-style-type: none"> <li>High –</li> <li>Medium –</li> <li>Low –</li> </ul>
Efficient energy (L, S, M)		<ul style="list-style-type: none"> <li>Amount of energy savings per tonne of FFB/ CPO</li> </ul>	<ul style="list-style-type: none"> <li>Effective energy management<sup>†</sup></li> </ul>	
<b>Water</b>				
Water use (L, S, M)	High/ Medium	<ul style="list-style-type: none"> <li>Amount of water savings per tonne of FFB/ CPO</li> </ul>	<ul style="list-style-type: none"> <li>Effective water management<sup>†</sup></li> </ul>	Example water savings per tonne– <ul style="list-style-type: none"> <li>High –</li> <li>Medium –</li> <li>Low –</li> </ul>
Riparian zone (L)		<ul style="list-style-type: none"> <li>Improvements in riparian vegetation</li> </ul>	<ul style="list-style-type: none"> <li>Effective riparian zone management<sup>†</sup></li> </ul>	

Applicability ( ) : L = medium and large estates, 40.46 ha and more, S = smallholders, estates less than 40.46 ha, M = millers

◆ Indicates minimum scoring criteria

# Impact-based Risk Measurement

## - Transaction-level risk metrics and risk score (4/5)



Pollution Prevention



Supply Chain Management



Labor Right

Category	Inherent risk level	Metric	Mitigation	Risk score/ level <sup>21</sup>
<b>Pollution prevention and resource use efficiency</b>				
Waste/ effluents/ soil degradation (L, S, M) ◆	High/ Medium	<ul style="list-style-type: none"> <li>Improvement in water quality/ soil fertility metrics</li> <li>Improvement in treatment of waste</li> <li>Reduction of waste per tonne of FFB/ CPO</li> <li>Chemical usage per ha of estate</li> <li>Number of hotspots/ fires in estates</li> <li>Air quality</li> </ul>	<ul style="list-style-type: none"> <li>Effective pollution management<sup>†</sup></li> </ul>	Example chemical usage per ha – <ul style="list-style-type: none"> <li>High –</li> <li>Medium –</li> <li>Low –</li> </ul>
<b>Supply chain management</b>				
Status of certification (L, M)	High/ Medium	<ul style="list-style-type: none"> <li>% of supply chain MSPO/ RSPO certified</li> </ul>	<ul style="list-style-type: none"> <li>Time-bound action plan with effective monitoring</li> </ul>	Example % of supply chain MSPO certified – <ul style="list-style-type: none"> <li>High – 0-50%, no certification</li> <li>Medium – 51-99%</li> <li>Low – 100%, additional certification e.g. RSPO</li> </ul>
<b>Labour rights and working conditions</b>				
Use of migrant and vulnerable workers (L, S, M) ◆	High/ Medium	<ul style="list-style-type: none"> <li>% of migrant workers</li> <li>% of vulnerable workers</li> <li>Average salary per month</li> <li>Number of legal cases/ disputes per year</li> </ul>	<ul style="list-style-type: none"> <li>Effective human resource management<sup>†</sup></li> </ul>	Example % of migrant workers – <ul style="list-style-type: none"> <li>High – 50-100%</li> <li>Medium – 31-49%</li> <li>Low – 0-30%</li> </ul>
Labour management (L, S, M)				

Applicability ( ) : L = medium and large estates, 40.46 ha and more, S = smallholders, estates less than 40.46 ha, M = millers

◆ Indicates minimum scoring criteria

# Impact-based Risk Measurement

## - Transaction-level risk metrics and risk score (5/5)



OSH



Human Right

Category	Inherent risk level	Metric	Mitigation	Risk score/ level <sup>21</sup>
<b>OSH</b>				
OSH management (L, S, M)	High/ Medium	<ul style="list-style-type: none"> <li>• Number of occupational injuries/ accidents</li> <li>• Number of legal cases/ disputes</li> <li>• Satisfactory machinery maintenance reports</li> <li>• Satisfactory training reports</li> </ul>	<ul style="list-style-type: none"> <li>• Effective OSH management<sup>†</sup></li> </ul>	Example number of incidents– <ul style="list-style-type: none"> <li>- High – High number of incidents and claims (e.g. 20 per 100 workers)</li> <li>- Medium – Few number of incidents and claims (e.g. 10 per 100 workers)</li> <li>- Low – Rare incidents and claims (e.g. 1 per 100 workers)</li> </ul>
Machinery operation (L, S, M) ◆				
Sufficient protection (L, S, M) ◆	Medium	<ul style="list-style-type: none"> <li>• % of employee with protection (e.g. PPE, PERKESO)</li> <li>• Sufficient coverage (takaful/ insurance)</li> </ul>		Example % of employee with PERKESO– <ul style="list-style-type: none"> <li>- High – 0-50%</li> <li>- Medium – 51-99%</li> <li>- Low – 100%, adequate coverage e.g. 10-12 times of income</li> </ul>
<b>Human rights and community relations</b>				
Stakeholder management (L, M)	High/ Medium	<ul style="list-style-type: none"> <li>• Number of legal cases/ disputes</li> <li>• Number of complaints</li> <li>• Number of engagement programmes</li> <li>• Progress reports on complaints handling</li> </ul>	<ul style="list-style-type: none"> <li>• Effective stakeholder management<sup>†</sup></li> </ul>	Example number of legal cases/ disputes– <ul style="list-style-type: none"> <li>- High – High number of cases and claims (amount in RM)</li> <li>- Medium – Few number of cases and claims</li> <li>- Low – Zero cases</li> </ul>
Engagement programmes (L, M)				

