



AAK's progress report  
on sustainable palm oil  
– February 2017

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The Co-Development Company

**AAK**



# AAK's progress on sustainable palm oil

**Responsible sourcing of raw materials is fundamental to AAK and reflected in our strategy. We want to make a clear difference to the environment and to the local communities where our raw materials are grown and harvested. Palm oil being the highest volume as well as the most productive vegetable oil in the world is a crucial raw material in feeding an ever-growing global population. Therefore, producing palm oil sustainably is of utmost importance. In this progress report, we share with you AAK's part in the development towards a fully sustainable palm oil industry.**

## Palm oil achievements

### Traceability

- Traced 97 percent of palm oil, all palm kernel oil and derivatives back to mill origin;
- Updated all mills traceability data;

### Risk assessment

- Completed a qualitative risk assessment of all suppliers;
- Completed geospatial risk assessment of 100% supplier mills;
- Identified mills for our on-site verification program and completed five verifications in 2016, twelve in total;

### Supplier engagement

- Engaged in a dialogue with all our suppliers as regards progress of policy implementation, including the signing of AAK Palm Oil Policy,
- Completed two palm oil supplier engagement workshops engaging 40 mills in total;

### Processes and tools

- Developed an internal dashboard for detailed monitoring of progress and an external dashboard for communicating our achievements
- Finalized implementation of palm oil grievance procedure;
- Strengthened palm oil competencies among our global sales force through training and supportive materials;

### Customer support

- High level of support to our customers and the retailers.

### Smallholders

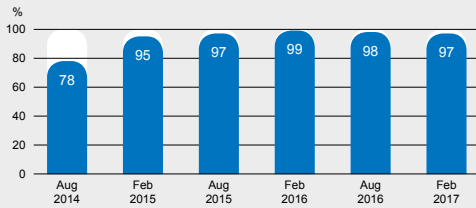
- Identified different options for smallholder project.

# Palm Oil DASHBOARD

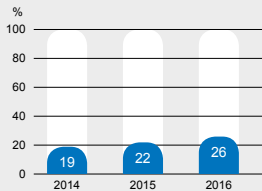


## Traceability

### To mill



### To plantation

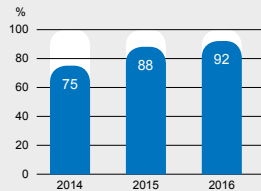


Traceability to mill remains high despite new AAK factories in the USA, India, China and Brazil that require time to implement AAK's Palm Oil Policy and high standard of traceability.



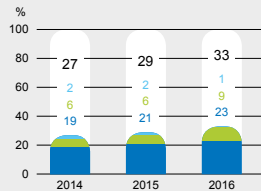
## RSPO status

### Volumes from RSPO members



It is our policy to source palm oil only from RSPO members. We are progressing towards that target, but some challenges remain in some parts of the world where we have factories and certification is not always a priority for growers.

### CSPO Demand



All our palm oil is under our Palm Oil Policy, risk assessed by Proforest.

- Book & Claim
- Mass Balance
- Segregated



## Risk Management

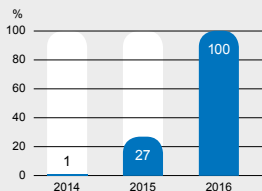
### Desktop risk assessment



Percentage of AAK's Palm suppliers risk assessed by Proforest:

100%

### Geospatial risk assessment

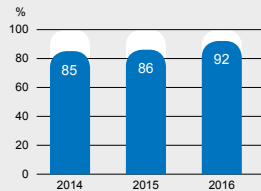


Volume covered by geospatial risk assessment.



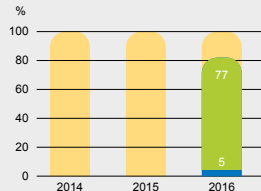
## Suppliers Engagement

### Supplier Code of Conduct



Volume covered by signed supplier Code of Conduct.

