5.4 Forest governance from an investor’s perspective

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Introduction

According to international law, states are the primary owners of the natural resources in their territory. Consequently, national and international governance is crucial in guiding natural resource industries to develop sustainably and in ensuring that the wealth that natural resource development creates is distributed equitably.

The operations of these industries have a strong impact on scarce resources such as water, energy, timber, food and minerals. Companies in a sector such as forestry, paper and packaging (FPP) will be increasingly relevant from an environmental, social and financial perspective in the years to come. As a responsible investor, and in line with John Ruggie’s “Protect, Respect and Remedy” framework,[SNS AM] sees it as their responsibility to minimize any negative impacts of their investments.

For the past decade, the FPP sector has been at the centre of shifting global conditions. This has been driven mainly by social and technological factors, such as the growing influence of digital media and the declining demand for traditional forest products in established markets. Timber-based building materials have also experienced declining demand since 2006, due to deterioration in the North American housing market.

At the same time, demand and supply patterns for forestry, paper and packaging products have shifted to emerging countries. As the FPP sector struggles to adapt to this evolving context, new trends — including stakeholder relations, climate change and product innovation — are emerging. They offer the greatest potential to positively affect financial performance and generate opportunities for sustainable development.

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Maximizing the potential of responsible forestry governance

Whether the FPP industry will contribute to sustainable development and equitable wealth distribution depends on the overall governance framework, including both corporate and sovereign elements. With good governance, natural resource development can generate significant revenues that are helpful in promoting growth and reducing poverty. Weak governance structures, however, often contribute to situations where poverty, corruption and conflict are more prevalent.

SNS AM does not finance forestry projects. Instead, it leverages its influence as a shareholder of companies in the FPP sector. Engaging these and other companies in environmental, social and governance (ESG) issues is central to SNS AM’s responsible investment strategy. Current ESG engagement themes of interest to SNS AM and other investors include community engagement (e.g., respecting the right to be consulted in good faith, through representative institutions, with the objective of seeking free, prior and informed consent (FPIC) from local communities); health and safety management; sustainable forest management; and the prevention of illegal logging practices.

Shareholders are equally concerned about issues such as corruption, organized crime syndicates, weak national rule of law and insufficient enforcement mechanisms. Such risks in the government domain can make it difficult for the FPP sector to ensure compliance with the ESG standards demanded by responsible investors. In SNS AM’s view, the effective management of corporate social responsibility (CSR) starts with four factors:

- commitment and policy;
- robust (life-cycle) management systems and adequate due diligence;
- transparency and accountability; and
- an effective corporate governance structure.

These best practice areas can help FPP companies minimize their negative ESG impacts.

Commitment and policy

The starting point for the management of ESG issues is the creation of a CSR policy. Such a policy, along with the commitment to operate according to international best-practices, can provide a framework for mitigating ESG issues. The Ruggie Principles provide general recommendations that may form the basis of a policy statement. SNS AM considers the following elements when evaluating a company’s CSR policy:

- specific programmes and policies;
- short- and long-term targets and objectives;
- reference to international standards;
- a clear statement against the use of specific no-go areas, practices or regions (i.e., an FPP company should recognize that logging and biodiversity conservation may not be compatible for protected areas and High Conservation Value Forest (HCVF));
- the recognition of specific policies for ESG-sensitive regions or products that are known to have an impact on companies or on local people and/or biodiversity;
- reference to stakeholders, including employees, customers, affected communities and others;
a commitment to establish formal mechanisms for dialogue with all relevant stakeholders, including civil society and governmental bodies, in human rights matters;
• clear extension of the policy to agents/intermediaries, suppliers, joint venture/business partners; and
• commitment to a full due-diligence process including risk assessments, transparency, the adoption of implementation programmes and mechanisms, and monitoring and reporting.

Life cycle management/due diligence
SNS AM recognizes the need to manage forestry and logging operations over long time horizons and across a forestry project’s life cycle. A life cycle approach complements the long-term perspective of forestry operations by highlighting the multiple aspects of large-scale forestry operations, which each have specific economic, social and environmental impacts to be managed.

For example, wood sequesters carbon while it is growing. Although there has been a growing focus on carbon to evaluate the environmental performance of forest products, this category is only one subset of a life cycle management approach. A comprehensive life cycle analysis programme assesses additional relevant impacts on the environment, such as the rate of biodiversity loss, changes in land use, chemical pollution, global freshwater use and air acidification. Life cycle management should complement a long-term approach to sustainable forest management by accounting for the extended impacts of forestry and logging operations.

