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Chinese banks' forest-risk financing

Financial flows and client risks

About this report

This report has been commissioned by Rainforest Action Network. It is supported by TuK Indonesia, BankTrack, China Environmental Paper Network, and Jikalahari.

About Forests & Finance

Forests & Finance is an initiative by a coalition of campaign and research organisations including Rainforest Action Network, TuK Indonesia, Profundo, Repórter Brasil, Amazon Watch, BankTrack and Sahabat Alam Malaysia. Collectively, they seek to achieve improved financial sector transparency, policies, systems and regulations, that ultimately prevent financial institutions from supporting the kind of environmental and social abuses that are all too common in the operations of many forest-risk sector clients.

About Profundo

With profound research and advice, Profundo aims to make a practical contribution to a sustainable world and social justice. Quality comes first, aiming at the needs of our clients. Thematically we focus on commodity chains, the financial sector and corporate social responsibility. More information on Profundo can be found at www.profundo.nl.

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Summary

This report provides an overview of the financing of forest-risk companies engaged in six deforestation-risk commodities in three forest-rich regions by Chinese financial institutions as covered by Forests & Finance. It highlights the risks that the largest clients are still exposed to, and recommends concrete actions to mitigate those risks and improve corporate practice on the ground.

Analysis by Forests & Finance found that Chinese financial institutions are the second largest financiers of forest-risk companies covered by the database. Between January 2016 and April 2020, Chinese financial institutions provided approximately US\$ 15 billion in forest-risk loans and underwriting services. Chinese financial institutions are second to Brazilian financial institutions (US\$ 53 billion) and are more important than financial institutions from Indonesia (US\$ 14 billion).

Chinese financial institutions clearly play a significant role in financing forest-risk companies. Financial sector regulators in China have developed numerous measures over the past decade to foster sustainable finance.¹ At the United Nations Summit on Biodiversity in October 2020, President Xi Jinping called for sustained efforts by all to enhance biodiversity conservation and global environmental governance.² Within this backdrop, this report presents analysis of the forest-risk financing by Chinese financial institutions, and the risks they are still exposed to.

The report recommends a number of concrete steps to mitigate ESG related financial risks, and improve the corporate behaviour of the clients on the ground. These are:

- **Adopt policies**

Chinese financial institutions should formulate clear policies to manage forest-risk sector credit and investment decision-making. The minimum standards laid out developed by Forests & Finance should form the basis of those policies.

- **Conduct enhanced due diligence**

Chinese financial institutions should screen potential and existing investee companies and clients for compliance with their credit and investment policies and conduct enhanced due diligence by assessing company exposure to ESG risks, policy commitments, and capacity and track record to address such risks. Such enhanced due diligence is required by China's *Green Credit Guidelines*.

- **Be engaged**

It is essential that Chinese financial institutions regularly monitor clients and investees' activities to ensure that these companies continue to meet the standards set in their credit and investment policies. The Guidelines on Regulating the Banking Industry in Serving Enterprises' Overseas Development and Strengthening Risk Control call upon financial institutions to engage with affected communities, NGOs and other stakeholders. This is a welcome recommendation. In order to be most effective, Chinese financial institutions should open such channels of communications, and be responsive in their engagement with civil society organizations

- **Divest**

Chinese financial institutions should terminate financing agreements and sell bonds and shares if the company violates the terms of agreements regarding ESG-related policies, where they fail to take immediate action to correct any ESG policy violations and put in place corrective actions to prevent reoccurrence. Not financing companies with poor ESG performance records is an explicit recommendation of the Green Credit Guidelines.

Abbreviations

APP	Asia Pulp & Paper
APRIL	Asia Pacific Resources International Holdings Limited
BAP	Binasawit Abadi Pratama
BKS	Bahana Karya Semesta
CBIRC	China Banking and Insurance Regulatory Commission
CBP	Customs and Border Protection
CDB	China Development Bank
CFGC	China Forestry Group Corporation
COFCO	China Oil and Foodstuffs Corporation
ESG	Environmental, social, and corporate governance
FPIC	Free, Prior and Informed Consent
GAR	Golden-Agri Resources
ICBC	Industrial and Commercial Bank of China
KLHK	Ministry of Environment and Forestry
NDPE	No deforestation, no peat, no exploitation
NGO	Non-governmental organization
NPL	Non-performing loan
PCG	Pacific Century Group
PTPN	Perkebunan Nusantara
RAPP	Riau Andalan Pulp & Paper
RGE	Royal Golden Eagle
SASAC	State-Owned Assets Supervision and Administration Commission
TPL	Toba Pulp Lestari
UN-PRB	United Nations Principles for Responsible Banking
UN-PRI	United Nations Principles for Responsible Investment
WKS	Wirakarya Sakti

Introduction

This report provides an overview of the financing of forest-risk companies engaged in six deforestation-risk commodities in three forest-rich regions by Chinese financial institutions as covered by Forests & Finance. It highlights the risks that the largest clients are still exposed to, and recommends concrete actions to mitigate those risks and improve corporate practice on the ground.

Forests & Finance is an initiative by a coalition of campaign and research organisations including Rainforest Action Network, TuK Indonesia, Profundo, Repórter Brasil, Amazon Watch, BankTrack and Sahabat Alam Malaysia. Collectively, they seek to achieve improved financial sector transparency, policies, systems and regulations, that ultimately prevent financial institutions from supporting the kind of environmental and social abuses that are all too common in the operations of many forest-risk sector clients.

Forests & Finance reveals the finance flowing into commodities driving deforestation and land degradation in Southeast Asia, Brazil and Central & West Africa. The 300+ company groups selected for the study are involved in the supply chains of the beef, soy, pulp and paper, palm oil, rubber or timber sectors in Southeast Asia, Central & West Africa and Brazil – collectively referred to as ‘tropical forest-risk sectors’. This list is intended to be a representative sample of companies impacting or having the potential to impact tropical forests, and is not an exhaustive list of all companies impacting tropical forests. Other factors that led to their selection include the size of the company and land area of operation, access to information on their financing, and known negative impacts of their operations on tropical forests.

The report is organized as follows: Chapter 1 provides a brief discussion on the how sustainability risks in forest commodities can cause financial risks for investors and creditors; Chapter 2 presents an overview of the financing of forest-risk commodities by Chinese financial institutions; Chapter 3 investigates the environmental, social and governance risks of the top-5 clients of Chinese financial institutions in more detail, and; Chapter 4 concludes with recommendations.

A summary of the findings of this report can be found on the first pages of this report.

1

Forest commodity financial risk mitigation

Financing to companies engaged in forest-risk commodities such as palm oil, pulp & paper, rubber, soy, and timber, leaves financial institutions exposed to environmental, social and governance risks. These risks of the companies' operations can result a several financial risks for the companies financing them. Aware of these risks, the government of China has developed numerous guidelines and initiatives, as described below.

1.1 Agriculture sector guidelines

In 2018, the China Association for the Promotion of International Agricultural Cooperation (CAPIAC) – located under China's Ministry of Agriculture and Rural Affairs – published the *Guidelines on China's Sustainable Agricultural Overseas Investment*. The sustainable overseas agriculture guidelines provide instructions to Chinese agriculture producers and traders on establishing due diligence mechanisms to ensure that companies and suppliers adhere to international principles such as free, prior and informed consent; respect for the rights and interests of local communities in utilizing natural resources, and; abide by local laws and regulations, among other things.³

1.2 Forest sector guidelines

For the forestry sector, China's State Forestry and Grassland and the Ministry of Commerce issued the *Guide on Sustainable Overseas Silviculture by Chinese Enterprises* in 2007. These guidelines described the key principles and requirements for the Chinese enterprises engaged in timber operations to maintain sustainable silviculture. The 2007 guidelines were followed in 2009 by *Guide on Sustainable Overseas Forest Management and Utilization by Chinese Enterprises*, also issued by China's State Forestry and Grassland and the Ministry of Commerce. The guidelines were developed in cooperation with a number of international NGOs, including World Wide Fund for Nature, The Nature Conservancy, International Union for Conservation of Nature and Natural Resources Defense Council, and Forest Trends. The guidelines were intended to encourage Chinese enterprises to play a positive role in the sustainable development of forest resources.⁴

1.3 Rubber sector guidance

The Chinese Chamber of Commerce for Metals, Minerals and Chemicals Importers and Exporters released its *Guidance for Sustainable Natural Rubber* in 2017 with the support of UK's Department for International Development (DfID). The guidelines were developed with additional input from China's Ministry of Commerce, various research institutes, companies, and NGOs. The sustainable natural rubber guidance is a voluntary framework for Chinese companies to identify, prevent and mitigate risks, establish due diligence systems, and conduct effective monitoring and reporting. The guidance is primarily applicable to businesses that invest in, plant or process natural rubber, but can also be utilized by downstream actors.⁵

1.4 Finance sector guidelines

Efforts to improve the consideration of ESG risks by the financial sector date back over a decade. China Banking and Insurance Regulatory Commission (CBIRC) has developing a policy framework to promote sustainable finance, and the integration of ESG risks in due diligence processes. In 2007, China Environmental Protection Administration, the People's Bank of China, and China Banking and Insurance Regulatory Commission (CBIRC) published the first recommendations on mitigating financial risks driven by ESG risks.⁶

These recommendations were formalized into the *Green Credit Guidelines* in 2012. The *Green Credit Guidelines* apply to both commercial banks (ICBC, Bank of China, Agricultural Bank of China, and policy banks (China Eximbank and China Development Bank). The guidelines were developed to improve due diligence procedures by banks, improve their client compliance review and project assessment with respect to environmental and social issues. They also explicitly recommend that clients with poor ESG performance record should not be granted funding.⁷

The 2012 guidelines were followed by *Opinions on Green Credit Implementation* issued by the CBIRC in 2014. The supervisor called on financial institutions to further improve the implementation of the *Green Credit Guidelines*.⁸

In 2016, China's Ministry of Finance, National Development and Reform Commission, Ministry of Environment Protection, China Banking Regulatory Commission, China Securities Regulatory Commission & China Insurance Regulatory Commission, together issued the *Guidelines on the Construction of the Green Financial System*. These guidelines, as the title suggests, are geared towards integrating the various parts of the financial system into a holistic green financial system, one that promotes investment in green industries, and more effectively mitigates investment in polluting industries.⁹

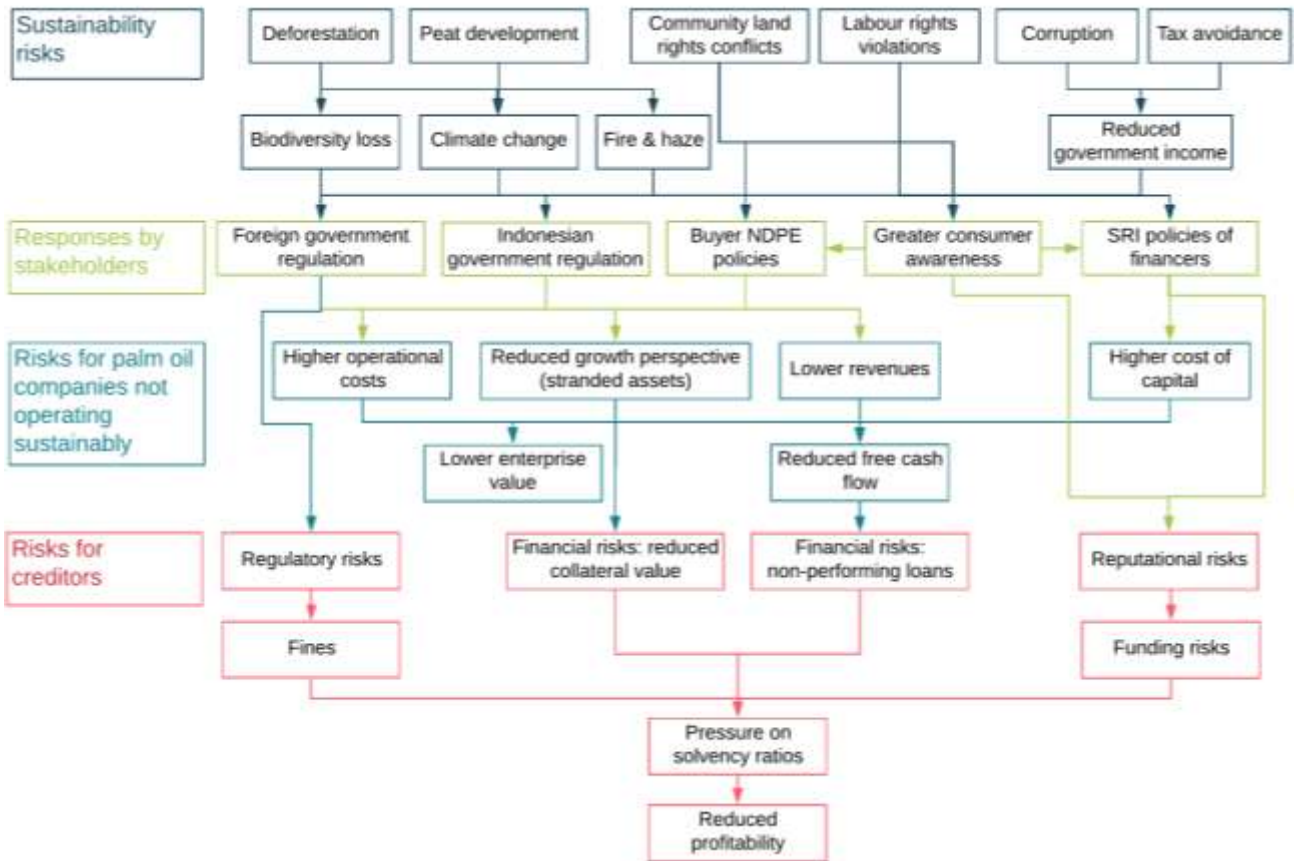
In 2017, the *Guidelines on Regulating the Banking Industry in Serving Enterprises' Overseas Development and Strengthening Risk Control* were issued by the CBIRC. These guidelines were developed to mitigate the increasing ESG risks that Chinese financial institutions and their clients were exposed to outside of China. The guidelines urged Chinese financial institutions to integrate environmental and social risk management into all stages of their overseas financing (including onboarding, monitoring and reporting). The guidelines specifically mention environmental and social risks, and call upon financial institutions to engage with affected communities, NGOs and other stakeholders when issues emerge.¹⁰

1.5 Discussion

From the above, it is clear that the Chinese government is well-aware of the environmental, social and governance risks of companies active in the relevant forest-risk sectors, and the risks that the financial institutions that finance them are exposed to. The government has developed a broad range of "guidelines" meant to address these risks, both domestically and abroad. However, these guidelines lack legal weight, and implementation remains weak. Chinese companies still struggle to comply with host country laws and regulations, not to mention the international norms and standards that they are called upon to uphold. Moreover, channels for communication with Chinese financial institutions by affected communities, and other stakeholders, still need significant improvement.¹¹

Within the context of growing consumer awareness of environmental and social issues related to the product they purchase, in addition to an increasing number of mid- and downstream operators committing to sustainable supply chains, the financial risks of financing companies with unsustainable corporate practices are even more relevant. Figure 1 presents a map of the potential risk flows of unsustainable corporate practices creating financial risks for their creditors and investors. The general flow is as follows: a sustainability issue triggers a response by one or more stakeholders, this response has an impact on the operations of the company not operating sustainably, resulting in a financial risk for its creditors and investors.

Figure 1 Sustainability risk flows



Risks to creditors and investors can be largely mitigated through appropriate minimum standards for onboarding clients, adequate due diligence procedures, consistent monitoring, and responsive engagement. All these elements have also been laid out the Chinese supervisory bodies, as has been detailed in section 1.4. When Chinese financial institutions fully implement the guidelines developed by supervisors, and Chinese companies fully adhere to guidelines relevant for their operations in forest-risk sectors, when many of the ESG risks will be mitigated. Issues that do arise, can then be resolved through responsive engagement with relevant financiers and companies.

An aerial photograph of a dense forest with a white text box overlaid in the upper left corner. The forest is composed of many trees with varying shades of green, and some brown patches of earth are visible between the trees. The text box contains the following text:

Chinese financiers provided US\$ 14.9 billion in forest-risk credit since 2015 and held US\$ 198 million in forest-risk investments in June 2020.

