

CONSULTATION RESPONSE

DEPARTMENT FOR ENVIRONMENT, FOOD AND RURAL AFFAIRS: DUE DILIGENCE ON FOREST RISK COMMODITIES

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ABOUT THE PRI

The Principles for Responsible Investment (PRI) is the world's leading initiative on responsible investment. The PRI is now a not-for-profit company with over 3,000 signatories (pension funds, insurers, investment managers and service providers) to the PRI's six principles with approximately US \$90 trillion in assets under management. 474 of these signatories, representing \$9 trillion, are based in the United Kingdom.

The PRI supports its international network of signatories in implementing the Principles. As long-term investors acting in the best interests of their beneficiaries and clients, our signatories work to understand the contribution that environmental, social and governance (ESG) factors make to investment performance, the role that investment plays in broader financial markets and the impact that those investments have on the environment and society as a whole.

The PRI works to achieve this sustainable global financial system by encouraging adoption of the Principles and collaboration on their implementation; by fostering good governance, integrity and accountability; and by addressing obstacles to a sustainable financial system that lie within market practices, structures and regulation.

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SUMMARY OF THE PRI'S POSITION

The PRI welcomes the UK Government's proposal to introduce regulation seeking to reduce the impact of their imports on deforestation, given the role of agricultural commodities trade as a key driver of deforestation.¹ Investors are increasingly aware of the impacts of deforestation on climate change and biodiversity loss, as well as the financial risks it poses for companies, markets and the financial system as a whole.

The PRI coordinates and supports investor action on deforestation risk in commodity supply chains, primarily through investor working groups focusing on advancing investor knowledge and promoting sustainable practices within the cattle, soy and palm oil supply chains.² Recently, there has been an increase in the number of investor initiatives tackling deforestation, notably including requests for policy reform. The PRI therefore supports increasing due diligence on forest-risk commodity imports, given the increased level of disclosure and attention it would bring to the issue of commodity-driven deforestation.

The PRI recommends:

1. **Due diligence requirements must be expanded where local laws are insufficient or poorly enforced.** A requirement to comply with local laws alone creates perverse incentives for businesses and producer countries.
2. **Expectations of an appropriate system of due diligence must be clear, robust,** focused on sustainability outcomes rather than just processes, and publicly disclosed.
3. **Fines for non-compliance should be material** enough to encourage robust due diligence processes, following a brief transition period.

¹ <https://science.sciencemag.org/content/361/6407/1108>

² <https://www.unpri.org/sustainability-issues/environmental-social-and-governance-issues/environmental-issues/sustainable-land-use>

DETAILED RESPONSE

Q1. Should the Government introduce legislation designed to make forest risk commodities more sustainable?

- [Yes](#)
- [No](#)
- [Don't know](#)

The PRI welcomes the Government's proposal to introduce legislation to make forest risk commodities more sustainable.

Agricultural commodities trade is a key driver of deforestation,³ and investors are increasingly aware of its negative impacts on climate change and biodiversity loss, as well as the financial risks it poses for companies, markets and the financial system as a whole. There has been increasing investor and company awareness of the reputational, operational and market access risks deforestation poses; recent publicised examples include:

- As much as 6.1 million hectares of forests and peatland have been deemed "stranded assets"⁴ on the balance sheets of Indonesian palm oil companies and cannot viably be developed⁵
- A seafood producer excluded a grain producer in its supply chain from the proceeds of its bond issuance over soy-related deforestation risk⁶
- An investor suspended purchases of Brazilian debt last year due to fires in the Amazon rainforest⁷

The PRI coordinates two investor working groups focusing on advancing investor knowledge and promoting sustainable practices within the cattle, soy and palm oil supply chains.⁸ In 2019, 254 investors representing approximately US \$17.7 trillion in assets signed a statement calling for companies to redouble their efforts and demonstrate clear commitment to eliminating deforestation within their operations and supply chains. In previous years, investors had issued commodity-specific expectation statements on cattle⁹ (signed by 46 investors representing approximately US \$6.8 trillion in assets), soybean¹⁰ (58 investors representing approximately US \$6.3 trillion in AUM) and palm oil¹¹ (62 investment organisations representing approximately US \$7.9 trillion in AUM). In the statements, investors stated they expect companies to tackle deforestation within their operations and supply chains, including through deforestation policies, monitoring and public disclosures of deforestation risk, and appropriate risk management strategies.

