

AIM COMMENTARY

Proposal for a regulation concerning certain commodities and products associated with deforestation and forest degradation

February 2022

We support a harmonised EU-wide legal framework on due diligence as part of a smart mix of measures to address global deforestation.

INTRODUCTION

Deforestation and forest degradation are occurring at an alarming rate, aggravating climate change and loss of biodiversity. EU-wide regulation is key to ensuring high standards of protection of forests, through minimising consumption of products coming from supply chains associated with deforestation or forest degradation, as well as avoiding a fragmentation of the Single Market and minimising duplication of efforts by companies and regulators. The regulation should provide clarity on what is expected from companies to have uninterrupted access to necessary raw materials, while offering legal certainty, creating a level playing field by holding all companies to the same standards and providing them with more leverage vis-à-vis their business partners to deliver on human rights and environmental commitments throughout the supply chain. The regulation should avoid supply chain disruptions, which is especially relevant in the context of global trade disruptions linked to COVID-19 and post-Brexit border controls.

We urge the EU institutions to **ensure coherence between the legislative proposal for an EU Regulation on deforestation-free products and the upcoming Sustainable Corporate Governance initiative** that will address human rights (including land rights) and environmental duty of care in business operations in general, as well as the future reporting requirements set out in the **Corporate Sustainability Reporting Directive** to be adopted in early 2022.

For the EU Regulation on deforestation-free products to realise its full potential - effectively protecting and restoring forests while avoiding unintended negative consequences on the environment, smallholder farmers and local indigenous communities in producing countries - a series of **concerns should be addressed, primarily related to the practical implementation of the Regulation's due diligence obligations on companies and their potentially adverse effects on smallholders and their livelihoods.**

We particularly recommend the following improvements to the EU Commission proposal:

- elaborate the definitions of traders and operators, with concrete examples, and clarify their respective roles to avoid duplication of due diligence statements;
- allow for a single due diligence statement covering several shipments of a commodity from the same origin over a specific period of time;

- include a specific reference to internationally recognised OECD guidelines as authoritative guidance for companies to conduct due diligence;
- frame due diligence as a “continuous process of improvement” aimed at incentivising companies to engage with their suppliers to drive better practices to prevent or mitigate any risk of deforestation and forest degradation, as well as to remediate former deforestation;
- acknowledge the valuable role of commonly recognised third-party certification schemes in the risk assessment of supply chains among the risk mitigation tools referenced in Article 10;
- mandate the Commission to issue commodity-specific guidance, setting traceability requirements tailored to supply chain and market structures; there should be at least 12 months between the release of such guidance and the end of the transition period of the regulation, no later than 2025;
- set baseline traceability requirements, including at the sub-national region of production level, or at landscape level, depending on the commodity and the relevant national legislation in the country of production;
- tailor the country-level benchmarking system to sub-national, landscape or ecosystem levels to provide local smallholders with incentives to improve their production practices;
- ensure that cooperation with third countries includes access to training and capacity building for smallholders and farmer cooperatives with a view to making progress on sustainable farming within producing countries;
- introduce a more reasonable transition period of 24-36 months, depending on the maturity level of a given commodity supply chain;
- provide for a scalable approach to penalties, defined at EU level, with more significant fines in case of repeated serious breaches.

1. SCOPE OF TRADERS AND OPERATORS

AIM recommends EU lawmakers elaborate, with concrete examples, who is covered by the definitions of traders and operators to provide necessary legal certainty about which companies fall within the scope of the regulation, and who bears responsibility to show compliance with the regulation and issue a due diligence statement.

The current text raises the question of potential duplication of due diligence statements by operators and traders in the chain, which the intended centralized reporting system may not solve.

In the case of recurring shipments of a commodity from the same origin for which due diligence has already been undertaken, EU lawmakers should consider allowing a due diligence statement covering a specific period of time, rather than one per shipment.