2

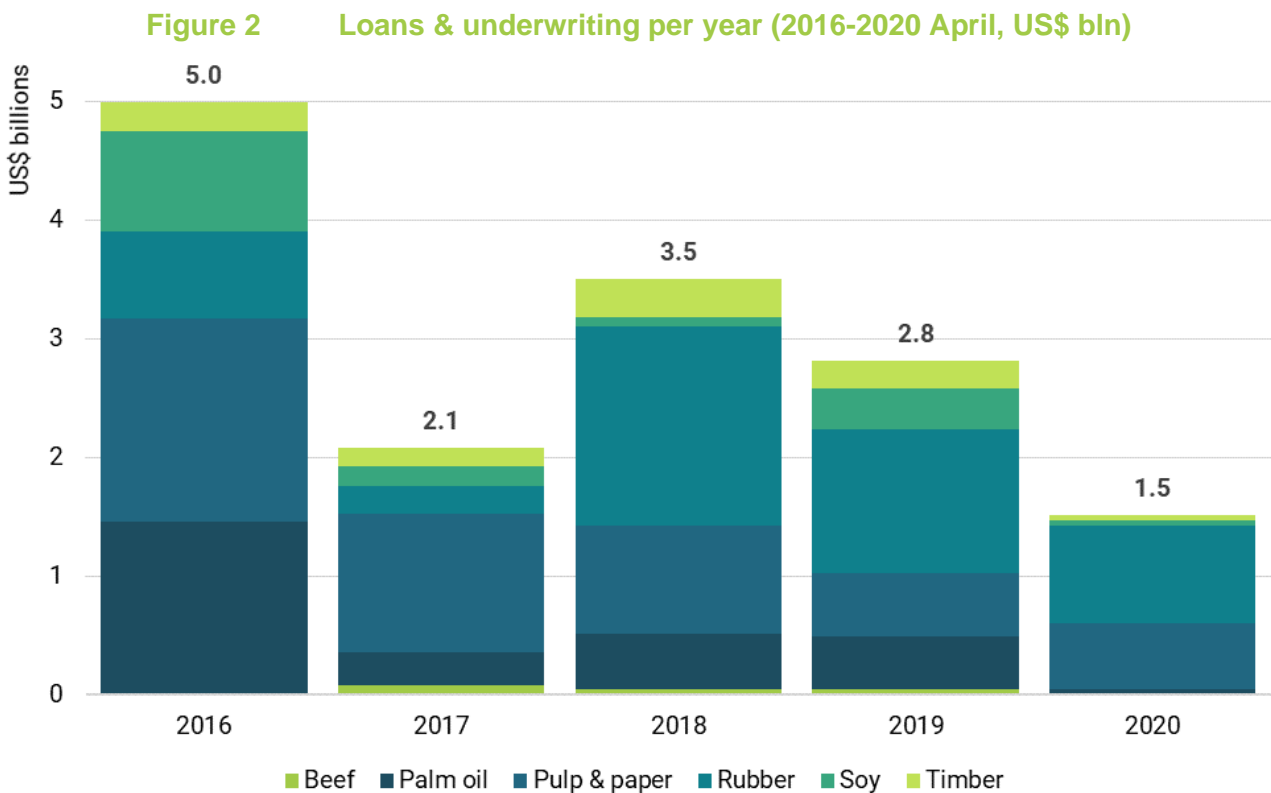
Financing analysis

Chinese financial institutions have provided US\$ 14.9 billion in forest-risk loans and underwriting services since the Paris Agreement was signed in December 2015. At the most recent filing date in June 2020, Chinese financial institutions held US\$ 198 million in forest-risk bonds and shares.

2.1 Creditors analysis

Forests & Finance is a database that maps financial flows to companies engaged in six key forest-risk agro-commodities – beef, palm oil, pulp & paper, rubber, soy and timber – in three forest-rich geographies – Brazil, Central & West Africa, and Southeast Asia. The identified financial flows, represent forest-risk figures per geography (see Forests & Finance for further details).

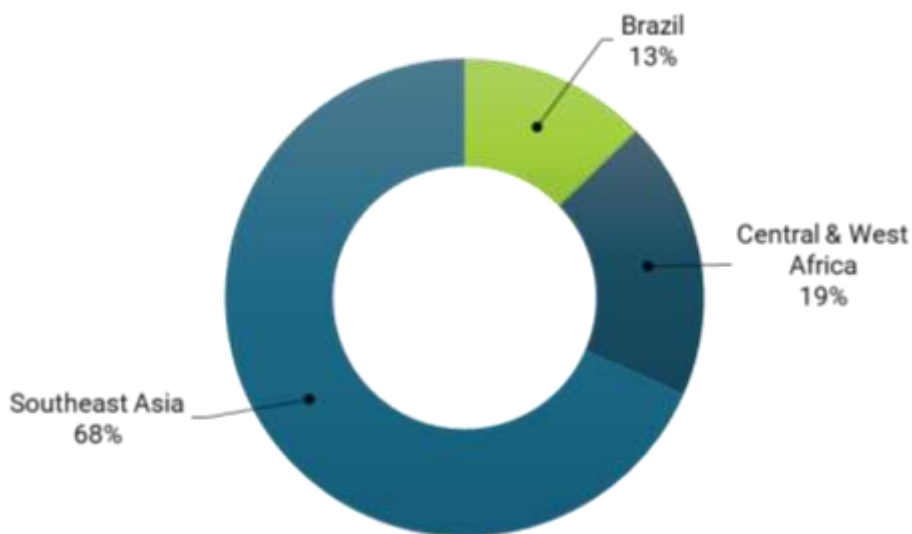
According to Forests & Finance, since the Paris Agreement was signed in December 2015, Chinese financial institutions have provided US\$ 14.9 billion in forest-risk loans and underwriting services. Figure 2 shows that there have been some fluctuations since 2016, with a general decrease overall. The figures of the 2020 are complete for the first quarter, a further rise is expected.



Source: *Forests & Finance*, online: <https://forestsandfinance.org/>, viewed in September 2020.

Figure 3 shows that approximately two thirds of this financing was to the activities of companies in Southeast Asia. Financing to the activities of companies active in Central & West Africa and Brazil accounted for 19% and 13% respectively of all identified financing to companies engaged in beef, palm oil, pulp & paper, rubber, soy and timber.

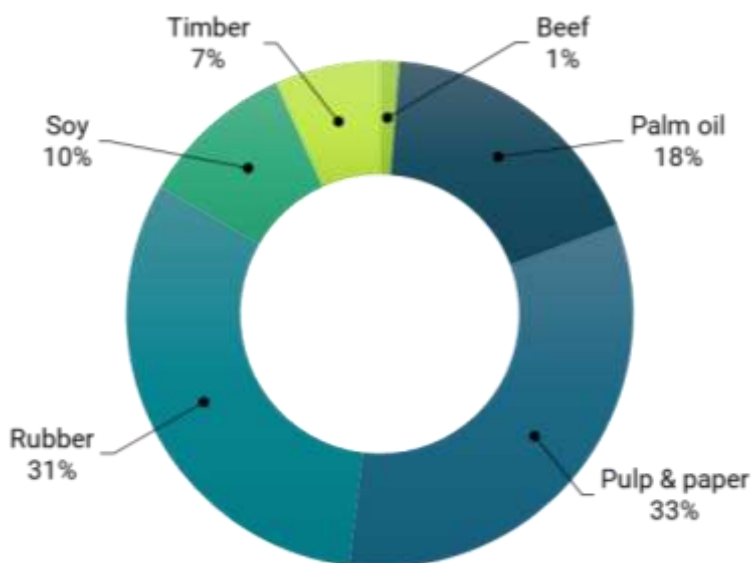
Figure 3 Regional distribution of Chinese forest-risk loans & underwriting (2016-2020 April)



Source: *Forests & Finance*, online: <https://forestsandfinance.org/>, viewed in September 2020.

Approximately, a third of financing was attributable pulp & paper, and another third to rubber. Lower levels of financing were attributable to palm oil and soy (see Figure 4).

Figure 4 Sectoral distribution of Chinese forest-risk loans & underwriting (2016-2020 April)



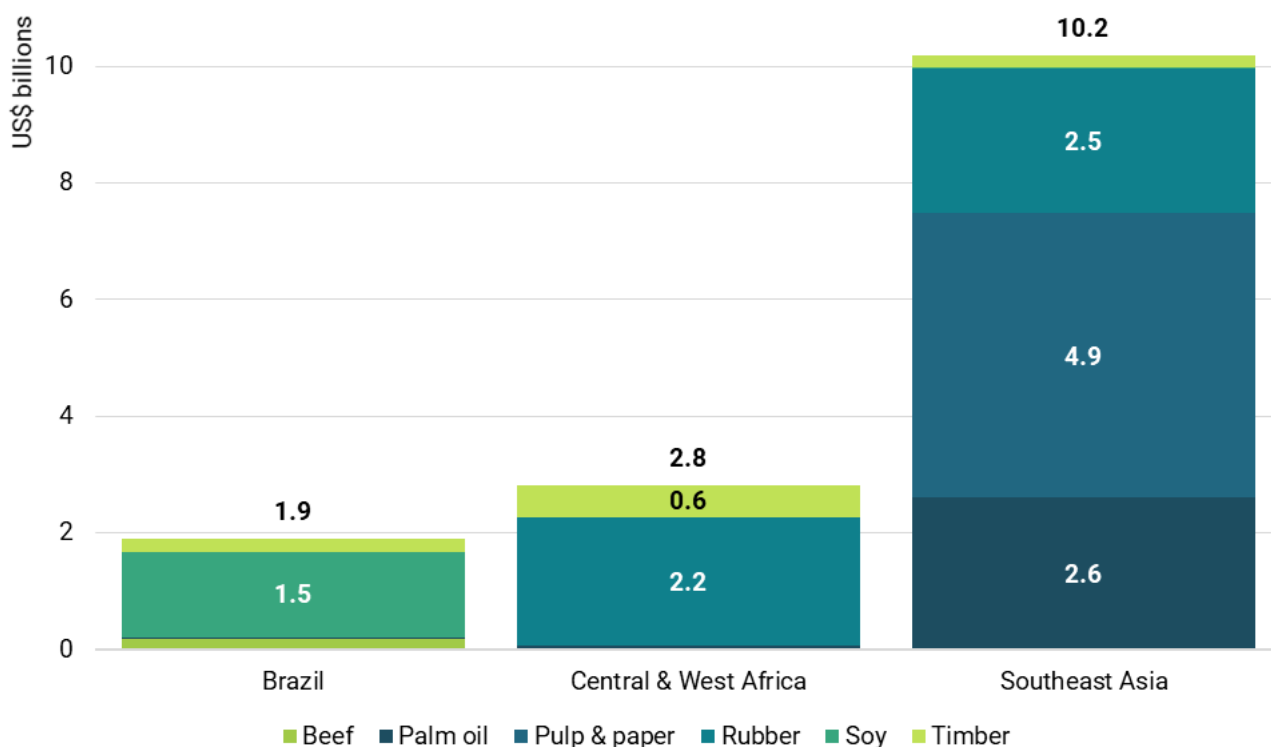
Source: *Forests & Finance*, online: <https://forestsandfinance.org/>, viewed in September 2020.

A closer look at the geographic and sectoral breakdown of Chinese financial institution credit flows, shows that US\$ 10.2 billion was attributable to forest-risk commodities in Southeast Asia. Approximately half of this financing was attributable to pulp & paper, followed approximately a quarter each to palm oil and rubber (see Figure 5).

Chinese financial institutions provided US\$ 2.8 billion in forest-risk loans and underwriting services attributable to Central & West Africa. 79% of this was attributable to rubber, 21% to timber. Financial flows from Chinese financial institutions to timber were, in fact, the highest in Central & West Africa.

The majority of Chinese forest-risk financing in Brazil was attributable to soy.

Figure 5 Geographic and segment breakdown of loans & underwriting (2016-2020 April, US\$ bln)



Source: *Forests & Finance*, online: <https://forestsandfinance.org/>, viewed in September 2020.

Figure 6 shows that bond issuances are the dominant source of financing provided by Chinese financial institutions to forest-risk companies, particularly since 2014. Bond issuances generally account for more than two thirds of all financing provided to the forest-risk companies in the *Forests & Finance* database.

The increase in bond issuances may be the result of banks' efforts to tackle the rising problem of non-performing loans. Figure 6 shows that as the NPL ratio has accelerated beyond 1% since 2013 up to almost 1.85% in 2018, topping 2% in the first of 2020, the proportion of credit provided through bond issuances has also increased. The increase of non-performing loans in China is a concern the government has been trying to tackle over the last 5-10 years. It is likely that NPLs will continue to increase as a result of the economic crisis caused by Covid-19.¹²

Figure 6 Loans & underwriting to forest-risk companies per financing type (2013-2020 April)

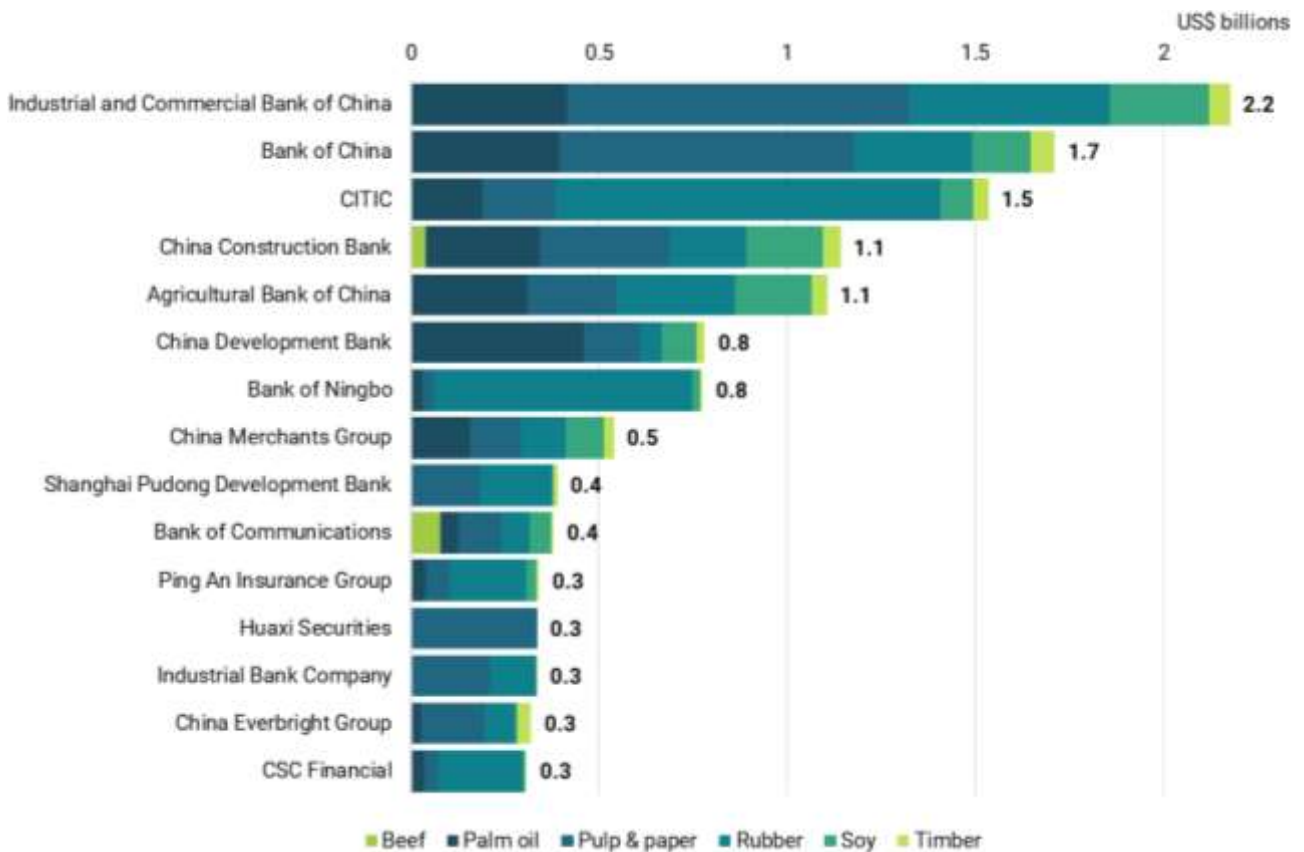


Source: *Forests & Finance*, online: <https://forestsandfinance.org/>, viewed in September 2020; World Bank Data (2020, September), *World Development Indicators* - FB.AST.NPER.ZS; *Xinhua* (2020, June 17), "China to accelerate non-performing loans settlement", online: http://www.xinhuanet.com/english/2020-06/17/c_139146249.htm, viewed in September 2020.

The top 5 Chinese creditors provided more than half of all identified forest-risk loans and underwriting period to companies active in the three forest-rich regions. The top 10 Chinese creditors provided more than 70%. A number of financial institutions – e.g. CITIC and Bank of Ningbo – provided comparatively more financing attributable to rubber, others – such as ICBC and Bank of China – provided comparatively more credit attributable to pulp & paper. In the period of scope, China Development Bank provided comparatively more financing attributable to palm oil.

The top 5 forest-risk clients of Chinese financial institutions account for approximately 90% of all identified financing to the forest-risk companies included in *Forests & Finance*. The largest among these is Sinochem, which attracted US\$ 4.6 billion in forest-risk loans and underwriting services from Chinese financial institutions, primarily attributable to its rubber operations (see section 3.5).