### Palm Oil Policy



- Suppliers informed about AAK's Palm Oil Policy
- Signed AAK's Palm Oil Policy
- Has aligned Policy (verified by Proforest)

## Other

6

Number of progress reports



394

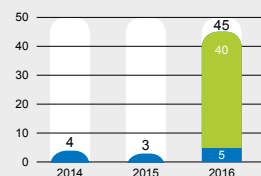
Number of AAK employees trained in AAK's Palm Oil Policy and Actions



### Mill engagement



Higher priority suppliers invited to workshops facilitated by Proforest.



- Number of mills who attended a Proforest/AAK workshop
- Number of on-site audits

# Traceability progress – through cooperation with our suppliers

Traceability to mill remains a prerequisite for how AAK assesses compliance of its palm and palm kernel oil supply chain with its sustainable palm oil policy. We are delighted that we have maintained a high level of traceability throughout 2016, despite additional challenges from expansion of the AAK group into new geographies which traditionally have not embraced traceable or sustainable palm oil, such as India and China.

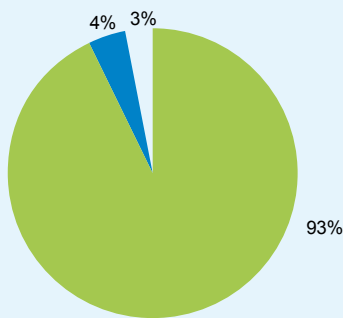
The focus on traceable supply chains continues to be strong. More suppliers are openly sharing or joining programs to facilitate that traceability is well defined and well reported.

However we continue to see challenges on traceability of palm kernel oil and derivatives, and we welcome initiatives to improve traceability.

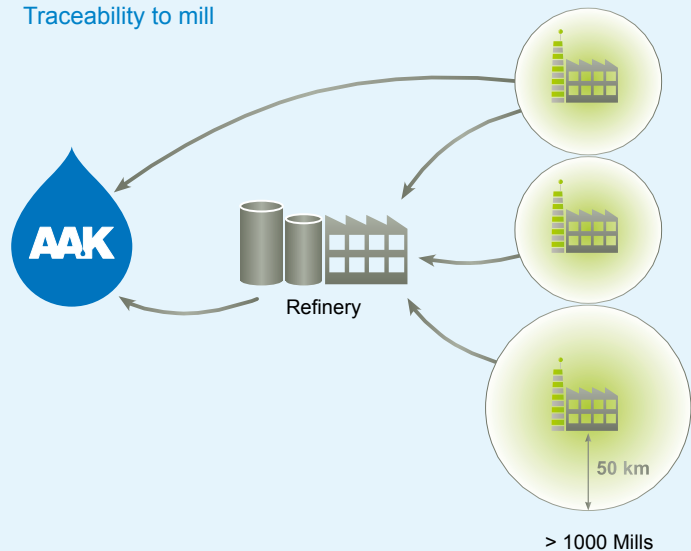
With acquisitions made by AAK in 2015 and 2016, and new greenfield developments, our work on traceability has spread to new parts of the world. These new supply chains are being aligned with AAK standards, including California Oils, the most recent acquisition. In 2016 our factories in Brazil and China commenced operations, with particular challenges due to the relatively high level of traded products in these areas.

## Traceability to mill status – February 2017

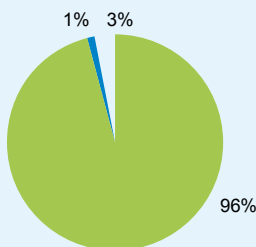
Overall progress 97%



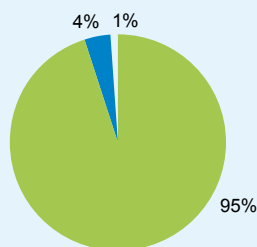
Traceability to mill



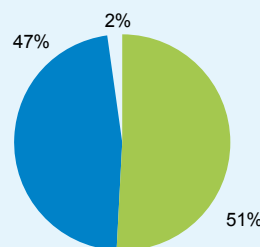
Palm oil from origin 97%



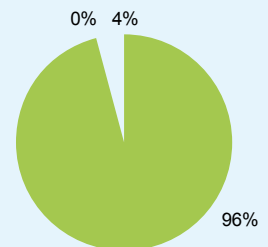
Palm kernel oils 99%



Palm oil – others



Derivatives 96%



**Indirectly traceable**

Our suppliers of the oil have an own policy with traceability that has been verified by Proforest and that we trust