2. DUE DILIGENCE PROCESS

Due diligence should be risk-based. As such, companies obligated under the deforestation regulation shall **focus their due diligence on their own activities and those of their business relationships through the value chain** (“control point enterprises”¹, OECD Due Diligence Guidance for Responsible Business Conduct) where

¹ ‘Control point enterprises’ will likely have greater visibility and/or leverage over their own suppliers and business relationships further up the supply chain than enterprises closer towards consumers or end-users. Conducting due diligence on control point enterprises to determine whether they are in turn conducting due diligence in line with this Guidance provides some comfort that risks of adverse impact directly linked to suppliers have been identified, prevented and mitigated.”

they are the greatest risks of deforestation. **AIM would suggest that the regulation specifically refers to the internationally recognised OECD Guidelines as authoritative guidance for companies to conduct due diligence.**

Due diligence should be considered as a **“continuous process of improvement” to minimise the risk of deforestation and forest degradation, and not as a compliance exercise *stricto sensu***, based on transformative stakeholder engagement, in line with internationally recognised due diligence frameworks. As such, the **regulation should explicitly incentivise companies to engage with their suppliers to drive better practices** to prevent or mitigate any risk of deforestation and forest degradation, as well as to remediate past deforestation or forest degradation.

The proposed regulation acknowledges the **valuable role that commonly recognised third-party certification, verified proprietary schemes**, and other voluntary initiatives, can play in assisting companies in their risk assessment of supply chains – provided that these schemes are compliant with EU minimum requirements. By leveraging and enabling continuous improvement of solid third-party schemes, faster adoption and large-scale compliance is likely to result. In addition, credible and robust voluntary sustainability standards and certification systems could play an important role to support compliance of smallholders with the regulation.

The recognition of the role of third-party certification schemes is in line with the recent European Parliament report (2020/2006(INL)) stressing that *“voluntary third-party certification can be an auxiliary tool to assess and mitigate deforestation risks when designed and fully implemented with regard to well-defined, measurable and ambitious sustainability criteria it is based on, the robustness of the certification and accreditation process, independent monitoring and compliance mechanisms, possibilities to monitor the supply chain and sound requirements to protect primary forests and other natural forests and promote sustainable forest management.”* In addition, the recent Preferred by Nature study² on schemes commissioned by the EU Commission confirms that while schemes can improve selected practices, they already provide significant support to operators in their efforts to meet obligations for due diligence: *“the Competent Authorities should recognise that certification schemes are an important tool for Operators to assess and mitigate risks in their supply chain. This process has the potential for Operators to achieve a high level of confidence in their supply chain with minimal use of resources and effort. This is an optimal solution from a cost efficiency perspective.”*

AIM agrees that **adherence to a standard or certification scheme is not per se a substitute for an effective system of due diligence, but should rather be a supporting mechanism.**

We support the Commission’s intent through Article 32 (Review) to clarify the role of certification in achieving the objectives of the regulation. In addition, **we recommend that Article 10 recognizes third-party certification schemes as one of the risk mitigation tools, alongside audits and reporting.**

3. TRACEABILITY REQUIREMENTS

AIM supports workable traceability requirements as part of increased supply chain transparency. A one-size-fits-all full traceability requirement, as put forward in the proposed regulation, may not be workable

² Preferred by Nature, Report: Study on Certification and Verification Schemes in the Forest Sector and for Wood-based Products, July 2021, p. 152

across all the commodities. Such an approach risks making compliance impossible (including with relevant local legislation³), and/or risks unduly penalising smallholders in developing countries.

With this in mind, while full transparency along the supply chain should be the ultimate objective, we believe the pathway to get there may need to be different in terms of timeframe and steps to be taken in the various commodity supply chains.

Therefore, **we support the development of commodity-specific guidance, setting commodity-specific levels of traceability tailored to supply chain and market structures.** This guidance should be developed before the entry into force of this regulation. The commodity-specific traceability levels should follow the principle of continuous improvement towards the most appropriate level of traceability needed to demonstrate compliance with the information gathering requirements in the regulation, taking into consideration current and forecasted traceability levels per commodity and enabling legislation and environments in producer countries.