Figure 7 Top-15 Chinese providers of loans and underwriting services for forest-risk companies (2016-2020 April, US\$ bln)

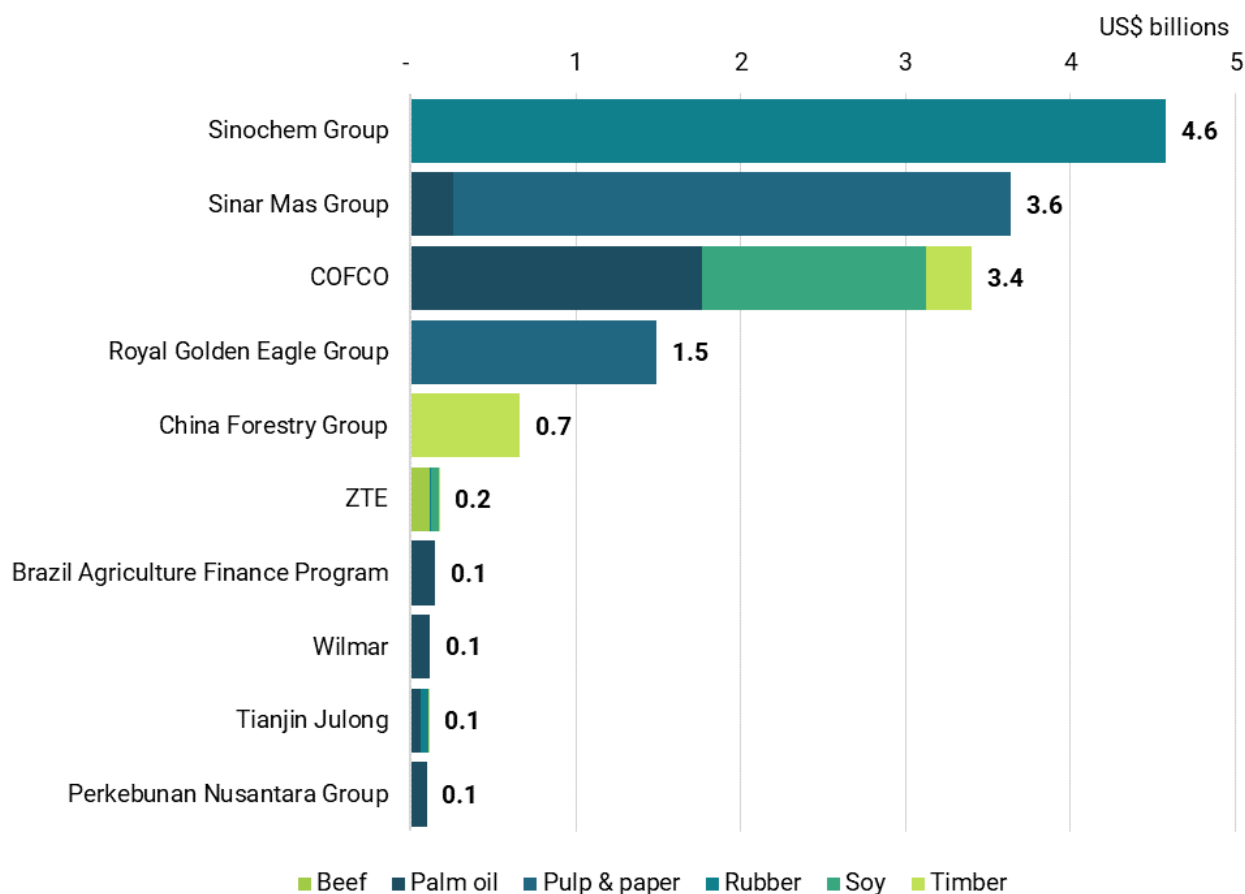


Source: *Forests & Finance*, online: <https://forestsandfinance.org/>, viewed in September 2020.

The second largest forest-risk client of Chinese financial institutions was Sinar Mas Group (see section 3.4), which attracted US\$ 3.6 billion in forest-risk loans and underwriting services from Chinese financial institutions from January 2016 to April 2020. More than 90% of this financing was attributable to pulp & paper, and the remainder to palm oil.

Agro-commodity company COFCO was the third largest forest-risk client of Chinese financial institutions. Between January 2016 to April 2020 it attracted US\$ 3.4 billion in loans underwriting services from Chinese financial institutions attributable to the forest-risk commodities assessed by *Forests & Finance*. Approximately half of this was attributable to palm oil, 40% to soy and the remainder attributable to timber (see section 3.2).

Figure 8 Top 10 recipients of loans and underwriting services for forest-risk companies by Chinese financial institutions (2016-2020 April, US\$ bln)



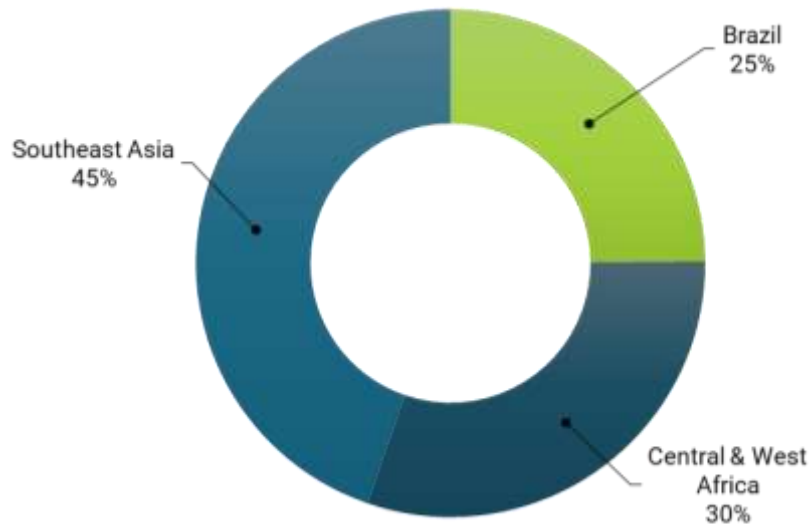
Source: *Forests & Finance*, online: <https://forestsandfinance.org/>, viewed in September 2020.

2.2 Investor analysis

At the most recent filing date in June 2020, Chinese financial institutions held US\$ 198 million in forest-risk bonds and shares in the companies in the scope of *Forests & Finance*. Slightly less than half of these investments were attributable to Southeast Asia, and just under a third to Central & West Africa (see Figure 9).

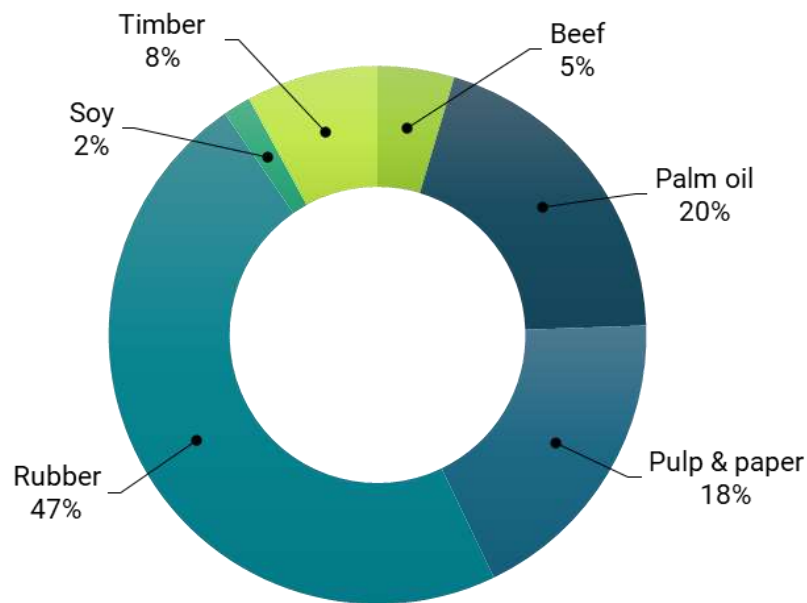
Investments in bonds and shares attributable to rubber accounted for approximately half of all forest-risk investments (see Figure 10). Investments attributable to palm oil and pulp & paper accounted for a approximately a fifth each of all identified Chinese investments in forest-risk companies.

Figure 9 Regional distribution of Chinese forest-risk investments in bonds and shares (2020 June, most recent filing date)



Source: *Forests & Finance*, online: <https://forestsandfinance.org/>, viewed in September 2020.

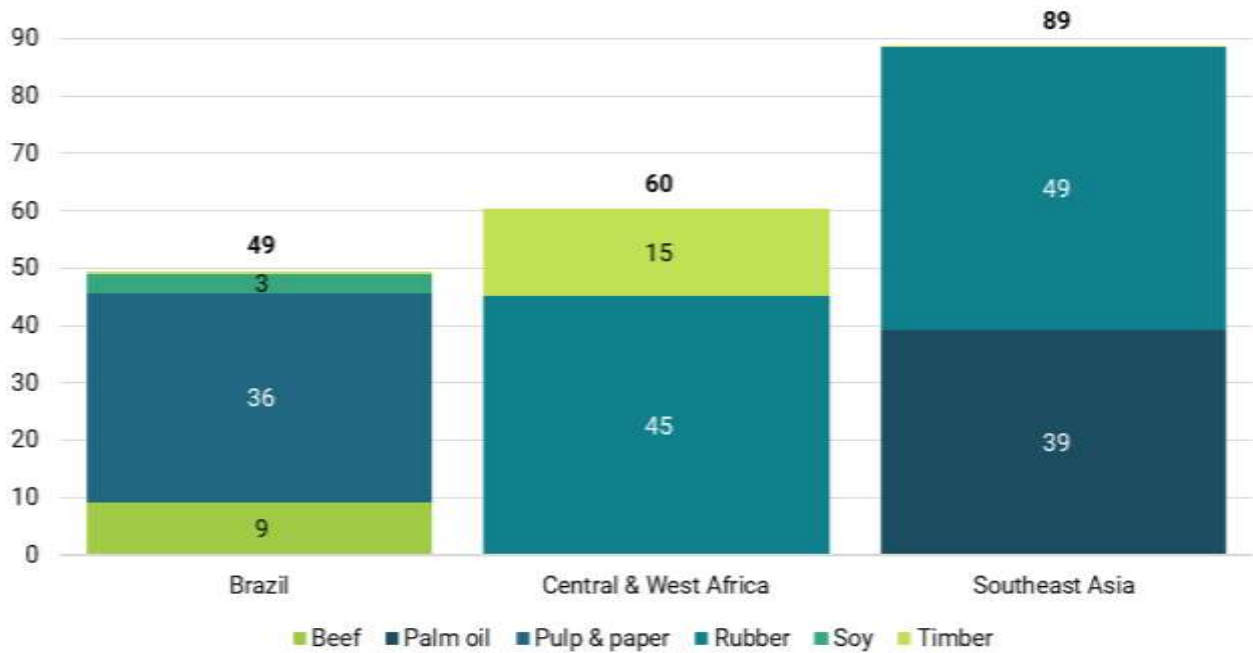
Figure 10 Sectoral distribution of investments in bonds and shares (2020 June, most recent filing date, US\$ mln)



Source: *Forests & Finance*, online: <https://forestsandfinance.org/>, viewed in September 2020.

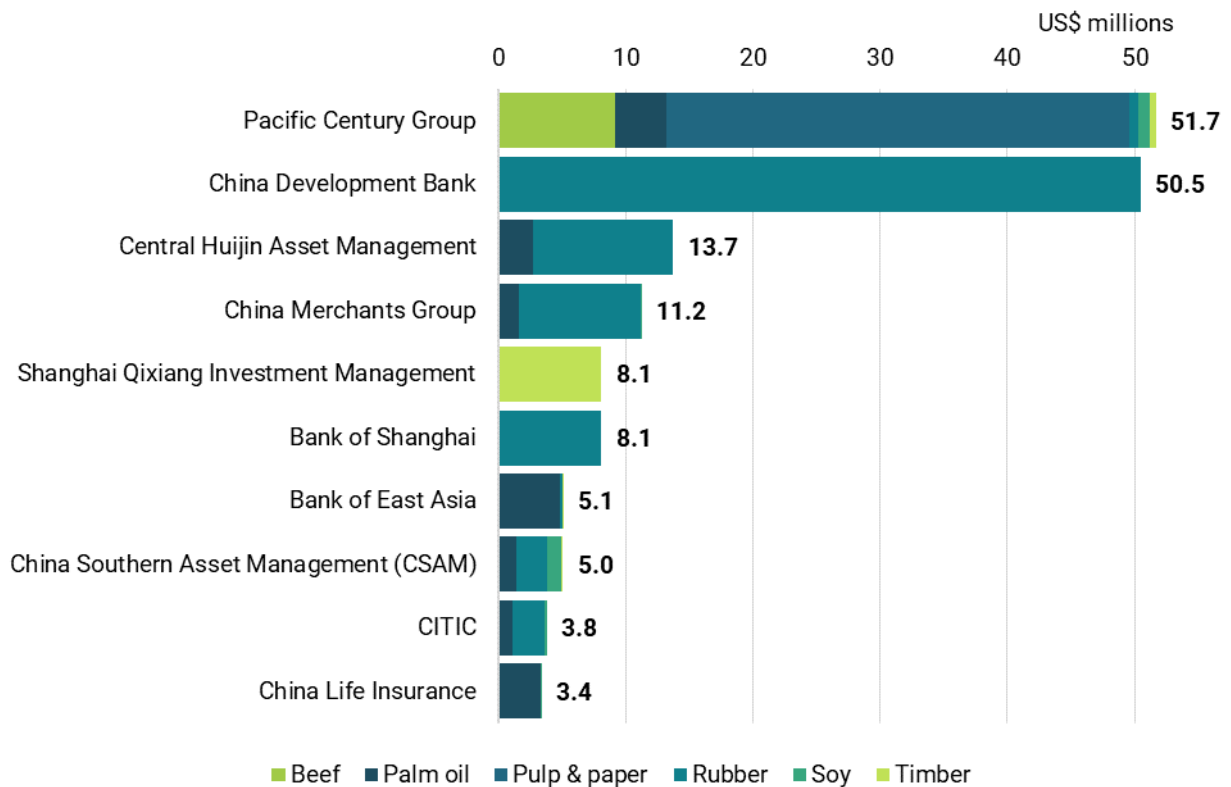
Figure 11 shows that more than half of all Chinese investments in Southeast Asia were attributable to rubber, and approximately 44% were attributable to palm oil. In Central & West Africa, a quarter of all identified investments were attributable to rubber, and a quarter to timber. Approximately 73% of the forest-risk investments in Brazil by Chinese financial institutions were attributable to pulp & paper, and 18% to beef.

Figure 11 Geographic and segment breakdown of investments in bonds and shares (2020 June, most recent filing date, US\$ mln)



Source: *Forests & Finance*, online: <https://forestsandfinance.org/>, viewed in September 2020.

Figure 12 Top 10 Chinese investors in forest-risk companies (2020 June, most recent filing date, US\$ mln)

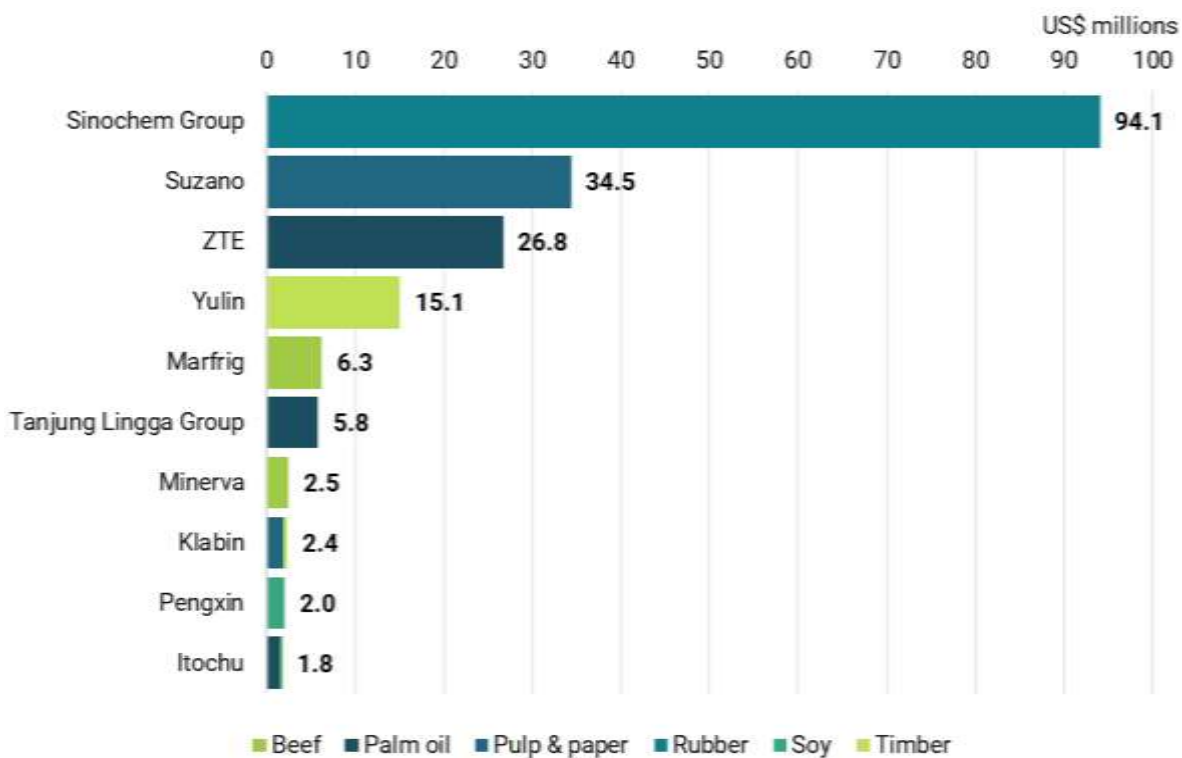


Source: *Forests & Finance*, online: <https://forestsandfinance.org/>, viewed in September 2020.

