

HSBC Agricultural Commodities Policy

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Agricultural Commodities Policy

This document is one of HSBC's sustainability risk policies. It should be read in conjunction with **Introduction to HSBC's Sustainability Risk Policies** which explains common features and technical terms¹.

Introduction

The agricultural commodities sector essentially feeds and, to a lesser extent, clothes the world. It exists in almost all countries and includes a huge and diverse range of commodities such as cocoa, coffee and cotton. However, the sector can also have significant adverse impacts on both people and the environment, especially where large new plantations are proposed which affect the existing nature and use of that land.

HSBC's approach

HSBC does not wish to finance unacceptable impacts in this potentially high-risk sector. We wish to ensure that our customers operate in accordance with good international practice, helping those that make acceptable progress, but closing relationships with those who do not and will not meet our standards. For the purposes of this policy, we focus on commodities with a potentially high impact where HSBC has significant numbers of customers involved with that commodity. HSBC also needs to ensure that its commitments can be successfully checked. Consequently, the standards which we require of our customers vary for different commodities and for different types of customer in the supply chain according to the due diligence which a bank can reasonably undertake or rely on.

The types of due diligence are:

Certification - An independent certification scheme confirms that specific customer operations either meet a range of legal, environmental and social standards or have a time-bound plan to do so. It allows producers, processors and traders to prove to buyers, banks and others that products are from a sustainably managed source. Credible schemes have robust criteria, a broad membership, including companies and non-government organisations (NGOs), and offer a complaints system to investigate allegations of non-compliance. HSBC encourages these schemes and their continued development to meet growing market standards and expectations. Where they have a material market share, we will use them to check that customers meet our standards. Where in development, we will support credible ones with a view to extending the reach of our policy as they gain critical mass and acceptance.

Independent Verification - Some customers may introduce, and publish details of, additional due diligence conducted by independent experts to confirm that they meet policy commitments which have not yet been incorporated into certification standards.

Relationship Manager Due Diligence – The technical complexity of sustainability impacts means that relationship managers can only undertake a limited check on defined issues, as well as investigating credible allegations that customers are not compliant with our policy.

Essentially, this policy defines HSBC's minimum standards. Details are concise in order to aid good implementation of the policy. However, HSBC's engagement with this sector is broader. We encourage higher standards, help customers to improve, support the continued development of certification schemes and provide additional support – see HSBC's **Statement on Forestry and Palm Oil**.

Palm oil

Introduction

Palm oil is the world's main vegetable oil, with 60 million tonnes produced per year. 80-90% of palm oil comes from Indonesia and Malaysia, with the main importers being China, India and Europe, and significant intra-country use in Indonesia. It is used in various forms for products such as cooking oils, margarine, ice cream, biscuits, soap, biodiesel and animal feed. The sector has improved living standards in producer countries and is efficient in that palm oil's yield per hectare is 5-9 times greater than vegetable oil produced from rapeseed, sunflower or soy.

However, if not managed responsibly, oil palm plantations can have adverse impacts on people or on the environment. New plantations may result from the cutting or burning of natural forest. Social conflict may develop with local communities, who rely on the forest for their livelihood. Important wildlife habitat may be destroyed and harm endangered species such as the orang utan. Deforestation and the draining of peat swamps can encourage climate change by releasing large quantities of greenhouse gases. Palm oil can also be used to make biodiesel, which could indirectly increase pressure on land resources, increase food prices and further accelerate deforestation.

¹ The policy is made public for information only. HSBC's sustainability risk policies are for HSBC's use only and HSBC shall owe no liability to third parties in relation to them.

Sector Definition

- Growers (plantations) and mills - excluding smallholders with less than 50 hectares.
- Refiners and traders - including bulkers and shippers who consolidate palm oil purchases; excluding desktop traders who do not take physical possession of a commodity.

Prohibited Business

HSBC will not knowingly provide financial services to customers involved directly in or sourcing from suppliers involved in:

- Illegal operations.
- Deforestation, that is: the conversion of areas (often forests) necessary to protect high conservation values (HCVs)², the conversion of high carbon stock (HCS) forests³; the conversion of primary tropical forests; or land clearance by burning⁴.
- New plantation development on peat, regardless of the depth.
- Exploitation of people and communities, such as: harmful or exploitative child labour or forced labour; the violation of the rights of local communities, such as the principle of free prior and informed consent⁵; and operations where there is significant social conflict.

These commitments are consistent with No Deforestation, No Peat and No Exploitation (NDPE) policies increasingly common within the palm oil supply chain.