Information gathering requirements should be proportionate and work to prove a negligible risk of deforestation or forest degradation. A solution could be **to set baseline traceability requirements, including at the sub-national region of production level (as is the case under the EU Timber Regulation), or at landscape level, depending on the commodity and the relevant national legislation in the country of production.**

Strict traceability requirements to exact plots of land cannot yet be proven for many of the commodities with existing tools and technologies and the level of segregation required is likely to disrupt global supply chains, leading to the exclusion of high-risk areas where engagement to address deforestation and forest-degradation is crucial. For several agricultural commodities, use of geo-localisation coordinates could have disproportionately negative impacts on smallholders⁴. Given the high costs of verifying traceability to the exact land plot, the likely consequence of this requirement will be to shift supply of commodities from smallholders to large plantations that are better equipped to provide geo-localisation coordinates of each shipment. This would undermine major progress in some geographies in improving the livelihoods of smallholders and local communities.

Without access to the EU market, smallholders may be forced to supply to countries which have lower environmental and social standards, resulting in practices that threaten the well-being of communities, forests and biodiversity. Given their low share of voice, smallholders have difficulties to achieve the basics that larger landholders may take for granted, such as obtaining legal land tenure. Geo-localisation of these informal sectors should not lead to their further marginalisation and rather should lead to their inclusion in formal supply chains. In most cases it would be appropriate that the EU allocate sufficient funds to assist smallholders in countries of production to attain the right level of traceability for the raw materials in question.

³ Indonesian law does not allow public disclosure of geo-location data with third parties

⁴ With regards to Palm Oil, RSPO defines smallholders as “farmers who grow oil palm, alongside with subsistence crops, where the family provides the majority of labour and the farm provides the principal source of income, and the planted oil palm area is less than 50 hectares. More than 3 million smallholders and small-scale farmers make a living from palm oil globally. While their farmlands are small compared to industrial plantations, in Malaysia and Indonesia alone, smallholder production represents approximately 40% of the total oil palm plantation area, making smallholders significant contributors towards a sustainable oil palm industry.

4. RISK BENCHMARKING SYSTEM

With regard to the risk benchmarking system put forward in the proposed regulation, AIM recommends that EU lawmakers provide the detailed methodology on the risk benchmarking, in particular on the weighting or timing of elements to be assessed.

The country-level benchmarking system should be tailored to sub-national (e.g. administrative region), landscape or ecosystem levels to provide local smallholders with incentives to improve their production practices so that their region is not considered 'high-risk'. A national system would not give incentives to local producers to improve their sourcing practices and create the risk of companies abandoning high-risk countries where impactful action on the ground to mitigate these risks is most needed. This would also create unintended consequences, such as penalising suppliers within high-risk countries who are making progress to produce and source sustainably.

The tiered system of due diligence requirements (simplified due diligence for low-risk origins and enhanced due diligence for high-risk origins) should be maintained, in line with the regulation's risk-based approach.

Finally, the European Commission should ensure a regular review of low, medium and high-risk classification at all relevant levels, in collaboration with producer countries and at intervals that will give sufficient time for companies to review and adapt their due diligence processes in the countries of production whose rankings will change, without disrupting company supply chains.

5. COOPERATION WITH THIRD COUNTRIES

AIM welcomes the inclusion of a specific provision on increased cooperation between the EU and third countries, including both producing countries and other demand-side countries, through the establishment of partnerships and the EU's involvement in multi-lateral fora.

The effectiveness of the regulation will be limited unless it is coupled with the strengthening of the enabling environment in producing countries to make progress on sustainable farming. Partnerships with producing countries should include, amongst other measures, **access to training and capacity building for smallholders and farmer cooperatives** is required to make progress on sustainable farming within producing countries. Closer dialogue with other demand-side countries should help to mainstream high standards of production, which is also key to avoid the creation of a two-tiered market, where 'clean' products are routed to the EU but products linked to deforestation find buyers elsewhere.