Figure 12 shows that the two largest investors were Hong Kong based private investment group Pacific Century Group (PCG), and China's state policy bank China Development Bank (CDB). They held bonds and shares worth US\$ 51.7 million and US\$ 50.5 million respectively. PCG's investments are spread over the bonds and shares of 20 companies covered by Forests & Finance, all active in a variety of forest-risk commodities. The investments of CDB are concentrated primarily in Sinochem, whose forest-risk agro-commodity is rubber.

The top three forest-risk investees of Chinese financial institutions are Sinochem (US\$ 94 million), Suzano (US\$ 35 million), and ZTE (US\$ 27 million) (see Figure 13). All three are engaged in different agro-commodities: Sinochem in rubber, Suzano in pulp & paper, and ZTE in palm oil in Indonesia through Zonergy. The fourth and fifth largest investees, Yulin and Marfrig, are engaged in timber and beef respectively.

Figure 13 Top 10 forest-risk investees of Chinese financial institutions (2020 June, most recent filing date, US\$ mln)



Source: *Forests & Finance*, online: <https://forestsandfinance.org/>, viewed in September 2020.

An aerial photograph of a dense forest with a dirt road winding through it. The trees are mostly green, with some brown patches on the ground. The text is overlaid on a white box in the upper left corner.

4 of the top 5 clients of Chinese financial institutions have ESG issues directly affecting the financed group.

3

Client risk analysis

This chapter takes a closer analysis of the top-5 forest-risk clients of Chinese financial institutions. The following table provides an overview of recent cases described in the sections below. It shows that Chinese financial institutions are exposed to numerous environmental, social and governance risks through the companies they finance. 4 of the top 5 clients of Chinese financial institutions have ESG issues directly affecting the financed group. One company – COFCO – did not appear to be directly involved in ESG violations, however, it was exposed to all relevant forest-risks through its supply chain.

Table 1 ESG flags top-5 clients of Chinese financial institutions (2016-2020 April)

Group	Environmental issues		Social issues		Governance issues		Section
	Deforestation	Fire	Community rights	Labour rights	Corruption	Illegal operations	
China Forestry Group	X		X		X	X	3.1
COFCO	S	S	S	S	S	S	3.2
Royal Golden Eagle Group							3.3
<i>RGE – Pulp & paper</i>	X	X	X		X	X	
Sinar Mas Group							3.4
<i>Sinar Mas – Palm oil</i>	X	X	X	X	X	X	
<i>Sinar Mas – Pulp & paper</i>	X	X	X		X		
Sinochem Group	X		X	X	X	X	3.5

X = issues with company directly

S = issues in supply chain

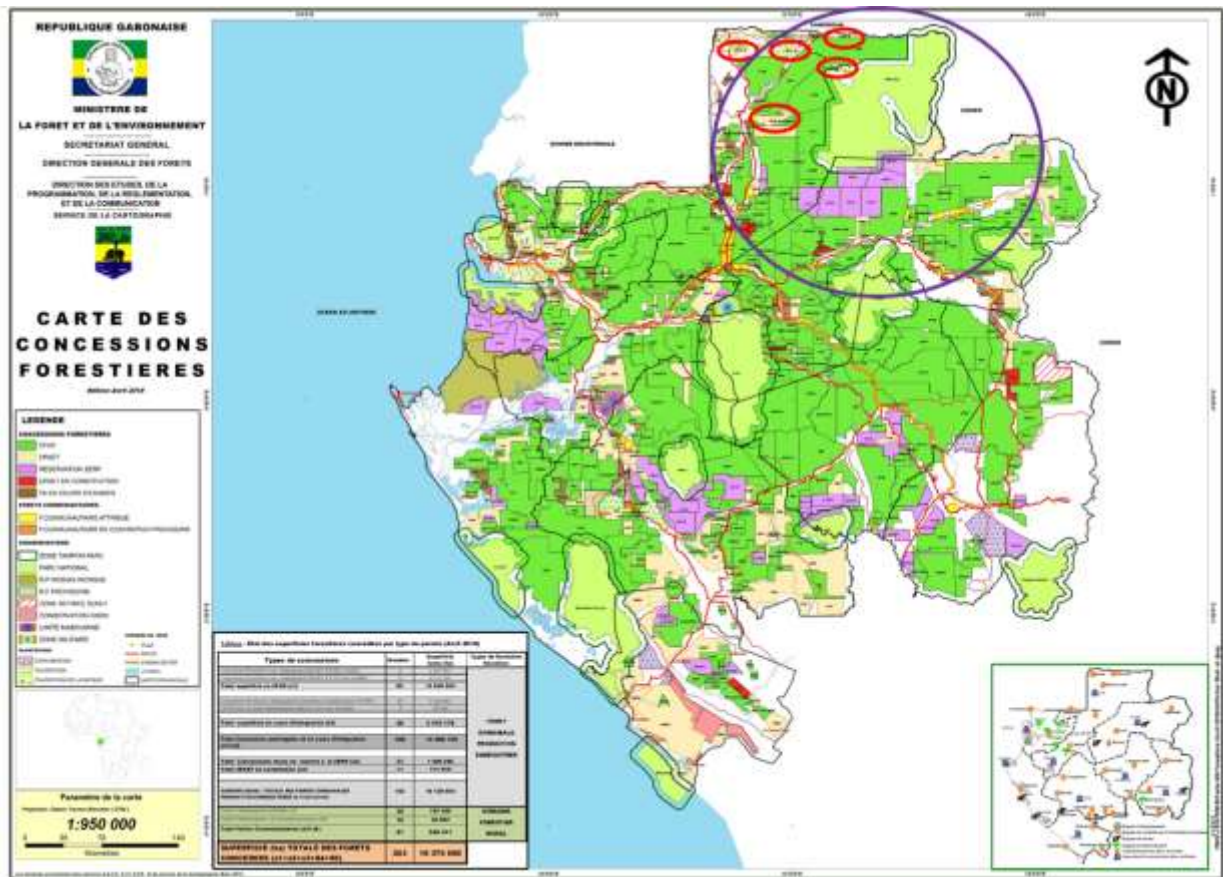
3.1 China Forestry Group

China Forestry Group Corporation (CFGC) is Chinese state-owned enterprise. It is the only company under the supervision of the State-Owned Assets Supervision and Administration Commission (SASAC) that is engaged purely in the forestry industry. The company has more than 70 subsidiaries which operate in China, New Zealand, Russia, Singapore and Myanmar.

One of the subsidiaries of CFGC is SA Hua-Jia de l'Industrie des Bois (Hua Jia) in Gabon. Four of Hua Jia's concessions are located in the Dja-Odzala-Minkébé cross-border forest (TRIDOM), which is spread over three countries – Cameroon, the Republic of Congo and Gabon. TRIDOM covers an area of 178,000 km², or 10% of the rainforest in the Congo Basin. Under a 2004 agreement, the three governments have committed to the sustainable development of the interzone between protected areas.¹³ TRIDOM is considered a UNESCO World Heritage Site.¹⁴

Hua Jia's concession is approximately 350,000 hectares, or 3,500 square kilometres – approximately 2% of TRIDOM area (see Figure 14).¹⁵

Figure 14 China Forestry Group concessions in Gabon

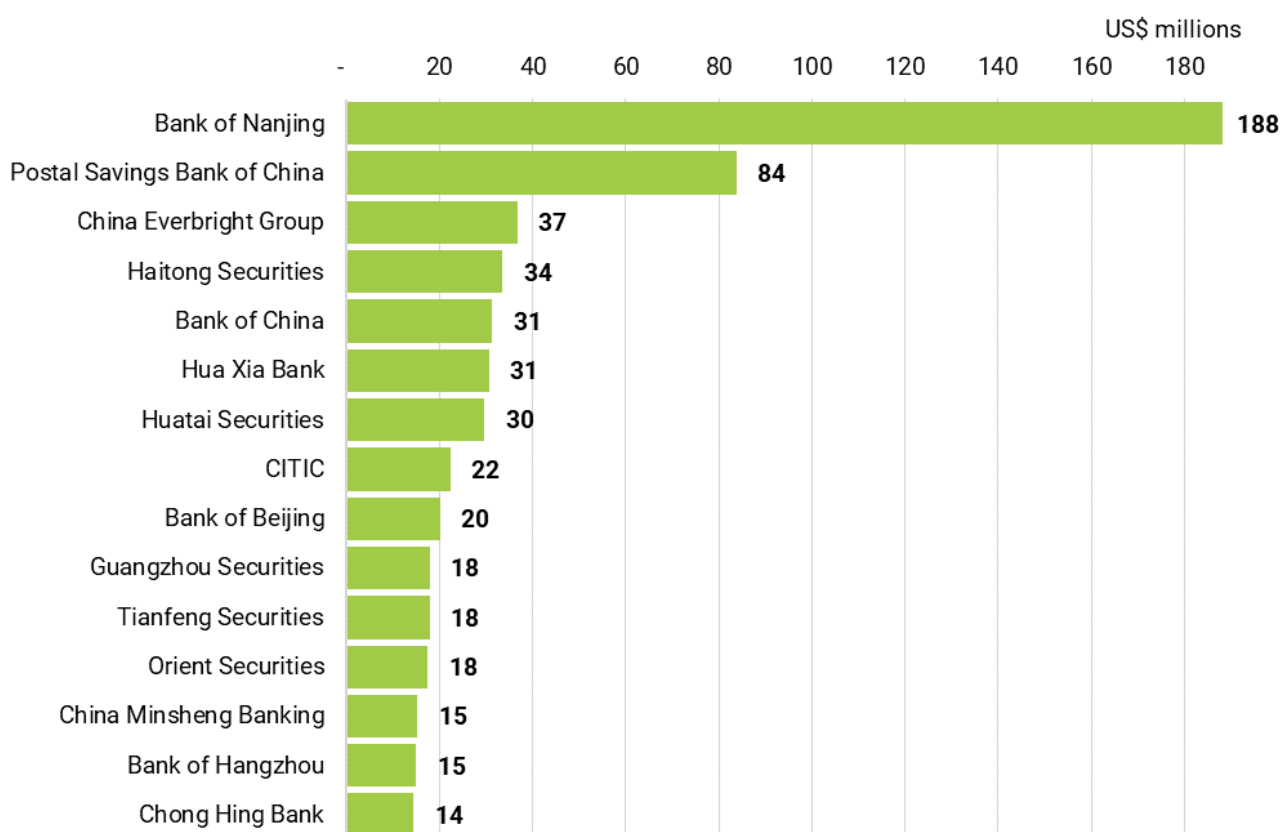


Source: Republique Gabonaise Ministère de la Foret et de l'Environnement (2018, April), *Cartes des Concessions Forestieres*.

Purple circle: TRIDOM region, Red circles: Hua Jia timber concessions

Since January 2016, Chinese financial institutions provided US\$ 663 million in forest-risk financing to CFGC. This accounted for 89% of all identified forest-risk financing provided to CFGC in this period. Figure 15 presents a list of the Top-15 banks providing credit to CFGC, and its subsidiaries between January 2016 and April 2020. It is noteworthy the banks that are among the 15 largest banks in China provided US\$ 268 million (40%) in the period of study. This implies that CFGC received most of its credit from smaller banks.

Figure 15 Top-15 Chinese providers of loans and underwriting services to China Forestry Group (2016-2020 April, US\$ mln)



Source: *Forests & Finance*, online: <https://forestsandfinance.org/>, viewed in September 2020.

3.1.1 Environmental, social and governance issues

In 2019, the Environmental Investigation Agency exposed illegal and corrupt practices of CFGC subsidiary Hua Jia. In an undercover interview with an official from Hua Jia, the official admits to illegal logging operations, and bribing local officials at least US\$ 29,000 every month. The official claims that illegal logging and bribery are standard practice in Gabon.

Illegal logging included harvesting on agricultural land without authorization, and logging on smallholder land without legitimate contracts. Moreover, Hua Jia did not keep track of timber harvests, in direct violation of Gabon’s national legislation on timber traceability.

Even though Hua Jia pledged in 2016 to comply with the Chinese government’s *The Guide on Sustainable Management and Utilization of Overseas Forests by Chinese Enterprises*, the official stated in the interview “Those domestic regulations don’t apply to us. This is Africa. We only follow whatever is locally required.”¹⁶

3.1.2 Discussion

Illegal practices may result in the suspension of logging rights, concessions being revoked, and the confiscation of inventory, among other measures. This was the case for another Chinese company operating in Gabon – Dejia Group. As a result of investigations by the EIA, the Gabon government suspended Dejia’s logging rights, seized logs in the company’s possession, and launched an in-depth investigation.¹⁷ The deputy director of another Chinese logging company operating in Gabon was arrested by authorities for illegal logging and tax evasion.¹⁸ Arrests and punitive measures taken by the government for illegal practices impacts the ability of companies to repay their loans. This means that loans to CFGC and its subsidiaries may be at risk due to the practice of Hua Jia.

Moreover, when illegal practices come to light in the supply chain, buyers may consider terminating contracts as they often have to meet the sustainable sourcing demands of the customers. Buyers terminating contracts reduces revenues, further putting pressure on the ability of companies to repay their loans.

Additionally, deforestation and environmental damage within a UNESCO World Heritage Site may violate the policies of financial institutions financing the group. This could result in financial institutions terminating their relationships CFGC, making it more difficult for the group to access finance and increasing the cost of the capital.

One of the banks financing CFGC – Hua Xia Bank – is a founding member of the United Nations Principles for Responsible Banking (UN-PRB). The UN-PRB banks share the vision that companies should make sustainable use of natural resources. If CFGC subsidiary Hua Jia violates this, then Hua Xia Bank may consider terminating its relationship with the company.

In the case of Hua Jia, the blatant disregard of the Chinese government’s *The Guide on Sustainable Management and Utilization of Overseas Forests by Chinese Enterprises*, is also of concern. Although the guide is voluntary (see section 1.2), Chinese financial institutions following the *Green Credit Guidelines* and *Guidelines on Regulating the Banking Industry in Serving Enterprises’ Overseas Development and Strengthening Risk Control*, may reference the sustainable forestry guidelines when considering extending credit to the company.

As mentioned in section 1.4 the *Green Credit Guidelines* explicitly recommend that clients with poor ESG performance record should not be granted funding. If Chinese financial institutions were to conduct thorough due diligence on CFGC and its subsidiaries, they may conclude that CFGC should no longer be eligible for financing. This is due to the poor environmental performance of its subsidiary, and the financial risks financiers are exposed to through the practices of that subsidiary.