Implementation

HSBC requires customers to obtain certification under the Roundtable on Sustainable Palm Oil (RSPO) certification scheme, or equivalent, which is accepted as verification of compliance with HSBC's policy, with the exception of the requirements on HCS and peat. These are not covered by RSPO (although its voluntary higher standard of RSPO NEXT may do so in future). The table below shows the combined implementation details.

| Growers and Mills | | By |
|----------------------|--|------------------|
| A | 1) Member of RSPO (preferably parent company, or relevant subsidiaries). 2) At least one management unit certified under RSPO. 3) A time-bound plan for 100% certification by 31 December 2018. | Now* |
| B | 1) Public commitment on the protection of HCS and peat (typically via an NDPE policy). 2) Publication of due diligence on HCS and peat for any new plantation being proposed for development (this aligns with RSPO's New Planting Procedures). | 30 June 2017 |
| C | 1) 100% certification of management units. 2) Evidence of independent verification of HCS and peat commitments to be made publicly available by customer. | 31 December 2018 |
| Refiners and Traders | | By |
| A | 1) Member of RSPO (preferably parent company, or relevant subsidiaries). 2) At least one owned facility (such as a refinery or storage/shipping facilities) is certified, under RSPO supply chain certification. 3) A time-bound plan for 100% certification of owned facilities by 31 December 2018. 4) A plan to exclude palm oil from controversial sources, by providing "traceability", within a set timeline. | Now* |
| B | Public commitment on the protection of HCS and peat (typically via an NDPE policy). | 30 June 2017 |
| C | 1) 100% certification of owned facilities. 2) Evidence of (own or suppliers') independent verification of HCS and peat commitments to be made publicly available by customer. | 31 December 2018 |

*The RSPO membership deadline was introduced at 30 June 2014. Other current requirements were introduced at 31 December 2014.

2 High Conservation Values (HCVs) are critical ecological attributes, ecosystem services or social functions – for example, forests containing endangered species or key hunting areas or sacred burial grounds of local communities.

3 High Carbon Stock (HCS) forests hold large stores of carbon, the release of which contributes to global warming. The HCS Convergence Agreement of 4 November 2016 defines a common methodology for application in the palm oil sector.

4 Consistent with the ASEAN Guidelines.

5 Consultation which is **Free** of intimidation, conducted **Prior** to any impacts, with communities **Informed** of relevant information, who give their **Consent**.

Under a 3 month transition period for the introduction of Requirement B, HSBC will not agree new financing facilities for customers who have not made the appropriate commitment.

Customers who develop or acquire new uncertified operations in the future may be unable to meet the RSPO certification deadline of 31 December 2018 in C1 above - for example, a new refinery to be developed in 2019. Such customers must gain the additional certification within a reasonable timeframe, typically 4 years for growers and mills and 1 year for refiners and traders.

New customers are required to consent, before financial services are provided, to HSBC being able to disclose publicly whether the customer is or was a customer of the bank. This requirement recognises both the public concern over the role of financial institutions in this sector and the legal constraints on HSBC relating to customer confidentiality.

Global Businesses must manage these risks on an appropriate ongoing basis, not just at annual reviews. They must use internal implementation templates where provided. They must give a copy of the public summary of our policy, plus the **HSBC Statement on Forestry and Palm Oil**, to customers.

Policy Compliance

There may be **exceptional** circumstances where customers meet the spirit, but not the letter of this policy, or where enquiries about a customer's compliance are incomplete. Where supported, Global Businesses must submit a clearance request, using a Sustainability Risk Rating of **Near-Compliant**. This rating will be a temporary rating pending a change to Compliant or Non-Compliant. The circumstances envisaged are:

- Customers who have not submitted an up-to-date Annual Communication of Progress (ACOP) to RSPO, but are rectifying the situation.
- Customers subject to formal complaints at RSPO. Global Businesses must discuss complaints with customers and encourage their speedy resolution. HSBC intends to follow the RSPO complaints process when deciding how to proceed, noting that RSPO allows minor breaches if commitments address the problems, but may exit customers who are RSPO members where risks are high.

Global Businesses must exit relationships, as soon as possible, with **Non-Compliant** customers, including:

- Customers expelled from RSPO (including those who terminate their membership during complaints investigations) or whose certification is withdrawn.
- Customers not on a credible path to meeting HSBC's policy deadlines.

Where a customer group also operates in other sectors, Global Businesses must:

- not provide financial services directly supporting Non-Compliant companies;
- actively engage with the controlling parent company, if a customer, to highlight the benefits of meeting this policy; and
- submit a recommendation to their regional Reputational Risk and Client Selection Committee (RRCSC) as to whether HSBC should continue or close the relationship with the parent and the rest of the group. The review must take into account the scale and nature of any negative impacts and, if any relationship is continued, the restrictions proposed for any financing.

Continuing relationships will be rated Near-Compliant and subject to annual clearances and two-yearly referral to the RRCSC.

Covenants

Global Businesses must request covenants in documentation for facilities of longer than 1 year. Where this is not successfully negotiated (for example, in syndicated facilities for listed companies), the position must be satisfactorily explained/mitigated in the sustainability risk analysis.

Soy, Cattle Ranching and Rubberwood

Introduction

Soybeans are primarily grown in the US, Brazil and Argentina. They are processed directly into human food products such as tofu or soy milk or crushed into meal used as animal feed or into oil used for cooking and biodiesel. Increased cropland has had a negative impact on biodiversity, particularly in South America and on the Amazon rainforest. Soy has been planted on land which may have been recently cleared of rainforest by ranchers for grazing their cattle. It has also replaced native vegetation such as in the Cerrado area of savannah woodland in Brazil and the Pampas grasslands in Argentina.