It will be critical for the European Commission and Member States to work with producer country governments to ensure EU legislation also supports their respective strategies against deforestation. Initiatives such as the FACT (Forests, Agriculture, Commodities and Trade) dialogue and roadmap launched at COP26 should be leveraged to maintain a constructive dialogue between the EU and the rest of the world.

6. COMMODITY-SPECIFIC GUIDANCE

Commodity-specific guidance will be key to ensuring effective implementation of the detailed requirements set out in the regulation pertaining to the due diligence process. It should, in particular, clarify what is meant by proving a "negligible risk" of deforestation and forest degradation, based on the model of the Conflict

Minerals Regulation with regard to conflict-affected and high-risk areas. Such guidance is also necessary to lay down the processes and rules for commodity-specific levels of traceability.

Sufficient time will be necessary to develop guidance, which is key for the implementation of the regulation. This guidance should be developed in collaboration with interested parties (countries of production, traders, operators and civil society organisations). There should be at least 12 months between the release of such guidance and the end of the transition period of the regulation, no later than 2025.

7. TRANSITION PERIOD

The transition period foreseen by the EU Commission proposal (12 months) risks being insufficient, since most smallholders and companies in third countries will be unaware of these new EU rules, whilst operating legally under the relevant legislation of the country of production. Under the current situation there is a risk that companies will only be able to source from large plantations, who would be the only operators potentially able to adapt to the new EU requirements within the mandated timeframe. **We call on EU lawmakers to introduce a more reasonable transition period – depending on the maturity level of a given commodity supply chain** which could range between 24-36 months – to allow smallholders, companies and other actors to put in place policies and processes to comply with the regulation while avoiding unintended consequences on the environment, farmers and local communities. The implementation period should also seek to align with commitments made by governments⁵ and financial institutions⁶, both key actors with significant leverage to accelerate action to tackle global deforestation. Moreover, the Commission should engage directly with third countries to raise awareness of the regulation and expectations from local traders to ensure that the rules are known and complied with.

8. PENALTIES

The regulation should provide for a scalable approach to penalties, with more significant fines in case of repeated serious breaches. The focus should be on the commodity concerned rather than imposing fines on the company's global annual turnover. Fines foreseen under EU regulations governing the safety of food and cosmetic products placed on the EU market could be used as a reference point for developing similar approaches. Penalties should be defined as clearly as possible at EU level, in order to avoid a patchwork of systems at Member State level that will lead to distortions in the internal market.

⁵ 9 European countries (including Belgium, Denmark, France, Germany, Italy, the Netherlands and Spain) have joined the Amsterdam Declarations Partnership and are committed to eliminate deforestation in relation to agricultural commodities by 2025

⁶ In November 2021, over 30 financial institutions committed to use best efforts to eliminate agricultural commodity-driven deforestation from portfolios by 2025

Brand manufacturers represented in [AIM – European Brands Association](#) operate and source globally. Many of our member companies are leading on responsible sourcing practices, seeking to minimise environmental impacts and ensure respect of human rights across their supply chains. From experience gained through our global collaborative sourcing initiative [AIM-Progress](#), it has become clear that supply chain verification and assessment processes are key to ensuring adherence of suppliers to brands’ responsible sourcing expectations and commitments; but verification alone will not improve overall supply chain sustainability. Remedy approaches and capability building, jointly with local stakeholders in risk-prone sourcing regions, are equally important for continuous improvement and rooting out unsustainable practices. Therefore, and in accordance with the UNGP-based approach of human rights and environmental due diligence, a primary focus of AIM members is supplier and stakeholder engagement to remedy shortcomings and to build capability to ensure that sustainable supply of relevant commodities in a global trading environment is guaranteed in the future. It is important that a harmonised EU framework on due diligence – which we fully support – addresses global deforestation as part of a smart mix of measures.