³ <https://science.sciencemag.org/content/361/6407/1108>

⁴ Stranded assets are "[assets that have suffered from unanticipated or premature write-downs, devaluations or conversion to liabilities.](#)"

⁵ <https://chainreactionresearch.com/reports/indonesian-palm-oils-stranded-assets/>

⁶ <https://www.ft.com/content/bd0f4705-36fa-4e74-8018-ca1f50771835>

⁷ <https://www.reuters.com/article/us-brazil-environment-investors-idUSKCN1VK1S0>

⁸ <https://www.unpri.org/sustainability-issues/environmental-social-and-governance-issues/environmental-issues/sustainable-land-use>

⁹ <https://www.unpri.org/download?ac=10609>

¹⁰ <https://www.unpri.org/download?ac=10610>

¹¹ <https://www.unpri.org/download?ac=10612>

Recently, investors also began engaging the Brazilian government, beginning with a letter signed by 29 financial institutions managing more than \$3.7tn in total assets, demanding that rising deforestation rates be tackled.¹²

Question 2: Should it be illegal for businesses to use forest risk commodities in the UK that have not been produced in accordance with relevant laws?

- **Yes**
- **No**
- **Don't know**

While the PRI agrees that it should be illegal for businesses to use forest risk commodities in the UK that have not been produced in accordance with relevant laws, the PRI does not believe that this represents a sufficient minimum standard to reduce deforestation risk. Instead the PRI recommends the following three step approach:

1. The UK government sets a minimum sustainability standard which local laws and their enforcement must meet. When importing from a region or country whose laws meet this standard, importing businesses' due diligence processes should ensure that forest risk commodities have been produced in accordance with these relevant laws.
2. The UK government publishes a list of countries or regions whose laws do not meet this standard. When importing from these regions or countries, importing businesses' due diligence processes should reflect the proportionally higher risk, and should ensure that forest risk commodities have not been produced in a manner inconsistent with relevant international agreements and deforestation targets.
3. The UK government works with countries in the latter group to improve their reporting and monitoring standards and capacity.

The PRI considers the proposed standard of compliance with relevant laws to be insufficient for the following reasons:

- Local laws are themselves frequently insufficient. An example of this is the Democratic Republic of Congo, whose relevant laws were found by a Chatham House analysis to be ambiguous, incoherent, and lacking harmonisation across areas such as forest protection and land use regulation.¹³
- Even where appropriate legal frameworks exist, poor enforcement can lead to unsustainable environmental outcomes. Brazil and Indonesia are examples of countries with stronger forest protection legislation, however recent increases in deforestation rates and fires have shown that the enforcement of these laws is failing to prevent environmental destruction.¹⁴

¹² <https://www.ft.com/content/ad1d7176-ce6c-4a9b-9bbc-cbdb6691084f>

¹³ <https://forestgovernance.chathamhouse.org/countries/democratic-republic-of-the-congo>

¹⁴ <https://forestgovernance.chathamhouse.org/publications/forest-governance-and-deforestation-addressing-the-disparity>

- The current proposal would create a “leakage” risk of buyers switching to supplier countries with weak environmental standards in order to more easily meet due diligence requirements.
- There is a similar risk of creating perverse incentives for producer countries, where a country may weaken its laws to prop up its agricultural exports. Earlier this year, Brazilian wood was shipped from an Amazonian port without authorisation from Ibama, the environment agency. After customs officials in Europe and the United States alerted Brazil of the issue, the president of Ibama changed regulations to do away with previously required export authorisations.¹⁵

The PRI therefore recommends that the UK government set a standard against which local laws be assessed for alignment. Laws should be tested for alignment with the zero deforestation goals of international protocols and agreements such as the New York Declaration on Forests, the Amsterdam Declarations, and relevant deforestation targets within the Sustainable Development Goals and the Convention on Biological Diversity. The PRI recommends that such a standard is aligned with Accountability Framework Initiative guidance.¹⁶ Additionally, the strength of enforcement of such laws should be compared with deforestation rate trends (i.e. whether deforestation rates are aligned with the goal set out in policy).

The government will need to publish a list of countries whose laws do not meet this standard, and keep the list updated. The due diligence process for these countries should reflect the proportionally higher risk.¹⁷ We suggest the government also use the tools available to them to help producer countries enforce their regulation and raise their standards, whilst ensuring sustainable economic development.

Many investors have already publicly highlighted a desire for companies to go beyond local laws. Several investors signed the Cerrado Manifesto Statement of Support, which previously collaborated with a Brazilian multi-stakeholder initiative to design financial incentives for farmers to go beyond regulatory requirements and take part in conservation efforts.¹⁸ Investors also recently began engaging the Brazilian government, beginning with a letter signed by 29 financial institutions managing more than \$3.7tn in total assets, demanding that rising deforestation rates be tackled.¹⁹

Question 3: Should businesses in the UK be obliged to have a system of due diligence in place to ensure that the forest risk commodities they use have been produced in accordance with relevant laws?