Additionally, in line with the Ruggie Principles, SNS AM expects companies to apply strong due diligence practices that discourage corruption and bribery. This proactive approach helps companies identify corruption risks associated with their operations and enables them to respond more effectively. This means that a clear statement against the use of corruption and bribery, which addresses facilitation payments, gifts and political donations, as well as confidential “whistle-blower” protections, should be formalized. Furthermore, all businesses should be required to consider bribery issues and corrupt activities as part of assessing their business conduct risk.

Governments around the world recognize that illegal logging is a global issue. To illustrate this point, the new EU Timber Regulation, which will come into force in March 2013, requires forestry extraction operations to establish due diligence systems to minimize the risk that illegal products will enter the EU.

SNS AM has combined the two concepts of life cycle management and due diligence and determined the following indicators:
• ESG Impact Assessment: this includes baseline study and identification and assessment of social and environmental risks for large-scale new-build expansion and development projects — it also entails designing effective mitigation measures and building a monitoring framework to measure performance;
• a management system built on an iterative management process such as the “Plan–Do–Check–Act” model to ensure that ESG matters are systematically identified (Plan), implemented (Do), measured (Check) and that progress is analyzed (Act);
• risk management and mitigation mechanisms that ensure the effective integration of ESG information into business functions;
• emergency preparedness plans that include risk/accident prevention measures for on-site and off-site incidents;
• monitoring and evaluation to ensure that ESG policies and programmes are effective; and
• access to grievance and remedy mechanisms for all relevant stakeholders.

Transparency and accountability
One of the most efficient ways to improve the impact of FPP companies in countries that depend heavily on natural resources is through increased transparency and accountability. This is especially significant in the case of disclosure of key policy indicators. In the short term, it offers a comparative view of what companies in the FPP sector claim to be doing and measures whether a company has good practice management tools in place and is committed to their implementation.

In the case of illegal logging, SNS AM — in line with key legislative trends and cooperation agreements, such as the U.S. Lacey Act and the EU Timber Regulation — requires transparency and accountability from FPP companies. The resulting openness supports a more attractive business climate in countries that depend on natural resources, and reduces political and other related risks. More concretely, SNS AM encourages companies to carry out several tasks:
• disclose relevant financial data on a country-by-country and project-by-project basis;
• disclose relevant policy indicators that offer a comparative view of what FPP companies claim to be doing and measure whether a company has “good practice” management tools in place and is committed to their implementation;
• provide site-specific forest or plantation information;
• report in accordance with the Global Reporting Initiative (GRI);7
• create a high level of transparency about business activities in risk countries;
• obtain independent, external verification from bodies such as the Forest Stewardship Council (FSC) and the Programme for the Endorsement of Forest Certification Schemes (PEFC); and
• embrace voluntary initiatives such as the Forest Footprint Disclosure (FFD) and Extractive Industries Transparency Initiative (EITI) and work to promote them.8,9

Corporate governance
With a strong governance and leadership structure, a company is better able to meet the financial and non-financial challenges of the FPP sector and adhere to the highest standards and best practices of local, national and international parties. This is essential in order to enhance companies’ long-term economic value.
For its overarching guidelines on good corporate governance practices, SNS AM has adopted the International Corporate Governance Network’s (ICGN) principles, which are internationally recognized as the standard of good practice.\(^\text{10}\) As a minimum, we expect companies in the FPP sector to observe corporate standards in their domestic markets. Specifically, SNS AM encourages companies to develop a corporate governance structure that includes the following:

- the Board of Directors addresses environmental, social, ethical and governance issues. The board is accountable for the impact of these issues on the company, both in terms of reputation, risk and performance;
- designated board committees to address these issues;
- at least one member of the board should have expertise in environmental, social and ethical issues relevant to the FPP sector;
- a function specifically and solely designated to addressing ESG issues — this function should be well resourced and should be granted adequate authority, accountability and financial resources to meet these responsibilities;
- a whistle-blower policy should apply to all employees, especially since employee health and safety and labour rights are very important in the FPP sector;
- whenever appropriate, remuneration plans should factor in performance on environmental, social and ethical issues; and
- shareholders should receive sufficient and timely information, so that they have an informed view of the company’s environmental, social and ethical performance and management of the social, environmental and ethical risks that the company is exposed to.