Cattle ranching is a USD500bn global industry centred on the US, Brazil and the EU. There has been a significant increase in the number of cattle and in the land used for grazing, much due to increases in global prosperity and living standards which have resulted in more people eating meat. While cattle ranching is not an agricultural commodity as such, the sector can have very similar impacts to new plantations. It has been particularly controversial in the Amazon region, where it has been the leading cause of deforestation. This can have a negative impact on the rights of local people, on the environment and on climate change.

Rubberwood plantations produce latex, which is used to manufacture rubber for products like tyres. Many plantations are decades old, although they are replanted every 30 years or so, with the old wood typically used for manufacturing furniture. However, there has been a recent increase in new plantations - especially in China, Laos and Cambodia - amid concerns that land or forest may be cleared which is used by local people or contains rare animals and plants.

HSBC takes a risk-based approach to these agricultural commodities as any certification schemes, if available at all, are in development and/or not widely used.

Sector Definition

The policy applies as follows:

| Commodity | Customers | Countries |
|-----------------|--|---|
| Soy | 1. Growers with plantations of 10,000 hectares or more. 2. Processors with annual crushing capacity of 30,000 tonnes or more. | Argentina, Bolivia, Brazil, Paraguay, Uruguay |
| Cattle ranching | 1. Ranchers with 1,000 head of cattle or more. 2. Processors with slaughter-house capacity of 500 cattle per day or more. | Argentina, Brazil, Colombia, Mexico, Paraguay, Uruguay |
| Rubberwood | New plantations of 1,000 hectares or more | Africa, Cambodia, China, Indonesia, Laos, Malaysia, Thailand, Vietnam |

Prohibited Business

HSBC will not knowingly provide financial services to high-risk customers involved directly in or sourcing from suppliers involved in:

- Deforestation, that is: the conversion of areas (often forests) necessary to protect HCVs; the conversion of primary tropical forests; or clearance by burning.
- Exploitation of people and communities, such as: harmful or exploitative child labour or forced labour; the violation of the rights of local communities, such as the principle of free, prior and informed consent; and operations where there is significant social conflict.

The prohibitions relating to burning and conversion apply from 1 July 2004 for soy and rubberwood, reflecting the introduction of HSBC's original Forestry policy. HSBC accepts later cut-off dates if certified by a credible certification scheme. The other prohibitions were introduced from the date of our original policy in March 2014.

HSBC supports the concept of high carbon stocks (HCS) being included in the definition of deforestation, but recognises that field trials and current methodologies have focused on the palm oil sector to date. We welcome and support further research and clarity from companies and technical experts that would allow HCS to be used more broadly.

Implementation

1. Global Businesses must ask customers and conduct desk-top due diligence, in accordance with the appropriate templates, to establish – as far as can be reasonably identified - whether customers have undertaken any Prohibited Business.
2. Global Businesses must investigate incidents of or credible allegations of policy breaches. They must refer any allegations relating to impacts on HCS to Group Sustainability Risk, for evaluation against developing standards in this area.
3. For customers with one operation certified and a time-bound plan to complete certification, Global Businesses need only conduct further enquiries where (a) the customer is being investigated by the scheme's complaints system or (b) aware of other credible allegations of non-compliance. Acceptable certification schemes are:
 - Soy - Roundtable on Responsible Soy (RTRS).
 - Rubberwood – FSC or PEFC (for Forestry Management)
4. Where a customer undertakes Prohibited Business, decisions will be made on a case-by-case basis but HSBC's typical approach is: follow certification schemes where appropriate; exit where burning or HCV clearance takes place as those activities are wholly inconsistent with our policy; and engage with customers on other Prohibited Business to understand the seriousness and the customer's future plans.

Policy Compliance

Global Businesses must ensure that Sustainability Risk Ratings are accurate. Clearance will generally be required where a client is below Compliant, which will assist in ensuring a consistent approach is taken.

- Compliant customers must meet the above standards.
- Leaders will be Compliant as above, but be a leading advocate and practitioner on certification.
- Near-Compliant customers will be those on a credible path to compliance, with no material unacceptable areas of non-compliance, or those where allegations are being investigated.
- Non-compliant customers are those that clearly breach HSBC's policy and must be exited.
- All customers within the defined sector should be graded High Risk.

Where a customer group also operates in other sectors, Global Businesses must:

- not provide financial services directly supporting Non-Compliant companies;
- actively engage with the controlling parent company, if a customer, to highlight the benefits of meeting this policy; and
- submit a recommendation to their regional Reputational Risk and Client Selection Committee (RRCSC) as to whether HSBC should continue or close the relationship with the parent and the rest of the group. The review must take into account the scale and nature of any negative impacts and, if any relationship is continued, the restrictions proposed for any financing.

Continuing relationships will be rated Near-Compliant and subject to annual clearances and two-yearly referral to the RRCSC.