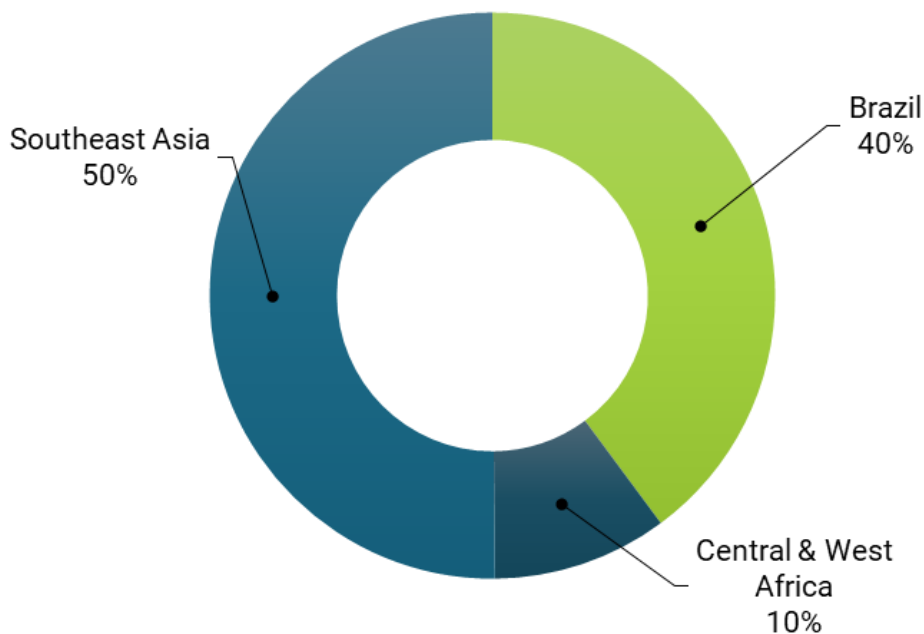
3.2 COFCO

China Oil and Foodstuffs Corporation (COFCO) was established in 1949, and is currently still under the supervision of the State-Owned Assets Supervision and Administration Commission (SASAC). Until 1987, COFCO was responsible for all of China’s trade in agricultural products. Since then, the company has grown to become one of the world’s leaders agricultural trade, logistics, processing and production. In 2007, COFCO subsidiary China Agri-Industries Holdings Limited listed on the Hong Kong Stock Exchange. In 2014, COFCO merged Noble Agri and Nidera, accelerating its internationalization strategy. Currently the company has a global presence, including in all the forest-rich basins included in the scope of Forests & Finance.¹⁹

As an agro-commodity trader and producer, COFCO sources commodities from suppliers as well as producing a number of commodities itself. Forests & Finance has estimated the forest-risk financing for three commodities COFCO is engaged in: palm oil, soy and timber.

Since 2016, Chinese financial institutions have provided at least US\$ 3.4 billion in forest-risk attributable loans and underwriting services to COFCO. More than half of this (US\$ 1.8 billion) was attributable to palm oil, 40% (US\$ 1.4 billion) to soy, and US\$ 270 million to timber. Figure 16 shows, similar to the commodity trends, about 50% of forest-risk financing to COFCO was attributable to Southeast Asia, which includes mostly palm oil attributable financing. Approximately 40% of forest-risk financing to COFCO was attributable to Brazil, which included primarily financing attributable to soy. Financing to Central and West Africa was mostly attributable timber. COFCO has two concessions

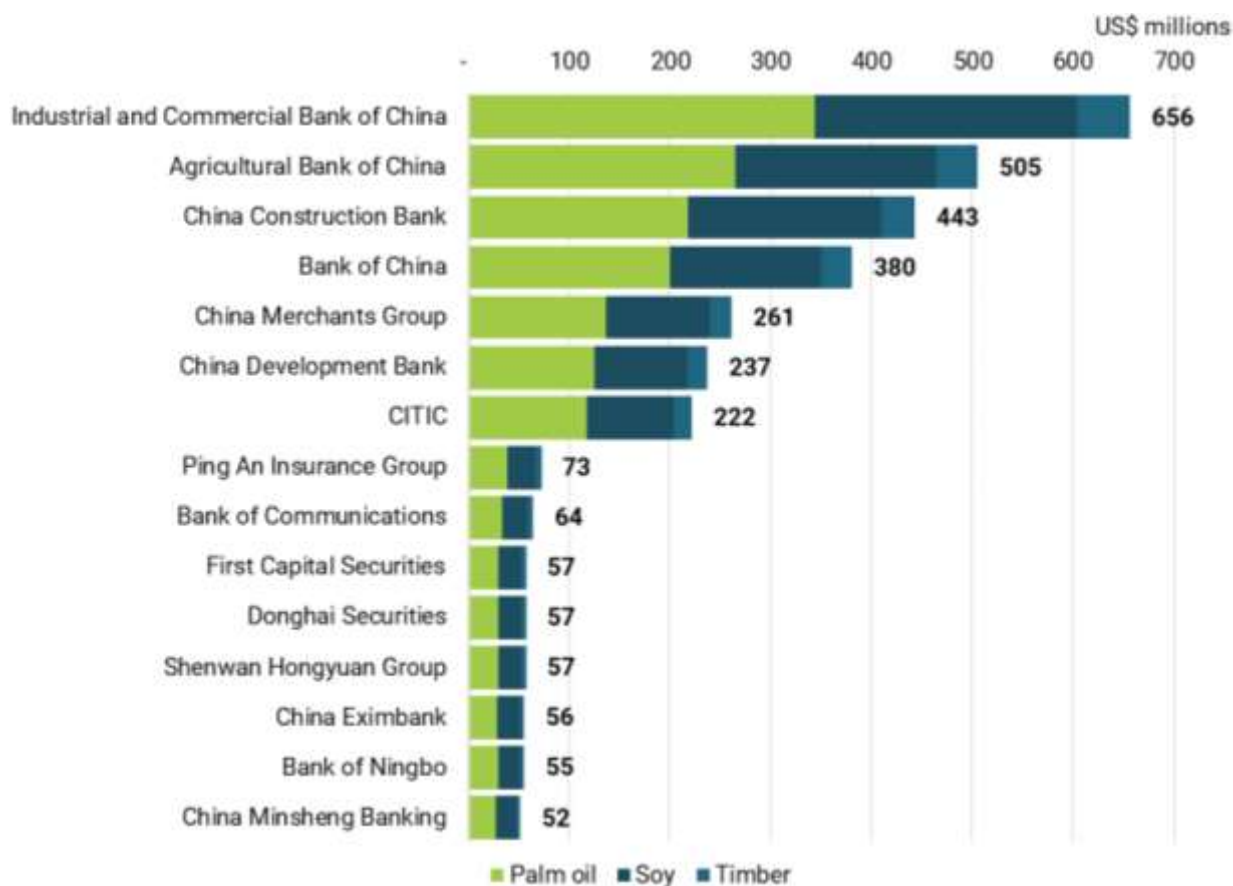
Figure 16 Regional distribution of Chinese forest-risk loans & underwriting to COFCO (2016-2020 April)



Source: *Forests & Finance*, online: <https://forestsandfinance.org/>, viewed in September 2020.

Figure 17 shows that founding member of the UN-PRB, ICBC, provided US\$ 656 million in forest risk loans and underwriting services to COFCO between January 2016 and April 2020. It was followed by the Agricultural Bank of China (US\$ 505 million) and China Construction Bank (US\$ 443 million).

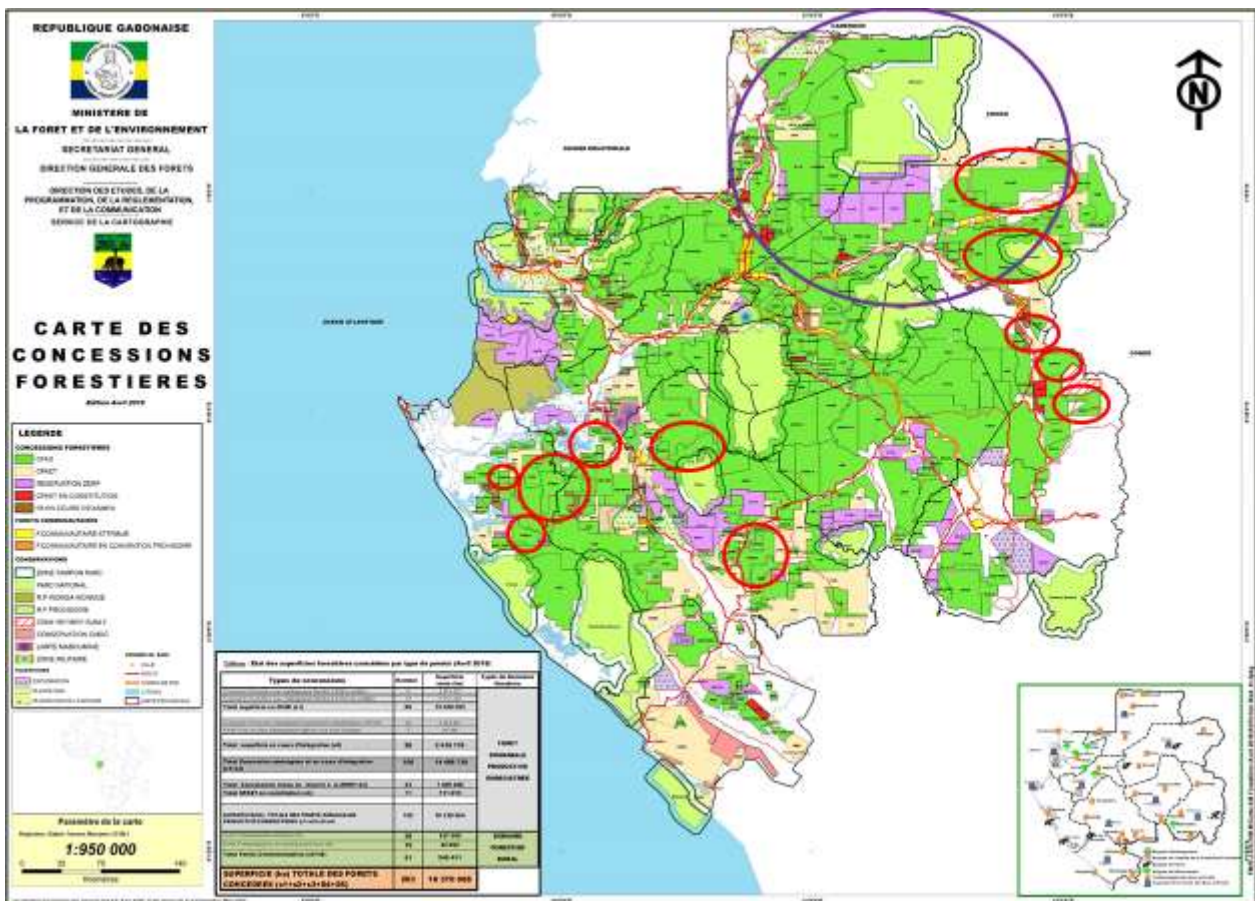
Figure 17 Top-15 Chinese providers of loans and underwriting services to COFCO (2016-2020 April, US\$ mln)



Source: *Forests & Finance*, online: <https://forestsandfinance.org/>, viewed in September 2020.

COFCO operates several timber concessions in Gabon (see Figure 18). Two subsidiaries – Sunly and Sunry – together hold 18 permits, covering a total land area of 1,025,429 hectares. This accounts for about 30% of Gabon’s managed forests. Two concessions are located within the TRIDOM region. They cover an area of 330,196 hectares, or 3,302 square kilometres – approximately 2% of the TRIDOM area.²⁰ Additionally, at least one concession borders a national park, and a number of concessions are in mangrove areas.

Figure 18 China Forestry Group concessions in Gabon



Source: Republique Gabonaise Ministère de la Forêt et de l'Environnement (2018, April), *Cartes des Concessions Forestières*.

Purple circle: TRIDOM region, Red circles: COFCO timber concessions

Although COFCO does not operate its own palm oil concessions in Southeast Asia, or its own soy farms in Brazil, it sources these commodities from these regions. As such, it is exposed to environmental, social and governance risks of these forest-risk commodities through its supply chain. These issues include deforestation, use of fire, labour rights issues, and land conflicts with local communities, among others. During the course of this research, no allegations of environmental, social, or governance issues directly involving COFCO were identified. Nevertheless, the company remains exposed to these risks through its supply chains.

3.2.1 Environmental issues

COFCO is exposed to environmental issues both through its palm oil and soy supply chains, and through its timber concessions in Gabon. Although no allegations against the company's operations in Gabon were found, the company has operations in a high risk landscape, with concessions located adjacent to a national park and mangrove area, and in the TRIDOM region. A search of the FSC and PEFC certification sites did not identify any relevant certificates for COFCO or its subsidiaries operating in Gabon. As these certification standards demand sustainable forest management practices, a lack of certification indicates an elevated risk of unsustainable forest management in these concessions.

COFCO is among the top 10 customers of Cresud. Approximately 37% of Cresud's agricultural land is managed by BrasilAgro.²¹ In the period 2012-2017, BrasilAgro cleared 21,690 ha of native vegetation in the Brazilian Cerrado.²² A year later, the company had cleared a further 1,194 hectares, and a further 5,000 were at imminent risk of being cleared by the company.²³ COFCO sourcing from Cresud and its subsidiary implicated in deforestation, risks violating No Deforestation, No Peat, No Exploitation (NDPE) policies of COFCO's buyers. These buyers include international companies with NDPE commitments sourcing from COFCO, as well as other Chinese companies with NDPE sourcing commitments from their international and national clients.

In palm oil supply chain, COFCO is exposed to several issues. Combining COFCO's 2019 palm mill list with data on concessions in which fires occurred in the 2019 fire season, significant links to fire are identified in the supply chain. Approximately a quarter of COFCO's supplying mills in Indonesia were operated by companies whose concessions had been sealed for the use of fire in 2019.²⁴ Among these are Kuala Lumpur Kepong, Austindo Nusantara Jaya, IOI Corporation and Tianjin Julong, among others.

A recent study by Chain Reaction Research found that eight of the 25 largest palm oil refiners had yet to adopt NDPE policies. Among these, at least four are suppliers of COFCO International – Tunas Baru Lampung, Incasi Raya, Darmex Agro (Duta Palma), and Perkebunan Nusantara (I, II, III, IV, V, VI, and XIII).²⁵

Moreover, the palm mill list shows that among COFCO's supplier there are at least 15 palm oil producers and processors that have consistently failed to comply with their own NDPE policies or those of their buyers.²⁶ These suppliers include Royal Golden Eagle Group and Sinar Mas Group companies. Details of the environmental issues these companies are implicated in are provided in section 3.3 and section 3.4 respectively. Other COFCO suppliers failing to meet NDPE policies include Torganda which has a proven track record of deforestation in Sumatra.²⁷ COFCO also sources from Jhonlin, which was the second largest deforester in 2019.²⁸

3.2.2 Social issues

COFCO is primarily exposed to social issues through its supply chains. As noted above, the palm mill list shows that among COFCO's supplier there are at least 15 palm oil producers and processors that have consistently failed to comply with their own No Deforestation, No Peat, No Exploitation (NDPE) policies or those of their buyers.²⁹ Royal Golden Eagle Group and Sinar Mas Group are among these suppliers. Details of the social issues these companies are allegedly involved in are provided in section 3.3 and section 3.4 respectively.

Other COFCO suppliers failing to meet NDPE policies include Wilmar, with whom they also have a joint venture partnership called COFCO East Ocean Oils & Grains Industries. In November 2019, allegations were brought against Wilmar at the annual RSPO event. The allegations claim that that community lands and customary forest areas have been converted to oil palm plantations without free prior and informed consent (FPIC) of the affected communities. The report is based on complaints by fifty communities negatively affected by Wilmar's oil palm operations and its suppliers who lost access and control of their customary lands and in several cases also reported about intimidation and criminalisation after raising concerns and complaints with the companies. The presented cases involve nine Wilmar subsidiaries in West Sumatra for which the HGU area totals 27,437 ha.³⁰

In 2016, Amnesty International interviewed 120 workers on plantations owned by two Wilmar subsidiaries and three Wilmar suppliers. The report identified a number of labour issues including: use of child labour; forced labour; severe injuries from the use of the toxic chemical paraquat, even though it was banned by Wilmar itself and the EU; inadequate safety equipment and hazardous working conditions; pay below minimum wage and penalties, and; compensation based on unrealistic targets and including financial penalties for not meeting targets.³¹

Another COFCO supplier exposed to labour issues is Felda Global Ventures. In October 2020, after a year of investigations, the US Customs and Border Protection (CBP) blocked the import of palm oil products from Felda Global Ventures over forced labour concerns. CBP referenced physical and sexual abuse, debt bondage and abusive conditions as the main motivations for banning products from the company. The CBP investigation also raised concerns over forced child labour potentially being used in FGV's palm oil production process.³²

Similar labour issues and complaints have also been found among other COFCO suppliers.

3.2.3 Governance issues

In recent years, COFCO supplier Golden Agri Resources (GAR) has been the subject to a number of RSPO complaints. The most recent complaint – currently still under investigation – was filed by Forest Peoples Programme and Elk Hills Research in February 2020. The complaint reports the conviction of GAR officials in Central Kalimantan on bribery charges. The intention of the bribes was to prevent the publication and public hearing of in-site inspection results on GAR's PT Binasawit Abadi Pratama (PT BAP) concession. PT BAP was operating without the legally mandated HGU permit and was conducting unlawful waste disposal operations in an unlawful manner.³³

In 2019, a witness admitted to bribing an official at Perkebunan Nusantara III (PTPN III) – another COFCO supplier – approximately US\$ 255,000. The bribe was intended to secure a long-term offtake contract between PTPN III and the company the witness worked for.³⁴

3.2.4 Discussion

COFCO has taken steps to improve the sustainability of its supply chain. COFCO is a member of RSPO, and it has partnered with the IFC to improve the transparency and sustainability of its soy supply chain in Brazil.³⁵ COFCO also announced support shoring up “sustainable” practices and curbing deforestation in commodity supply chains at World Economic Forum in January 2019.³⁶ Nevertheless, as a review of its 2019 palm mill list, and other soy suppliers suggests, forest-risks persist within COFCO's supply chain. These issues risk COFCO violating the policies of both its financiers and its buyers. An increasing number of buyers have NDPE policies in place. These buyers include the direct customers of COFCO, and also the buyers of companies that source from COFCO.