**Responsible investing in practice**

Poor corporate governance is increasingly considered as a root cause of poverty and conflict. Over the years, poor and marginalized people have been highly vulnerable to the impacts of the FPP industry's rapid expansion, often losing their livelihoods and homelands in the process. As a result, social conflicts involve more and more people across the world. Widespread corruption in some of the region's rainforest nations — combined with ineffective laws and corporate exploitation of weak government regulations — have long been recognized as key drivers behind the rapid expansion of the FPP industry.

In general, SNS AM does not exclude companies from its investment portfolios because of their presence in poorly governed or contested contexts. Companies should recognize however, that the capacity of governments and host societies to deliver the expected benefits from natural resource operations, such as logging, may be limited, as will their ability to monitor social and environmental protection. This is all the more important if there are indications of weak transparency, high levels of corruption, manipulation of data, and controversial links with the informal sector. Companies that choose to operate in a poorly governed context should abide by national and international standards and not take advantage of lax health, safety and environmental laws.
Donors and international financial institutions generally base their state aid and government loans on the presence of good governance, both corporate and sovereign. Investors such as SNS AM also pay attention to good governance in their ESG analysis of investment targets. SNS AM seeks appropriate disclosure on the best practice areas mentioned above for the FPP companies in which it invests. For this purpose, SNS AM’s ESG analysts make use of professional data from ESG rating agencies. Best-in-class rankings are made available to SNS AM that assess FPP companies’ performance on indicators such as “policy on bribery and corruption,” “CSR reporting quality” and “transparency on payments to host governments.” In this way, the rating agencies indicate which companies need further improvements to their risk management standards, and also help find examples of best practices in the FPP sector.

This thorough assessment results in a recommendation to include, exclude or engage with FPP companies, depending on the presence of controversies related to weak governance. When there is clear evidence that an FPP company is directly cooperating with a military regime or trading in illegal timber, SNS AM will exclude it from investment. When an FPP company operates in a conflict area/fragile state and does not uphold best practices for forest governance or social and environmental issues, SNS AM will try to engage with it to encourage it to adopt best practices. The outcome of the resulting dialogue is determined by assessing the readiness of companies to answer questions from SNS AM, to cooperate in the process of the engagement, to be transparent, to address matters of concern and ultimately to demonstrate improvement in its ESG performance. Despite the fact that company engagement requires a long time and success is not always guaranteed, it has great potential for investors in raising awareness on the on the importance and effectiveness of good forest governance for sustainable business development.
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Endnotes
1. The Ruggie principles outline the state’s duty to protect human rights, the corporation’s responsibility to respect human rights, and the need for access to remedy. In 2011, the UN Human Rights Council unanimously endorsed the principles. Investors stand to benefit from them; they can be used to support the implementation of responsible investment strategies. www.sustainalytics.com/sites/default/files/ruggie_principles_and_human_rights.pdf.

2. SNS Asset Management (SNS AM) is the asset manager of the Dutch retail banking and insurance provider SNS REAAL and enjoys a leading position in responsible institutional asset management. SNS AM manages the portfolios of REAAL, ASN Bank, ASN Investment Funds, SNS Investment Funds and the Zwitserleven Investment Funds and all separate accounts. SNS Asset Management also manages assets for external clients and the participants in the funds of SNS AM.

3. That is, SNS AM does not invest directly in forests, but in listed FPP companies through the stock market. An investment in FPP companies is not an end in itself and SNS AM never takes a majority stake.

4. Free Prior and Informed Consent is founded in the rights articulated in the UN Declaration on the Rights of Indigenous People.

5. HCVFs are not yet formally endorsed as protected areas; rather, these areas are identified by businesses and NGOs as areas of high conservation value due to biodiversity, cultural and landscape significance.


7. See www.globalreporting.org for more information.


9. The FFD initiative acts as a hub for information, research and best practice case studies on deforestation issues and encourages innovation through exchange and collaboration with all stakeholders. In addition, FFD engages companies to encourage them to report on their forest footprint, which is based on exposure to natural resources that occur on forested lands, such as cattle products and biofuels. EITI is a global standard that promotes revenue transparency. It has a robust yet flexible methodology for monitoring and reconciling company payments and government revenues at the country level. The process is overseen by participants from government, companies and national civil-society organizations. The EITI board and the International Secretariat are the guardians of the EITI methodology internationally.

10. The ICGN principles can be found at www.icgn.org/icgn-global-corporate-governance-principles.php.