**Traceable to known source**

AAK has a list of mills the oil can come from which relates to a specific refinery

# Traceability to plantation

For AAK, traceability to plantation is defined as follows:

Palm oil and palm oil by-products in AAK products are traceable via the upstream supply chain to the supply base of the identified crude palm oil mill, including:

- Estate information (> 50ha): estate names, parent company names, certification status, % of overall FFB tonnage to mill and a GPS point coordinate
- Dealers: dealer names and % of overall FFB tonnage to mill
- Smallholders (< 50ha): number of smallholders, certification status and % of overall FFB tonnage to mill

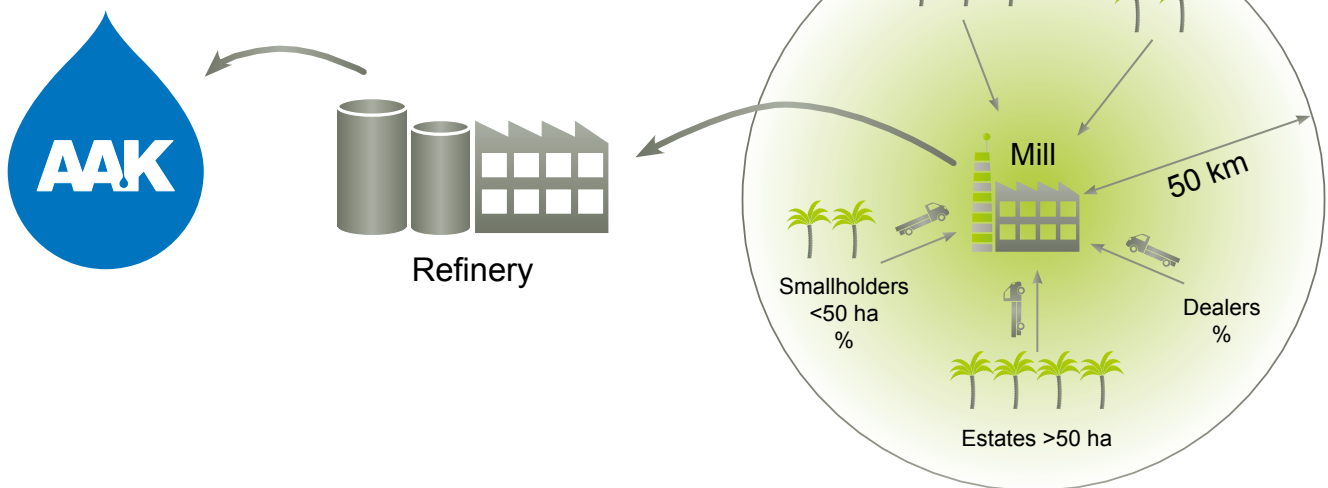
AAK has focused most palm sustainability efforts on establishing traceability to mill, followed by Proforest's risk assessment of suppliers and mills, engagement with suppliers, and on-site mill assessments for those identified as the highest priority. It is generally agreed that more than 90 percent of fresh fruit bunches delivered to a mill derive from growers located within 50 kilometers of that mill. Hence, focus on mill traceability and assessment provides very good coverage of growers too.

Taken together with the large number of mills in AAK's extended supply chain (more than 1,000) and difficulties in identifying unique names for mills, the identification and recording of names, parent company names and GPS coordinates for every grower supplying those mills is a Herculean task which AAK judges to have far less impact than tracing to mill and the subsequent risk-based approach adopted.