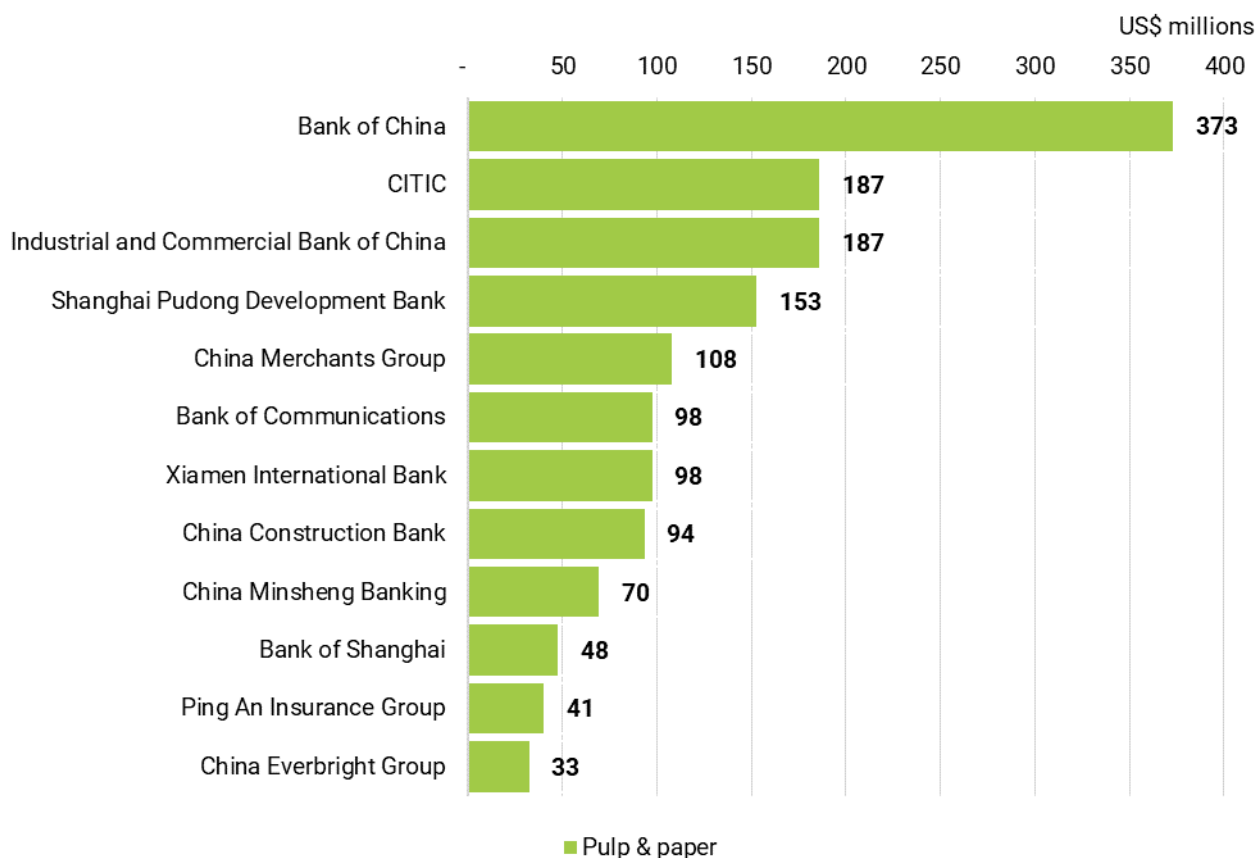
Violations of creditor ESG risk mitigation policies will reduce the sources of funding for COFCO and increase the cost of capital from those funders willing to take on the risk. Violating the sustainable sourcing policies of its customers risks the company losing customers, put pressure on its revenues and thus its ability meet its debt commitments.

3.3 Royal Golden Eagle Group

The Royal Golden Eagle Group (RGE) is a large Indonesian conglomerate, based in Medan, North Sumatra, Indonesia. The company is founded by Sukanto Tanoto. RGE was formerly known as Raja Garuda Mas or RGM. RGE group of companies are involved in: pulp and paper (APRIL and Asia Symbol); palm oil (Asian Agri and Apical); specialty cellulose (Bracell); viscose fibre (Sateri and Asia Pacific Rayon), and; integrated energy (Pacific Oil & Gas).³⁷ The Tanoto family also owns PT Toba Pulp Lestari (TPL), a pulp company that supplies APRIL, but is part of RGE. TPL has a legacy of social conflicts in North Sumatra.³⁸

Chinese financial institutions provided US\$ 1.5 billion in loans and underwriting services to RGE since 2016. All of the identified financing was attributable to RGE’s pulp & paper operations. Figure 19 shows that the largest forest-risk creditor was Bank of China (US\$ 373 million). It was followed by CITIC and Industrial and Commercial Bank of China, who both provided US\$ 187 million in forest-risk loans and underwriting services between January 2016 and April 2020.

Figure 19 Chinese providers of loans and underwriting services to Royal Golden Eagle Group companies (2016-2020 April, US\$ mln)



Source: *Forests & Finance*, online: <https://forestsandfinance.org/>, viewed in September 2020.

68% of the identified forest-risk financing (US\$ 1 billion) was provided to APRIL whose operations are primarily in Indonesia, and 32% (US\$ 475 million) was provided to Asia Symbol whose operations are primarily in China (see Table 2 for details).

Table 2 Chinese financial institution financing RGE subsidiaries (2016-2020 April, US\$ mln)

RGE subsidiary	Investor	Value (US\$ mln)
Asia Pacific Resources International	Bank of China	228
	Shanghai Pudong Development Bank	153
	CITIC	137
	China Merchants Group	108
	Bank of Communications	98
	China Minsheng Banking	70
	Industrial and Commercial Bank of China	67
	Xiamen International Bank	48
	Bank of Shanghai	48
	China Everbright Group	33
	China Construction Bank	25
<i>Asia Pacific Resources International Total</i>		<i>1,016</i>
Asia Symbol China	Bank of China	145
	Industrial and Commercial Bank of China	120
	China Construction Bank	69
	Xiamen International Bank	50
	CITIC	50
	Ping An Insurance Group	41
<i>Asia Symbol China Total</i>		<i>475</i>
Total		1,491

Source: *Forests & Finance*, online: <https://forestsandfinance.org/>, viewed in September 2020.

- **APRIL**

In 1993, APRIL Group began plantation development in Riau province and mill construction in the town of Pelalawan Kerinci in Riau. Commercial pulp production was started in 1995, followed by commercial paper production in 1998. The group continued to expand production of pulp & paper by establishing an integrated pulp & paper mill that is considered one of the largest mills in the world, with a production capacity of 2.8 million tonnes of pulp and 1.15 million tons of paper annually.

In 1995, APRIL became the first Indonesian pulp & paper company to be listed on the New York Stock Exchange. Eight years later, the company was de-listed and privatized. Currently APRIL Group is a private entity. In Riau province, Riau Andalan Pulp & Paper (PT RAPP) is the operating arm of APRIL. Its flagship brand is PaperOne™.³⁹

- **Asia Symbol (China)**

Asia Symbol is a pulp & paper producer established in China in 2005. The company has a combined production capacity of 2 million tonnes of pulp, 1 million tonnes of fine paper and 530,000 tonnes of paper board annually. It manages mills in Shandong (Rizhao) and Guangdong (Xinhui) provinces in China. Its main products are bleached hardwood kraft pulp (BHKP), northern bleached kraft pulp (NBKP), liquid packaging board, high grade ivory board and uncoated wood free printing and office paper.⁴⁰ Given the large capacity of Asia Symbol, it is likely that Asia Symbol sources additional fibre outside of China.

3.3.1 Environmental issues

Between 2008-9 and 2011, APRIL suppliers cleared at least 140,000 hectares of natural forests. More than a quarter of all forest loss in the Riau province has been done to provide wood for APRIL mills, including some of the last habitat of the Sumatran Tiger.⁴¹

More recently, two subsidiaries of APRIL - PT Riau Andalan Pulp & Paper (PT RAPP) and PT Sumatera Riang Lestari – had their concessions sealed by the Indonesian government for the use of fire. One estimate based on Ministry of Environment and Forestry (KLHK) data puts the burned area at 750 hectares, or more than 400 football fields.

Earlier, in 2017, PT RAPP's general workplan (RKU) was suspended by the Ministry of Environmental and Forestry as the company denied revising its workplan to conform with the recent Indonesia Peat Protection and Management Regulation. This had an impact on the productivity of the mill, putting loan repayments at risk.⁴²

In 2018, it was reported PT RAPP sourced pulpwood from Djarum Group subsidiary PT Fajar Surya Swadaya, which had removed 68% (192 square kilometres) between 2013 and 2017. Sourcing from deforested lands violates APRIL's zero-deforestation policy.⁴³

In the summer of 2020, reports were made that PT RAPP had been draining peatlands and clearing lands Pelalawan. Some of the areas had been flagged as peat restoration area as they had been burned in 2015 and 2019. Draining of peatlands increases the risk of fires and haze.⁴⁴

In September 2020 a Jikalahari investigation revealed cases of deforestation, peatland conversion and land-grabbing by APRIL fibre suppliers in Riau.⁴⁵

And in October 2020, NGOs reported a further case of deforestation and peatlands degradation in Borneo.⁴⁶

3.3.2 Social issues

APRIL expanded its plantation landbank by encroaching on lands traditionally owned by local communities. An extensive survey in 2019 found that in just five provinces of Indonesia, at least 101 villages or communities are in active conflict with affiliates of APRIL, or its suppliers. 529 villages may have been impacted by their forestry operations. The total area of conflict and impact from operations was found to be over one million hectares.⁴⁷

According to APRIL's own 2019 sustainability the total area inactive due to unresolved land disputes – including through supply partners – as of December 31, 2019 is 102,953 hectares. Inactive area inactive due to unresolved land disputes with its own subsidiary PT RAPP was 28,249 hectares in the same period. This accounts for more than 6% of the land set aside for plantations, in PT RAPP's total concession area of 1,000,000 hectares.⁴⁸

PT RAPP was reported to be involved in land conflict with local communities in Bagan Melibur, Mengkirau, and Lukit villages, in Merbau District, Meranti, Riau. The company concessions overlap with the villages' land.⁴⁹

PT RAPP was reported to have been involved in land conflicts with Tani Bekato Basamo farmer group from Kuantan Senggigi.⁵⁰

PT RAPP subsidiaries PT Sumatera Riang Lestari and PT Sumatera Sylva Lestari were reported to have been involved in land conflicts with local communities of the following villages:

- Sei Kumago, Tambusai, Rokan Hulu
- Bayas Jaya, Tampuling, Indragiri Hilir
- Titi Akar, Bengkalis⁵¹

3.3.3 Governance issues

APRIL was also among the companies mentioned in the Panama Papers leaks for using global corporate structures to aggressive tax planning purposes.⁵² A further investigative report in 2020 exposed the company for being involved in of profit shifting and tax leakage.⁵³

In 2017, PT RAPP subsidiary PT Selaras Abadi Utama was involved in a bribery case against the former Riau Governor Rusli Zainal.⁵⁴

3.3.4 Discussion

The continued financing of RGE puts the financing of Chinese financial institutions at risk as RGE subsidiaries continue to have environmental, social and governance risks that have resulted in and will continue to result in government and buyer responses which impact the ability of RGE and its subsidiaries to generate sufficient revenue to meets its financial obligations.

A report released in May 2020 estimates that the pulp & paper industry in Indonesia may be exposed to US\$ 1-10 billion in social compensation claims.⁵⁵ For one of the two largest players in Indonesian pulp & paper, this poses a significant risk to RGE. This is just an example of the financial risk RGE is exposed to through one of the industries it is engaged in, and on only one issue. Add to this the environmental and governance issues it is exposed to in the pulp & paper industry, as well as the ESG risks of its palm oil activities, the overall financial risks to its financiers are considerable.

Moreover, these ESG issues also put Chinese financial institutions at risk of not living up to the objectives of the Green Credit Guidelines.

3.4 Sinar Mas Group

The Sinar Mas Group was founded by Eka Tjipta Widjaja founded as a trading company in 1962. Since its trading business beginnings it has grown to become one of the largest conglomerates in Indonesia. Sinar Mas Group currently has six business segments that include: pulp and paper; agribusiness and food; financial services; real estate and development; telecommunications; energy, and; Infrastructure. Many Sinar Mas Group companies are listed in various stock exchanges, however, the Widjaja family still owns the controlling stake in the Group.⁵⁶

Financing to Sinar Mas Group companies active in pulp & paper and agribusiness (primarily palm oil) are tracked by Forests & Finance. It found that Chinese financial institutions provided a total US\$ 3.6 billion in forest-risk loans and underwriting to the Sinar Mas Group between January 2016 and April 2020. This accounts for a quarter of all identified forest-risk financing to the group. Only financiers from Indonesia provided more credit to the group. 93% of Chinese credit to Sinar Mas Group was attributable to pulp & paper activities, with the remaining 7% attributable to palm oil. Chinese financial institutions provided approximately 30% of all identified pulp & paper attributable financing to the group. 75% of pulp & paper attributable finance from Chinese financial institutions was provided to Sinar Mas subsidiaries active in China (see below). However, the capacity of processing facilities in China exceeds the Sinar Mas' supply from plantations in China. To meet the demand Sinar Mas has to import pulp fibre from Indonesia and Vietnam, among others. Therefore, this financing is still considered forest-risk.

Sinar Mas Group's pulp & paper activities are carried out by Asia Pulp & Paper (APP) and its subsidiaries. The group's palm oil activities are carried out by Golden Agri-Resources and its subsidiaries. These are described in further detail below:

- **Golden Agri-Resources**

Golden Agri-Resources Ltd. (GAR) is the largest oil palm plantation group in Indonesia and the second largest in the world. GAR was founded in 1996, and listed on the Singapore Exchange in 1999. The company's primary activities include cultivating and harvesting of oil palm trees; processing of fresh fruit bunch into crude palm oil (CPO) and palm kernel; and refining CPO into value-added products such as cooking oil, margarine and shortening. GAR also has integrated operations in China including a deep-sea port, oilseeds crushing plants, production capabilities for refined edible oil products as well as other food products such as noodles.⁵⁷

- **Asia Pulp & Paper**

Asia Pulp and Paper (APP) is one of the largest pulp & paper companies in the world. APP controls two pulp & paper companies listed on the Indonesia Stock Exchange (IDX): PT Indah Kiat Pulp & Paper and PT Pabrik Kertas Tjiwi Kimia. APP controls both companies through PT Purinusa Ekapersada, which holds 52.72% of Indah Kiat and a 60% of Tjiwi Kimia.