- [Yes](#)
- [No](#)
- [Don't know](#)

¹⁵ <https://www.reuters.com/article/us-brazil-environment-lumber-exclusive-idUSKBN20R15X>

¹⁶ <https://accountability-framework.org/overview/for-government/>

¹⁷ A proportionate, risk-based approach to due diligence would mean that companies where there is a lower risk of environment or human rights impacts wouldn't need to do as extensive due diligence as a company importing a product or providing financing associated with higher risks. <https://www.documents.clientearth.org/wp-content/uploads/library/2020-06-05-strengthening-corporate-responsibility-coll-en.pdf#page=13>

¹⁸ <https://cerradostatement.fairr.org/about/>

¹⁹ <https://www.ft.com/content/ad1d7176-ce6c-4a9b-9bbc-cbdb6691084f>

The PRI supports a due diligence requirement for importing businesses, subject to the higher standard set out in response to Question 2. Any due diligence requirement will need to be robust, focused on achieving sustainability outcomes rather than just on process, and be publicly disclosed.

The PRI recommends the following minimum requirements for a system of due diligence:

- The UK government should provide clear and binding guidelines on the specific due diligence process to be followed and how it should be reported. This could, for example, follow the same format proposed for Modern Slavery Act reporting, including the format of the report and its frequency, relevant policies, plans for implementation of due diligence, risks identified and measures taken to mitigate the risks, monitoring and tracking, as well as sanctions for failing to publish reports.²⁰ The PRI recommends the reporting process be aligned with the recommendations of the Accountability Framework Initiative.²¹ This would allow investors to analyse and cross-reference company performance in this area.
- The Modern Slavery Act currently allows companies to report that they have taken no steps to address modern slavery in their supply chains.²² The PRI recommends that no such option is included in the proposed legislation, so that companies are obligated to carry out due diligence. Disclosure is essential for investors to understand ESG risks and opportunities and allowing companies to report that they have not carried out due diligence hinders this understanding. This view is substantiated by a recent Independent Review commissioned by the UK government, calling for the removal of the option to report that no due diligence has been done as part of the Modern Slavery Act.²³
- The requirements should include disclosure on performance and outcomes, not just on the process of due diligence itself.
- Due diligence should extend to all direct and indirect suppliers across the supply chain. Forest risk commodities can have complex supply chains. Brazilian cattle for example, passes from farm to farm before arriving at the slaughterhouse. If the supply chain is not fully traceable, it is likely that deforestation will not be detected.²⁴

²⁰ <https://www.documents.clientearth.org/wp-content/uploads/library/2020-06-05-strengthening-corporate-responsibility-coll-en.pdf#page=15>

²¹ <https://accountability-framework.org/core-principles/>

²² <https://www.documents.clientearth.org/wp-content/uploads/library/2020-06-05-strengthening-corporate-responsibility-coll-en.pdf#page=15>

²³ https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/815410/Government_Response_to_Independent_Review_of_MS_Act.pdf

²⁴ For example, see: <https://www.greenpeace.org/international/story/43497/meat-deforestation-amazon-protected-illegal/>

Question 4: Should businesses be required to report publicly on their system of due diligence?

- [Yes](#)
- No
- Don't know

Question 5: Should the Government be able to levy fines against businesses that use forest risk commodities not produced in accordance with relevant laws?

- [Yes](#)
- No
- Don't know

The PRI supports this proposal and recommends that fines are material enough to outweigh any gains from non-compliance. The PRI recommends a brief transition period before businesses could be subject to fines.

An absence of financial penalties and strong enforcement contributed to high rates of non-compliance with the Illegal Timber Regulation in certain EU Member States,²⁵ as well as the UK's own Modern Slavery Act.²⁶ Sanctions are necessary to secure compliance and need to be material enough to outweigh any gains from importing unsustainable commodities, to ensure a sufficient deterrent from buying and trading products linked to deforestation.

Many large companies will already have voluntary commitments to reduce deforestation in their supply chains.²⁷ The PRI believes that monitoring and reporting requirements should come into force as soon as possible, allowing for a brief transition period for companies to engage their suppliers. A lack of such a phase-in could cause abrupt supply constraints, which could lead to spikes in consumer good prices, as we have recently seen with the rise of pork prices in China due to a supply shortfall due to African swine fever and a fall in frozen pork reserves.²⁸

Question 6: Should the legislation apply to larger businesses, over an employee number and turnover threshold, that use forest risk commodities in production or trade?

- [Yes](#)
- No
- Other

²⁵ <https://www.cliffordchance.com/content/dam/cliffordchance/briefings/2020/09/client-briefing-proposal-for-due-diligence-on-forest-risk-commodities-revised.pdf#page=2>

²⁶ https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/815410/Government_Response_to_Independent_Review_of_MS_Act.pdf

²⁷ <https://forest500.org/analysis/insights/implementing-commitments-beyond-2020>

²⁸ <https://www.ft.com/content/31e88669-f6fc-4be7-b0f0-e5eb96394a1c>