However, AAK does expect mills in its supply chain to maintain such records to provide basic traceability to plantation, and on-site mill assessments seek to verify this is in place. Such traceability to plantation is important since there are – as recent reports on the Leuser ecosystem in the Aceh province of Indonesia show – non-compliant third-party growers which may find ways (for instance through intermediary dealers) to have their production enter the supply chain.

AAK has made significant progress on traceability to mill, subsequent risk assessment and policy implementation. But we are not yet satisfied. Traceability to plantation by the end of 2017 was a challenging target. AAK has made a positive decision to maintain traceability to plantation as an objective, but to defer the target date for 100 percent traceability from 2017 to an ambition of 2018/19. AAK will undeterred pursue full traceability to plantation and continue to report regularly on progress.

## Traceability to Plantation





## Update of AAK's Sustainable Palm Oil Policy

In June 2014 we saw the need to launch a policy specifically focusing on our commitment towards obtaining a fully sustainable palm oil supply chain. During our move towards a fully sustainable palm oil supply chain we have overcome many challenges and achieved significant progress towards our objectives.

In January 2017 we updated our palm oil policy. The main changes are:

- ◆ Traceability to plantation: AAK will achieve full traceability to plantation as soon as practically feasible with an ambition of achieving this goal in 2018/19 while still regularly communicating on progress.

- ◆ New commitment to support smallholders: during our journey towards a fully sustainable supply chain, we have recognized that the many smallholders that constitute a significant proportion of the palm oil production need special focus.

Smallholder inclusion in the supply chain is a key issue which is why we in our revised policy have included a new commitment to support smallholders.

See our updated palm oil policy page 18–19.

# Updated geospatial risk assessment methodology

Proforest has undertaken supplier risk assessments on behalf of clients for several years. This experience has helped us to develop more sophisticated methodologies; in fact, it is a constantly evolving process, as new data, tools, and thinking become available.

With AAK, Proforest currently performs two kinds of risk assessment: one focuses on Tier 1 suppliers and is more qualitative in nature; the second has a mill-level focus and looks at the geospatial risks that are present in a mill's potential supply base. It is this second type of risk assessment that is the focus of this article.

As part of its commitment to traceability, AAK maintains a record of the geographical coordinates of all the mills within its supply base. A 50km radius ring is applied to these coordinates to estimate the mill's supply base, as this is the distance that FFB can travel for processing before it begins to spoil and lose quality. In reality the actual supply base is unlikely to be so large or radiate out equally from the mill in all directions, it is likely to be heavily influenced by factors such as infrastructure (i.e. roads) and topography. The 50km

radius ring remains the accepted method for calculating a mill supply base, but this is likely to change as better data becomes available.

Within the radius ring four indicators are assessed: (1) general deforestation, (2) deforestation on peat, (3) deforestation in protected areas, and (4) number of fires. The three deforestation indicators are comprised of two measurements each: hectares of forest loss in 2013-2014, and hectares of forest remaining in 2015. For the peat and protected areas indicators, this deforestation data is overlaid onto peat maps and protected area maps respectively. These two measurements are required for each indicator because historical deforestation trends are indicative of present deforestation likelihood, but forest must be present in order to be at risk of deforestation. For fire risk, the number of fires that occurred during 2014–2015 within the 50km radius ring is summed.