In addition to these two listed companies, APP also controls five other pulp & paper companies in Indonesia:

- PT Univernus (in Riau)
- PT Pindo Deli Pulp & paper Mills (in West Jakarta)
- PT Ekamas Fortuna (in East Java)
- PT Lontar Papyrus Pulp & paper Industry (in Jambi)
- PT OKI Pulp & paper Mills (South Sumatra)

APP further owns a number of pulp & paper mills in China. The major pulp & paper mills in China are:

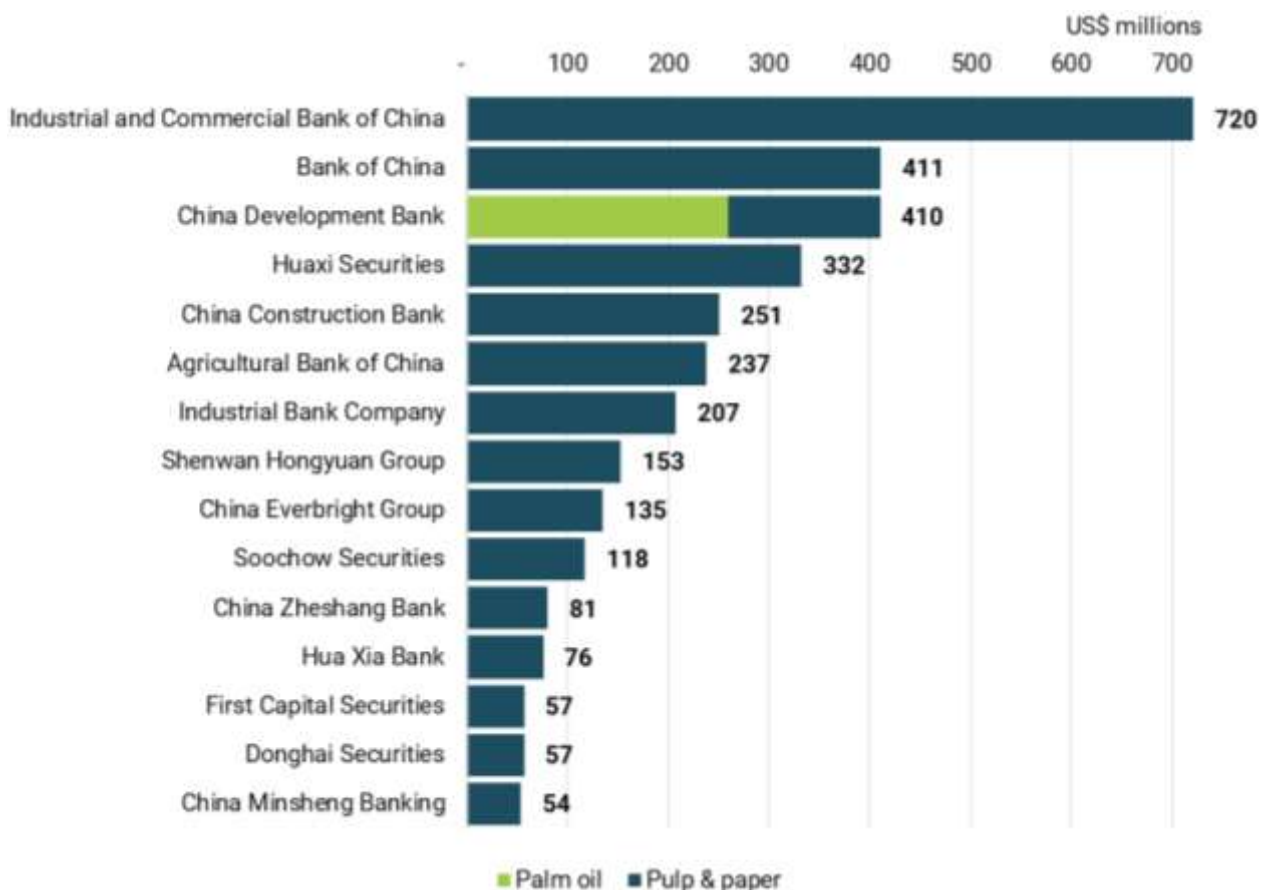
- Gold East Paper (in Jiangsu)
- Gold Hongye Paper (in Suzhou Industrial Park, Jiangsu)

- Gold Huasheng Paper (in Suzhou Industrial Park, Jiangsu)
- Hainan Jinhai Pulp & Paper (in Hainan)
- Ningbo Asia Pulp & Paper (in Zhejiang)
- Ningbo Zhonghua Paper (in Zhejiang)

Sinar Mas Group also has control over Paper Excellence B.V – a Dutch holding company – which operates a pulp & paper mills in Canada, France and Brazil.

Figure 20 shows that the largest forest-risk creditor between January 2016 and April 2020 was the Industrial and Commercial Bank of China (ICBC). ICBC – a founding member of the United Nations Principles for Responsible Banking – provided US\$ 720 million in loans and underwriting services to Sinar Mas’ pulp & paper activities. It was followed by the Bank of China (US\$ 411 million) and China Development Bank (US\$ 410 million). China Development Bank was the only Chinese bank to also provide financing for Sinar Mas’ palm oil activities during the period of study.

Figure 20 Top-15 Chinese providers of loans and underwriting services to Sinar Mas Group companies (2016-2020 April, US\$ mln)



Source: *Forests & Finance*, online: <https://forestsandfinance.org/>, viewed in September 2020.

3.4.1 Environmental issues

- **Asia Pulp & Paper (APP)**

APP has historically been responsible for more than 2 million hectares of deforestation, including habitat of tigers, elephants and orang-utan.⁵⁸

In May 2020, a critically endangered Sumatran Tiger was found dead in a trap inside a concession controlled by APP.⁵⁹ 10% of total Sumatran tiger population is in APP suppliers' concessions. Tiger habitat, already declining due to large scale conversion of natural forest and peatlands to plantations, has been worsened by the subsequent forest fires, leading the Sumatran tiger towards extinction.

Recently it was reported that three APP subsidiaries and suppliers (PT Bumi Mekar Hijau, PT Bumi Andalas Permai and PT Arara Abadi) were suspected of clearing 3,500 hectares of peat and constructing 53 kilometers of canals between August 2018- June 2020. Development on peat increases the risk and severity of fires. At the end of June 2020 alone, there was a fire of around 50 hectares in Arara Abadi.⁶⁰

In 2019, the concessions of three APP subsidiaries and suppliers were sealed (PT Finantara Intiga, PT Muara Sungai Landak and PT Bumi Mekar Hijau). Together, the burned area was approximately 966 hectares.

Over the years, APP has In 2018 Greenpeace ended all engagement with APP/Sinar Mas over continued links to deforestation.⁶¹

A coalition of NGOs known as Auriga reported that despite of the company's "no deforestation policy", APP is still involved in deforestation in East Kalimantan, by purchasing timber that was gathered from clearing the natural forest.⁶²

WWF recommended in 2018 that companies and financial investors avoid doing business with Sinar Mas Group/APP and its affiliates. As the company received supplies from illegal logging.⁶³

APP is questioned on its deforestation policy as the company purchased pulp feedstock from natural forest in East Kalimantan.⁶⁴

A coalition of NGOs, on the 5th Anniversary of Asia Pulp & Paper's *Forest Conservation Policy* in 2018 stated that APP's conservation policies still have the following issues:

- Do not prevent deforestation
- Land conflicts resolution is slow
- Lack progress in restoration and trading of degraded peatlands for areas that may have natural forest and community claims
- There is misinformation about relationship with wood suppliers, a lack of transparency, and a lack of independent monitoring.⁶⁵

In November 2020, a complete list areas where APP was not living up to its own *Forest Conservation Policy* was released.⁶⁶

APP's Oki Pulp & Paper Mills endangers Indonesia's climate change commitments. The mill production capacity exceeds the ability by suppliers' plantations to support the production, putting at risk company's commitments to stop deforestation.⁶⁷ The mill's wood supply is grown mostly on drained peatlands that causes high carbon emissions and, at times, prone to the occurrence of fires.⁶⁸ In 2013, APP received a US\$ 1.8 billion loan from China Development Bank to develop Indonesia's largest pulp mill – Oki Mill. In 2015, Sinar Mas Group, the parent of APP and Oki Pulp & Paper Mills, received a further US\$ 1.5 billion loan from China Development Bank and ICBC. Approximately half of this is reported to have been earmarked for Sinar Mas' pulp & paper activities, including Oki Mill.⁶⁹

- **Golden Agri-Resources (GAR)**

In recent years, GAR has been the subject to a number of RSPO complaints. The most recent complaint – currently still under investigation – was filed by Forest Peoples Programme and Elk Hills Research in February 2020. The complaint reports illegal deforestation on concessions in Central Kalimantan as well as a bribery scheme by GAR officials to cover up known land-use violations in the region. The concerned concessions cover an area of around 140,000 hectares, of which around 76,000 hectares overlaps with land classified as ‘forest zone’. Operate palm oil plantations on ‘forest zones’ is illegal under Indonesian law.⁷⁰

Chain Reaction Research found that for the year 2019, GAR was linked to 926 fire alerts in its palm oil concessions in Indonesia. GAR was ranked 9th among the top 10 companies with the highest number of alerts in that year.⁷¹ Greenpeace documented 323 fire hotspots in GAR-associated concessions between January and September 2019. In the 2015 fire season, GAR subsidiary PT Bahana Karya Semesta (PT BKS) was subject to a compliance order linked to fires.⁷²

3.4.2 Social issues

- **Asia Pulp & Paper (APP)**

APP fibre suppliers developed their plantations on lands traditionally owned by local communities. As a result, many social conflicts have arisen. An extensive survey in 2019 found that in just five provinces of Indonesia, at least 107 villages or communities are in active conflict with affiliates APP or its suppliers. 544 villages are sites of potential conflict. The total area of (potential) conflict found to be over 2.5 million hectares.⁷³

In 2014, PT Oki Pulp Mill and PT Bangun Rimba Sejahtera started construction of Oki Pulp Mill before the Free, Prior and Informed Consent (FPIC) process was completed. The mill is now still operational.⁷⁴

In March 2015 a local farmer and activist was tortured and brutally murdered by the company’s contracted security in an APP’s controlled concession in the Jambi province.⁷⁵

In 2017, Greenpeace called for an investigation into the relationship between Sinar Mas and its wood suppliers to APP that are involved in land conflict and deforestation.⁷⁶

Also in 2017, PT Arara Abadi was reported to have been involved in land conflicts with at least six local communities in Bengkalis, Siak and Pelawan regencies in Riau, Indonesia.⁷⁷

In 2018, APP subsidiary PT Bumi Persada Permai in Musi Banyuasin Regency, South Sumatra built roads on the community land without compensation/community consent.⁷⁸

Lubuk Mandarsah people in Jambi are now actively farming on land that they have used for generations, but the land is currently legally part of APP subsidiary PT Wirakarya Sakti’s plantations. The community still lives in fear of losing their land.⁷⁹

On March 4, 2020, in the village of Lubuk Mandarsah (Jambi province, Indonesia), an APP controlled plantation company, PT Wirakarya Sakti (WKS), was alleged to have sent drones flying over the community’s crops, spraying herbicide over villagers’ gardens in disputed land. The drones killed villagers’ crops in the middle of COVID-19 crisis.⁸⁰

Subsequently, WKS executives went to the local community gardens accompanied by an army officer who intimidated the villagers by shooting in the air.⁸¹

- **Golden Agri-Resources (GAR)**

In 2018, a complaint was filed against GAR subsidiary Sinar Mas Agro Resources Technology (SMART) alleging termination of employment without severance payment.⁸² In the same year, a separate complaint was filed with the RSPO regarding another GAR subsidiary, for terminating employment in violation of Indonesian Employment Law.⁸³

3.4.3 Governance issues

- **Asia Pulp & Paper (APP)**

In 2017, it was reported that PT Satria Perkasa Agung – subsidiary of Sinar Mas – was involved in a bribery case against the former Riau Governor Rusli Zainal.⁸⁴

In 2018, a coalition of NGOs published a full of APP's corporate structure, including companies considered 'independent' but in fact controlled by APP. It is often these 'independent' concession holders, that are involved in forest fires and deforestation. Their independent status allows APP claim that it does not have responsibility. The NGO map of APP's company structure shows that while it may not be the official owner of these independent companies, it does exercise control over them.⁸⁵

- **Golden Agri-Resources (GAR)**

The FPP complaint also reports the conviction of GAR officials in Central Kalimantan on bribery charges. The intention of the bribes was to prevent the publication and public hearing of in-site inspection results on GAR's PT Binasawit Abadi Pratama (PT BAP) concession. PT BAP was operating without the legally mandated HGU permit and was conducting unlawful waste disposal operations in an unlawful manner.⁸⁶

3.4.4 Discussion

As Chinese financial institutions continue to finance Sinar Mas Group, their finances continue to be at risk. Sinar Mas Group subsidiaries continue to have environmental, social and governance risks that have resulted in and will continue to result in government and buyer responses which impact the ability of the group and its subsidiaries to generate sufficient revenue to meet its financial obligations.

A report released in May 2020 estimates that the pulp & paper industry in Indonesia may be exposed to US\$ 1-10 billion in social compensation claims.⁸⁷ For one of the two largest players in Indonesian pulp & paper, this poses a significant risk to Sinar Mas. This is just an example of the financial risk Sinar Mas is exposed to through one of the industries it is engaged in, and on only one issue. Add to this the environmental and governance issues it is exposed to in the pulp & paper industry, as well as the ESG risks of its palm oil activities, the overall financial risks to its financiers are considerable.

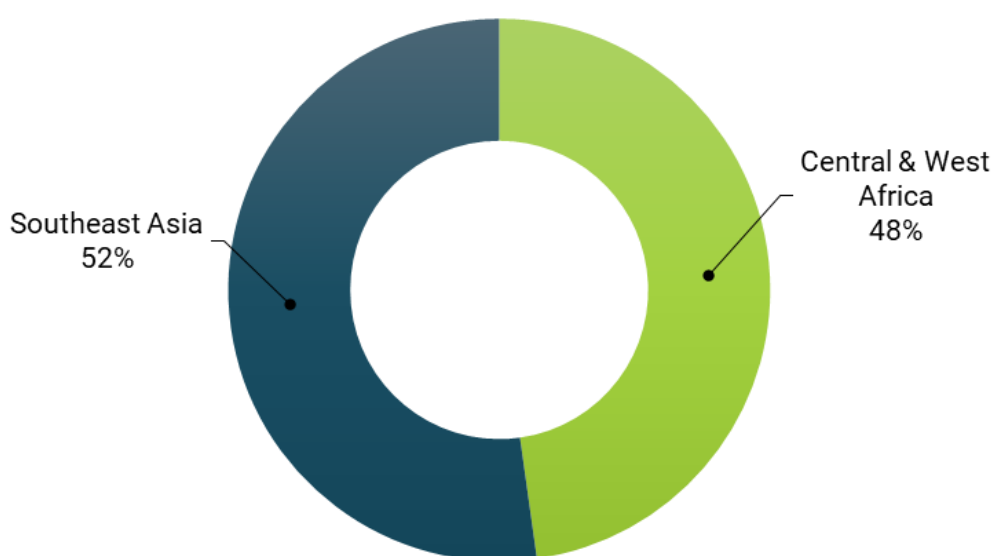
Moreover, continued ESG violations also put Chinese financial institutions at risk of not meeting their obligations under the Green Credit Guidelines, or acting in line with climate related commitments of the government.

3.5 Sinochem Group

Sinochem is an integrated oil and chemical company under the supervision of the State-Owned Assets Supervision and Administration Commission (SASAC). The company has give strategic business units, including: Energy, Chemicals, Agriculture, Real Estate and Finance. Sinochem is engaged in the forest-risk agro-commodity of natural rubber. A large proportion of this activity is carried out through its subsidiary Halcyon Agri. Singapore-based Halcyon Agri has rubber plantations in Malaysia, Cameroon and Ivory Coast. It also has factories in China, Malaysia, Indonesia, Thailand, Ivory Coast and Cameroon.⁸⁸

Figure 21 shows that approximately 48% of the identified forest-risk to Sinochem was attributable to its operations in Central & West Africa, 52% was attributable to activities in Southeast Asia.

Figure 21 Regional distribution of Chinese forest-risk loans & underwriting to Sinochem (2016-2020 April)



Source: *Forests & Finance*, online: <https://forestsandfinance.org/>, viewed in September 2020.

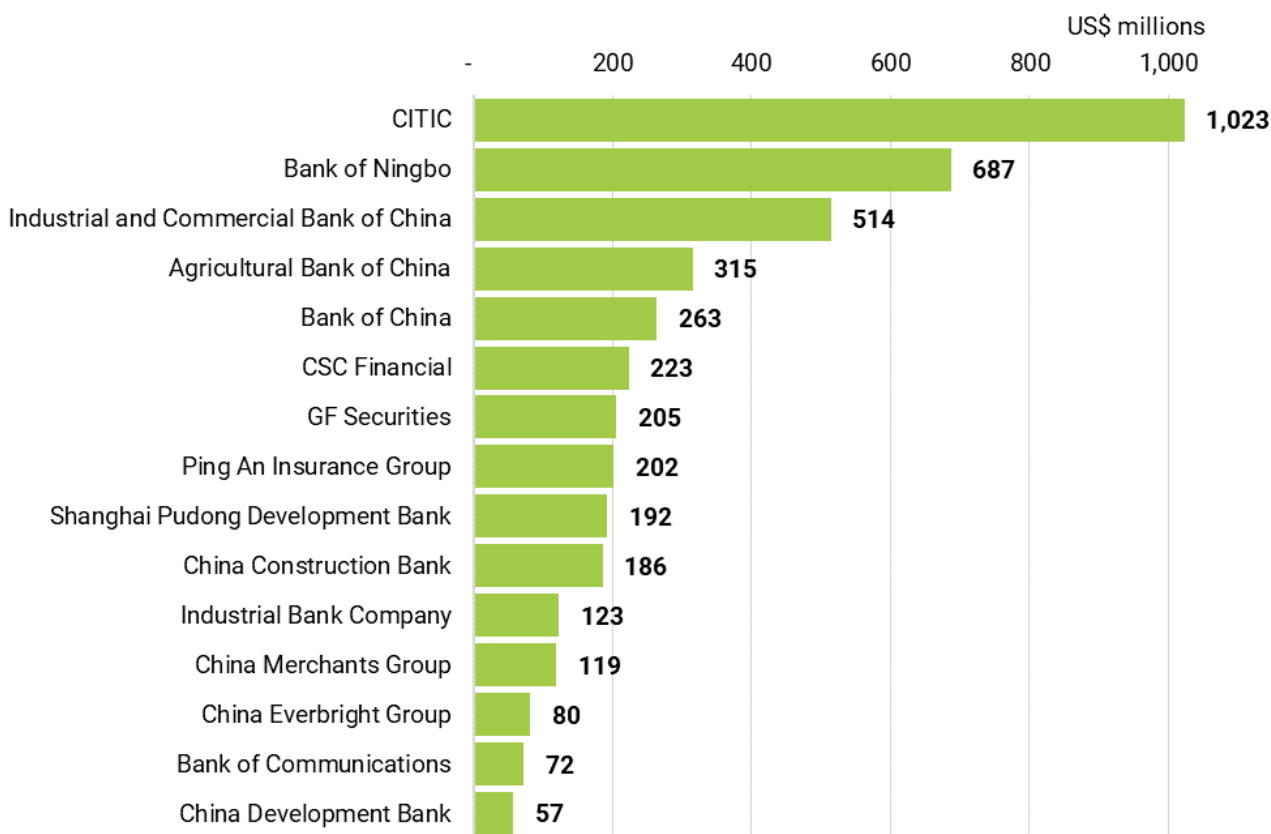
Chinese financial institutions provided US\$ 4.6 billion forest-risk credit provided between January 2016 and April 2020. This accounted for 80% of the total identified credit to Sinochem. All of the forest-risk credit was provided to Sinochem at the group level or its listed subsidiary (and the direct parent of Halcyon Agri) Sinochem International. No direct credit to Halycon Agri was identified.