Applicability ( ) : L = medium and large estates, 40.46 ha and more, S = smallholders, estates less than 40.46 ha, M = millers

◆ Indicates minimum scoring criteria

# Impact-based Risk Measurement

- *Transaction-level risk metrics and risk score (5/5)*

Example of decision-making rule :

Unacceptable risk	A transaction involving activities on the exclusion list. This includes existing counterparties that exhibit continuous poor impact performance. No approval should be given.
High risk	Scores “High” for the majority of key impact categories/themes but has satisfactory mitigation strategy. Approval must be subject to strict compliance conditions/ covenants.
Medium risk	Scores “Medium” or “Low” in the majority and exhibit evidence of effective mitigation strategy. Approval can be subject to standard compliance conditions/ covenants.
Low risk	Scores “Low” for all impact categories and exhibit evidence of effective mitigation strategy. Approval can be subject to standard compliance conditions/ covenants. (FIs may also consider not approving this category due to nature of sector and market developments)

## Other risk impact measurements:

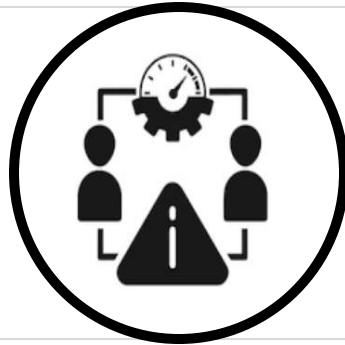
- Certification
  
- GHG Calculator / methodology
  - (i) RSPO PalmGHG Calculator
  - (ii) GHG Protocol as recommended by TCFD;
  - (iii) GHG methodology by RSPO;
  - (iv) GHG methodology by ISCC; or
  - (v) ISO 14064.
  
- Financial Risk Assessment (TCFD)

## Impact-based Risk Management and Mitigation



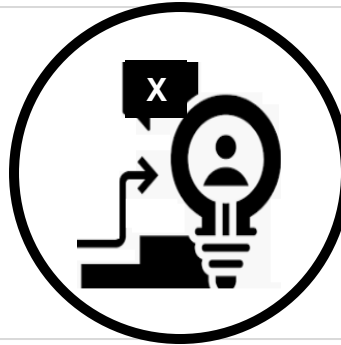
### Contractual Agreement

- Clear and comprehensive terms and conditions



### Improvement & Mitigation

- Expectations for improvements and mitigate negative impacts



### Escalation & Exit Procedures

- Identify time bound rectification plan, penalties and event of default



### Adequate Protection

- Yield protection
- Income protection
- CCS liability
- Pollution liability



### Nurturing Programmes

- Collaborate with government agencies / NGOs
- to provide training / awareness programmes to both customers & community

# Impact-based Risk Management

## - Impact-based risk reporting & monitoring

Stakeholder	Channel	Type of report/ information content	Frequency
<b>Internal</b>			
1. Board/ Risk Management Committee	<ul style="list-style-type: none"> <li>Board/ Management meetings</li> </ul>	<ul style="list-style-type: none"> <li>Impact-based risk</li> <li>Stakeholder feedback</li> </ul>	Regular
2. Employees (e.g. client relationship managers, credit officers)	<ul style="list-style-type: none"> <li>Department meetings/ focus groups</li> <li>Feedback forms/ surveys</li> <li>Intranet/ Internal communication channels</li> </ul>	<ul style="list-style-type: none"> <li>Impact-based risk</li> <li>Stakeholder feedback</li> <li>Trainings/ up-skilling programmes on relevant sustainability policies, procedures, systems, products and services</li> </ul>	Regular
<b>External</b>			
3. Regulators	<ul style="list-style-type: none"> <li>Meetings</li> <li>Seminars/ Forums</li> <li>Annual Report</li> </ul>	<ul style="list-style-type: none"> <li>Impact-based risk</li> <li>Stakeholder feedback</li> </ul>	Ad-hoc/ Regular
4. Shareholders/ Investors	<ul style="list-style-type: none"> <li>Annual Report</li> <li>Annual general meeting</li> <li>Briefings</li> </ul>	<ul style="list-style-type: none"> <li>Impact-based risk</li> <li>Stakeholder feedback</li> </ul>	Annually
5. Customers	<ul style="list-style-type: none"> <li>Distribution channels</li> <li>Feedback forms/ surveys</li> <li>Other technologies (e.g. social media, call centres)</li> <li>Annual report</li> </ul>	<ul style="list-style-type: none"> <li>Impact-based risk*</li> <li>Stakeholder feedback</li> </ul> <p>*customer/ transactional level information</p>	Ad-hoc
6. Community	<ul style="list-style-type: none"> <li>Community engagement programs</li> <li>Focus groups</li> <li>Feedback forms/ surveys</li> <li>Other technologies e.g. social media, call centres</li> <li>Annual report</li> </ul>	<ul style="list-style-type: none"> <li>Impact-based risk</li> <li>Stakeholder feedback</li> </ul>	Ad-hoc