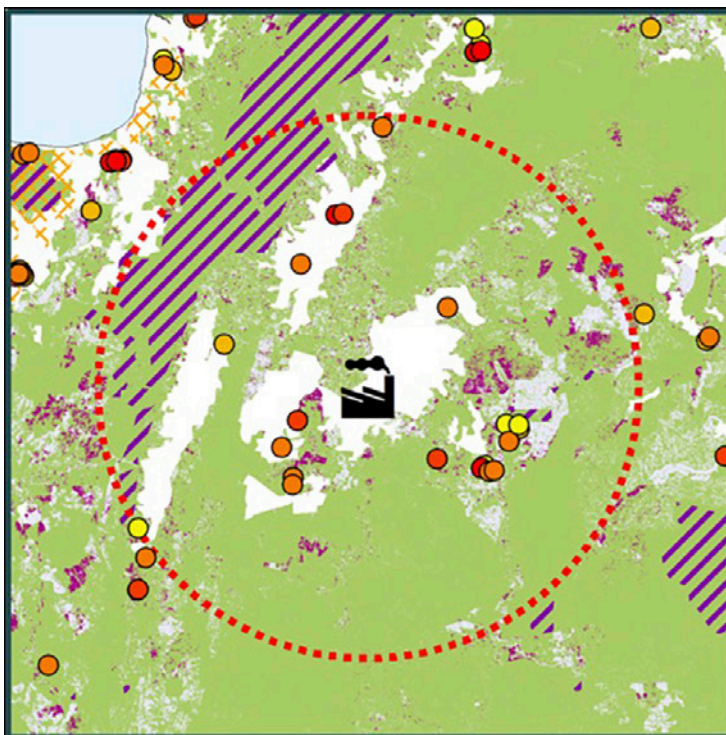
< 0.2	Lower risk
0.2 – 0.4	Medium risk
0.4 – 0.6	Medium – high risk
0.6 – 0.8	High risk
> 0.8	Extremely high risk
















Each mill is then assigned a risk category for each of the four indicators individually. An overall risk category is not calculated, as an overall value may mask specific risks present in a mill's potential supply base. For example, if a mill's location presents a high risk for deforestation on peat, but is lower risk for everything else, the lower scores on the three indicators will 'dilute' the overall risk score and hide the fact that peat is potentially an issue within the supply base.

In addition to a calculated risk value for each of the four indicators, the tool also allows the creation of maps to visualise the data. As with the risk categorisation, this can be done on a range of scales. Larger scale maps on a country or state level permit identification of clusters of higher risk mills in a particular landscape, which can be a good way to prioritise mills for engagement. Smaller scale mill level maps can also be produced to identify specific areas of interest within a 50km radius ring.



-  Target mill
-  50km buffer
-  Forest cover
-  Deforestation pre-2013
-  Deforestation 2013–2014
-  Other land use (e.g. plantation)
-  Peatland
-  Protected area
- Fire occurrence*
-  < 30% confidence
-  30–70% confidence
-  >70% confidence