More two thirds of the loans and underwriting services provided to Sinochem were provided by the Top-15 largest banks in China. This indicates that smaller (local) banks played a less significant role in financing Sinochem.

Figure 22 shows Top-15 Chinese creditors of Sinochem in the period January 2016 to April 2020. The largest among these is CITIC, which provided US\$ 1 billion in forest-risk loans and underwriting services to Sinochem. It was followed by the Bank of Ningbo (US\$ 687 million) and the Industrial and Commercial Bank of China (ICBC) which provided US\$ 514 in forest-risk credit to Sinochem. It should be noted that ICBC is a founding member of the United Nations Principles for Responsible Baking (UN-PRB). Industrial Bank Company, also among the top 10 forest-risk creditors of Sinochem, is also a member of the UN-PRB. The shared vision of the UN-PRB banks is:

"We believe that only in an inclusive society founded on human dignity, equality and the sustainable use of natural resources, can our clients and customers and, in turn, our businesses thrive."⁸⁹

Figure 22 Top-15 Chinese providers of loans and underwriting services to Sinochem (2016-2020 April, US\$ mln)



Source: *Forests & Finance*, online: <https://forestsandfinance.org/>, viewed in September 2020.

At the most recent filing date in June 2020, Chinese investors held US\$ 94 million in the bonds and shares of Sinochem, and its subsidiaries – including natural rubber producer Halcyon Agri. This accounted for just under half of all identified investments in the bonds and shares of Sinochem. Investors from United States, United Kingdom, Switzerland, Singapore, and Germany accounted for a further 40%.

Figure 23 lists the top 10 Chinese investors in the bonds and shares of Sinochem and its subsidiaries at the most recent filing date in June 2020. It shows that the largest among these investors was China’s state policy bank – China Development Bank – which held investments worth US\$ 50 million. It was followed by Central Huijin Asset Management (US\$ 11 million) and China Merchants Group (US\$ 10 million). Among the top 10 forest-risk investors in Sinochem, four are members of the United Nations Principles for Responsible Investment (UN-PRI). These are: China Merchants Group, China Southern Asset Management, E Fund Management, and China Universal Asset Management.

UN-PRI signatories share the following vision:

“As institutional investors, we have a duty to act in the best long-term interests of our beneficiaries. In this fiduciary role, we believe that environmental, social, and corporate governance (ESG) issues can affect the performance of investment portfolios (to varying degrees across companies, sectors, regions, asset classes and through time).

We also recognise that applying these Principles may better align investors with broader objectives of society.”⁹⁰

Figure 23 Top 10 Chinese investors in bonds and shares issued by Sinochem (2020 June, most recent filing date)



Source: *Forests & Finance*, online: <https://forestsandfinance.org/>, viewed in September 2020.

3.5.1 Environmental issues

In 2019, the Norwegian Government Pension Fund – Global placed Sinochem subsidiary Halcyon Agri on its exclusion. Norges Bank – which manages the pension fund – based its decision on a recommendation from the pension fund’s Council of Ethics which determined that there was unacceptable risk that Halcyon Agri is responsible for serious environmental damage.⁹¹

In 2018, Greenpeace Africa published a report on a Halcyon Agri subsidiary in Cameroon –Sud Hévéa Cameroun (Sudcam). It claims that Sudcam cleared High Conservation and High Carbon Stock forests between 2011 and 2018.⁹²

Sudcam’s concession is located on the periphery of the Dja Faunal Reserve, part of the TRIDOM region. In its 2018 State of Conservation assessment, UNESCO stated that the recent extension by 13,000 hectares of Sudcam’s concession granted by the government of Cameroon was “worrying and continue[s] to threaten the OUV [Outstanding Universal Value] of the property.”⁹³

In 2019, UNESCO Advisory mission on Sudcam concluded that the environmental and social impact assessment did not need the required standards for projects border on World Heritage sites. Although Halcyon Agri had committed to stop further land clearance in the expanded concession, UNESCO Advisory mission urged the government of Cameroon to not permit further expansion of the latex processing plant in the Sudcam central block and to classify the returned forest as permanent forest estate.⁹⁴

In 2019, Mighty Earth published a report on Sudcam's sister company Hévéc Cameroun SA (Hévécam). The report claims that in the period from Hévécam establishment in 1975 to 2008 when Sinochem became the majority shareholder, Hévécam had cleared over 41,000 hectares of mostly national forest. In 2012, the government granted Hévécam a 18,365 hectare extension to its concession. This extension is covered lowland tropical forests rich in biodiversity. Of this concession, 3,196 hectares has already been cleared.⁹⁵

The Mighty Earth study also reports that there are concerns from local indigenous communities that the waterways they rely on are being degraded and have become polluted. Villagers report health issues as a result of water contaminated with pesticides. They also state that the fish stock which they relied on as a food sources, has been depleted.⁹⁶

3.5.2 Social issues

Greenpeace Africa's 2018 report on Sudcam also documents forced displacement without adequate compensation, and no Free, Prior and Informed Consent (FPIC). Sudcam's concessions overlap with the customary lands of, among others, the Baka people. Greenpeace reports interviews with Baka people claiming their settlements in Sudcam's concession area had been completely destroyed. This is a violation of article 10 of the UN Declaration on the Rights of Indigenous Peoples, which stipulates that indigenous peoples shall not be forcibly removed from their lands or territories and that no relocation shall take place without agreement on just and fair compensation and, where possible, the option of return. Halcyon Agri responded that the laws of the land were followed, however, Cameroon's current legislation does not require compensation for all losses resulting from dispossession.⁹⁷

Mighty Earth's report on Sudcam's sister company Hévécam, also claims dispossession of community lands and a lack of FPIC. Mighty also states that indigenous people are discriminated against by the company. The company only employs them for temporary and menial tasks. They are also paid less than their non-indigenous peers. In addition to poor working conditions, most are paid less than US\$ 1 a day.⁹⁸

3.5.3 Governance issues

The Greenpeace Africa report raised concerns over the legality of Halcyon Agri's freehold ownership claims on Sudcam's concessions. While the government of Cameroon granted Sudcam freehold ownership of the 45,000 hectare concession in 2013, Cameroonian law does not allow foreigners to hold freehold rights over national lands, only leasehold rights. This would imply that the freehold rights of the company are illegal under Cameroonian law.⁹⁹

Although not directly related for Sinochem's forest operations, at least two high level executives of the company have been jailed in recent years on allegations of bribery.¹⁰⁰

3.5.4 Discussion

Halcyon Agri has responded to the allegations by halting deforestation, and working with some civil society organizations to resolve some outstanding issues. However, a number of issues pose a continued risk for the company and its financiers.

If the Cameroonian government takes measures to restrict operations of Sudcam's concession on the periphery of Dja Faunal Reserve, this will impact the company's revenues, potentially putting pressure on its ability to repay its outstanding debt commitments. If the government takes on board the recommendations of the UNESCO Advisory mission, this will imply temporary revenue restrictions, a revaluation of Sudcam's assets, and increased future capital expenditures as the company will need to expand concession areas and processing capacity elsewhere.

Violations of UN Declaration on the Rights of Indigenous Peoples by the company, may also violate the standards of financial institutions financing the company, particularly those that are signatory to the UN-PRB or UN-PRI. These financial institutions could terminate their relationship with Sinochem, restricting its sources of financing and increasing the cost of capital.

Halcyon Agri also faces the risk of allegations of lack of FPIC resulting in court cases in a potentially different political climate, in the future. These court cases may result in the government taking measures to remedy the claims, likely resulting in additional costs for Halcyon Agri, potentially putting pressure on the company's ability to meet its debt obligations.

Moreover, if the interpretations of the Cameroonian law are correct, Sudcam's claim to 45,000 hectares may also be at risk.

While the analysis of the ESG risks Sinochem has been exposed to have focused on documented cases from Cameroon, it cannot be ruled out that other operations of Sinochem elsewhere in West Africa or Southeast Asia are not at risk. These documented cases are examples of the kinds of risks that are prevalent in all tropical forest-rich regions where Sinochem operates its rubber business.

An aerial photograph showing a winding asphalt road that curves through a dense, lush green forest. The road is a light grey color with a white line down the center and yellow lines on the edges. The forest is composed of many different types of trees, including tall, thin evergreens and shorter, broader-leafed trees. The overall scene is vibrant and natural.

Concrete steps should be taken to mitigate ESG risks:
Adopt policies,
enhance due diligence,
be engaged, and
divest.

4

Conclusions and recommendations

Chinese financial institutions continued to be exposed to ESG risks through their forest-sector clients. A number of concrete steps should be taken to mitigate these risks, and improve the corporate behaviour of the clients on the ground.

The analysis above has found that Chinese financial institutions are exposed to environmental, social and governance risks through the companies they finance. The government has developed several guidelines and initiatives to foster sustainable financing practices. However, it appears that these have yet to fully integrated into the financing processes and translated into prudent financing decisions by Chinese financial institutions.

The *Green Credit Guidelines* explicitly recommend that clients with poor ESG performance record should not be granted funding. However, the analysis above has shown that companies with poor ESG performance are still receiving funding.

While current guidelines and initiatives developed by the Chinese government are laudable, they do present detailed criteria on which financial institutions can base their due diligence processes. *Forests & Finance* has designed a set of minimum standards financial institutions providing credit to or investing in the bonds and shares issued by the companies operating in forest-risk value chains can demand of their clients / investees (see Table 3). These criteria can be seen as elements of a detailed procedure in line with the spirit of the *Green Credit Guidelines* and *Guidelines on Regulating the Banking Industry in Serving Enterprises' Overseas Development and Strengthening Risk Control* specific of forest-risk sector financing.

Table 3 Forests & Finance policy assessment criteria grouped by category

No.	Category	Criteria
1	Environment	Companies and their suppliers must commit to zero-deforestation and no-conversion of natural forests and ecosystems
2		Companies and their suppliers must not drain or degrade wetlands and peatlands
3		Companies and their suppliers must not convert or degrade High Carbon Stock (HCS) tropical forest areas
4		Companies and their suppliers must not operate in, or have negative impacts on, protected areas
5		Companies and their suppliers must identify and protect High Conservation Value (HCV) areas under their management
6		Companies and their suppliers must not use fire for land clearing activities and fight fires
7		Companies and their suppliers must minimize their impacts on groundwater levels and water quality
8		Companies and their suppliers must not harvest, nor trade in, endangered species and must protect the habitats of endangered species
9		Companies and their suppliers must not use nor introduce genetically modified species or invasive alien species into the environment

No.	Category	Criteria
10		Companies and their suppliers must minimize or eliminate the use of pesticides
11	Social	Companies and their suppliers must respect the right of Indigenous peoples to give or withhold Free, Prior and Informed Consent (FPIC) if they could be affected by planned operations.
12		Companies and their suppliers must respect the right of all communities with customary land rights to give or withhold Free, Prior and Informed Consent (FPIC) if they could be affected by planned operations.
13		Companies and their suppliers must establish human rights due diligence processes and monitoring systems
14		Companies and their suppliers must respect the broader social, economic and cultural rights of communities affected by their operations, including the right to health and the right to an adequate standard of living
15		Companies and their suppliers must commit to the resolution of complaints and conflicts through an open, transparent and consultative process
16		Companies and their suppliers must maintain zero tolerance towards violence and the criminalization of land, environmental, and human rights defenders
17		Companies and their suppliers must not engage in forced labour nor in child labour
18		Companies and their suppliers must uphold the rights to freedom of association, collective bargaining and freedom from discrimination
19		Companies and their suppliers must pay at least a living wage
20		Companies and their suppliers must protect the safety and health of workers
21		Companies and their suppliers must have a gender-sensitive zero tolerance policy towards all forms of gender-based discrimination and violence
22	Governance	The financial institution has integrated sustainability objectives in its governance structure
23		The financial institution is transparent on the actions through which its forest-risk policies are implemented and enforced
24		The financial institution is transparent on its investments and financings in forest-risk commodity sectors
25		The financial institution discloses its forest-related impacts, including its forest-related financed GHG emissions and its forest footprint
26		The financial institution is transparent on its engagements with companies in forest-risk commodity sectors
27		The financial institution commits to a transparent and effective grievance mechanism regarding its financing of, or investments in, companies in forest-risk commodity sectors
28		Companies and their suppliers must provide proof of legality of their operations and commodity supplies, in particular proof of compliance with all prevailing laws and regulations on land acquisition and land operation
29		Companies and their suppliers must ensure supply chain transparency and traceability
30		Companies and their suppliers must publish geo-referenced maps of all the concession areas and, farms under their management
31		Companies and their suppliers starting new operations or expanding their operations must publish a social and environmental impact assessment
32		Companies and their suppliers must not get engaged in corruption, bribery and financial crimes

No.	Category	Criteria
33		Companies and their suppliers must comply with the letter and the spirit of the tax laws and regulations in the countries in which they operate and must not set up corporate structures solely for tax avoidance purposes
34		Companies and their suppliers must publish their group structure and country-by-country data

In addition to minimum standards, financial institutions develop and/or add existing tools to assist them evaluating ESG risks in their due diligence process. Some of the elements listed above require companies to disclose certain information publicly. These disclosures can be readily checked by the financial institution. However, the financial institution can also determine the track record and ESG risks of companies by referring to tools such as *Forests & Finance* and *Chain Reaction Research* which host detailed company case studies, ZSL SPOTT and Forest 500 which score companies on their policies and disclosures, and service providers such as SynTao Green Finance and Sustainalytics which provide assessments of companies based on ESG risk management performance.

Concretely, Chinese financial institutions should:

- **Adopt policies**

Chinese financial institutions should formulate clear policies to manage forest-risk sector credit and investment decision-making. The minimum standards laid out in Table 3 should form the basis of those policies. The policy should apply to all financial services and require compliance across all corporate group client/investee entities. For banks, client compliance with policies should be mandated through specific covenants in financing agreements. The financial institutions should also set key performance indicators and present red lines when they will terminate relationships with clients and investees that fail to meet up to the minimum standards set by the financial institution.

- **Conduct enhanced due diligence**

Chinese financial institutions should screen potential and existing investee companies and clients for compliance with their credit and investment policies and conduct enhanced due diligence by assessing company exposure to ESG risks, policy commitments, and capacity and track record to address such risks. Such due diligence may require site visits, input from independent third parties (such as those noted above), and documentation of company adherence to ESG-related processes. 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.

Enhanced due diligence is required by the *Green Credit Guidelines*.

- **Be engaged**

It is essential that Chinese financial institutions regularly monitor clients and investees' activities to ensure that these companies continue to meet the standards set in their credit and investment policies. Financial institutions should regularly consult with communities affected by company operations, civil society organizations, governmental bodies and other experts to do "reality checks" on company performance.

Investors should use their influence over investee companies by exercising their proxy-voting rights where necessary.

The *Guidelines on Regulating the Banking Industry in Serving Enterprises' Overseas Development and Strengthening Risk Control* call upon financial institutions to engage with affected communities, NGOs and other stakeholders. This is a welcome recommendation. In order to be most effective, Chinese financial institutions should open such channels of communications, and be responsive in their engagement with civil society organizations

- **Divest**

Chinese financial institutions should terminate financing agreements and sell bonds and shares if the company violates the terms of agreements regarding ESG-related policies, where they fail to take immediate action to correct any ESG policy violations and put in place corrective actions to prevent reoccurrence.

Not financing companies with poor ESG performance records is an explicit recommendation of the *Green Credit Guidelines*.

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