Example mill level risk map

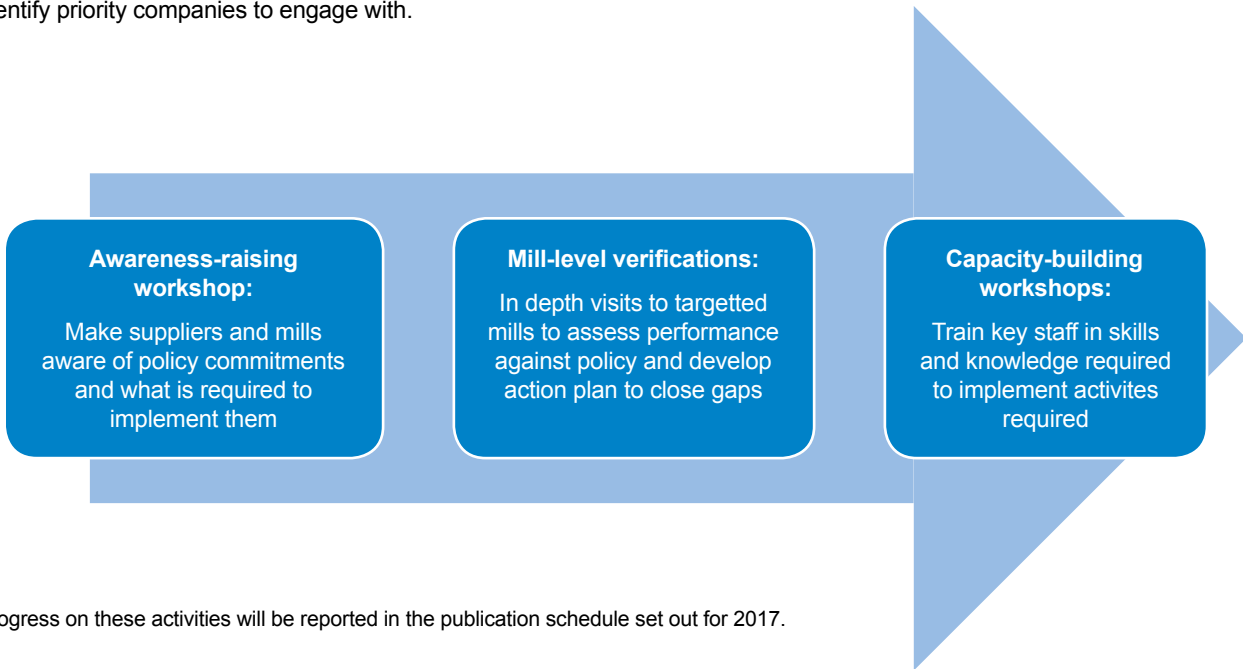




## AAK risk assessment activities in 2017

By the end of 2016 all AAKs mills had undergone a geospatial risk assessment on a global level using the new methodology described above. In 2017 this data will be analysed at different relevant scales, including by supplier, and on national and subnational levels where required or appropriate. The Tier 1 supplier risk assessment methodology will also be updated to incorporate new thinking and new data, and all of AAKs Tier 1 suppliers will be reassessed in Q1 2017 to identify priority companies to engage with.

This engagement will take the form of workshops to raise awareness of AAK policy commitments, and to build capacity of key staff at suppliers and mills in order to implement the changes required. The programme of in depth mill-level verification visits will also be continued from last year. The diagram below illustrates the process.



Progress on these activities will be reported in the publication schedule set out for 2017.

## Supplier mill engagement

Since the last Progress Update Report, Proforest has carried out one awareness raising workshop for mills located on Peninsular Malaysia that supply through a specific strategic supplier. Two of these mills were selected for mill-level verification visits that took place in October and December, and depending on the findings and support needed from the mills will be included in relevant capacity building workshops.

To ensure that our suppliers are committed to work towards a sustainable standard, we have engaged with each of them and asked them to acknowledge and sign our palm oil policy. This has now become a key requirement for becoming a supplier of palm oil to AAK, and will ensure that all new suppliers are committed to work towards the standard which is stated in our AAK Sustainable Palm Oil Policy.





## Grievance activities

As a founder member of the Roundtable on Sustainable Palm Oil (RSPO), AAK is committed to driving high sustainability standards throughout the palm oil industry. This commitment begins with our own supply chains.

AAK's Sustainable Palm Oil Policy and Supplier Code of Conduct set out our commitment to sourcing responsibly produced palm products. Fully implementing our policies can be challenging, because of the scale and complexity of our supply chains.

AAK has no direct grievances to report relating to plantations, because AAK does not own plantations. We source from a range of suppliers incorporating more than 1,000 mills. We are committed to tracking activity in the marketplace, and monitoring numerous NGO reports and scorecards to identify non-compliance with our policy.

Many of our suppliers are proactive and work to identify potential issues before they arise, or address them as early as possible.

Should a grievance relating to the AAK supply chain be raised through the RSPO grievance process, AAK will monitor the prescribed RSPO process. As an additional approach, we established our own grievance procedure to enable stakeholders to highlight any perceived issues in AAK palm oil supply chains, and to ensure they are approached in a timely, transparent and systematic manner.

AAK also includes reviews of third party (in particular NGO) reports in order to proactively identify potential grievances against suppliers. Examples of such reports include recently released documents by Amnesty International, Greenpeace, Mighty Earth and others, as well as particular issues relating to human rights in Borneo which have been brought to our attention by Swedwatch.

The procedure applies to AAK operations worldwide and to all third-party palm oil suppliers. It covers the following steps:

- Recording grievances and communicating with relevant parties;
- Developing plans to investigate a grievance;
- Deploying a field verification team where appropriate;
- Creating and implementing action and monitoring plans to resolve grievances.

If a supplier breaches AAK policies and is not able to resolve the issue related to the grievance, AAK will terminate commercial relations with that supplier.

AAK welcomes feedback from stakeholders on the grievance procedure, in order to measure the effectiveness of our policies and continue to improve them.

See grievance flow chart page 16.

# AAK and the RSPO

During the course of 2016 the RSPO has received more criticism than in almost any other year, including matters relating to membership suspension and reinstatement, quality of certification procedures, and increasingly relating to human rights.

As a founder member and ever-present Board member (re-elected for a further two-year term at RT14 in 2016), AAK is a long-term supporter of the RSPO, which is the benchmark for sustainable palm oil and the most credible global multi-stakeholder initiative and certification scheme for palm sustainability. Overall progress of the RSPO compares well with other similar industry initiatives, but there is no doubt that there is plenty of scope for further development.

RSPO certification is one of the parallel sustainability streams followed by AAK, the other being our own policy and implementation plan. Our target is for all palm oil (crude and refined) sourced by AAK to be RSPO certified by the end of 2020. This is a challenging objective, mainly because customers (and consumers) of many regions in the world show limited enthusiasm for RSPO certification, and are unwilling to pay the current premium over conventional palm oil. Without commensurate customer demand, like other processors AAK will find it difficult to move entirely to fully certified palm oil.

## Issues and concerns

There are particular issues in AAK's new markets such as China, India and Brazil. In China RSPO certified palm oil remains difficult to source. In Brazil demand is limited despite a strong focus on Amazonian deforestation. In India we have some hopes that local production of palm oil can be extended from its current low base (about 250,000 MT annually) in a sustainable way, to encourage further use of RSPO certified sustainable oil. However, for the time being demand for sustainable palm oil remains a small proportion of overall demand for palm oil, which in many parts of India is viewed as a cheap alternative to other oils. In a country with high levels of poverty, paying more for sustainability is not easy for all.

The RSPO now boasts more than 3,000 members. However, we are concerned that many members (often in the Traders and Processors or Consumer Goods Manufacturers categories) are passive and do not participate except where they are required to do so by their customers. At the same time new certification of mills is not happening fast enough – there are not enough applying to become certified. It is additionally troubling that certification is dominated by relatively few companies – more than half of the production of certified sustainable palm oil is from certified mills owned by five major plantation companies.

AAK is concerned that premiums for certified sustainable palm oil, which can be high in particular for palm kernel oil or for fractions, provide a disincentive to encourage further certification for those owners of mills and associated plantations already certified, and often in positions of influence, as increased supply without commensurate increase in demand may reduce premiums. It is in the financial interest of such companies to maintain the niche status of RSPO certified palm oil. This dilemma is not so easy to resolve. We must congratulate and support those who have reached the goal

of RSPO certification, but also encourage those who are still outside to become certified or at least improve sustainability credentials.

In particular we feel that the RSPO bar has been set too high for smallholders and small farmers (up to 500 hectares). While we congratulate those who have risen to the challenge of RSPO certification, it is essential to see greater participation from smallholders and small farmers, even at a lower level of certification, together with a commitment for continual improvement. It is generally accepted that smallholders comprise around 40 percent of total production. How can we have real progress without them?

## Future developments

The greater involvement of government, in particular relating to jurisdictional approaches to RSPO certification, particularly in South East Asia, but also emerging in Africa and Latin America, is very welcome and indeed may be regarded as a necessity to increase RSPO certified production given the limits of the global market noted above. Appropriate governmental intervention is essential in producing countries, as there are signs that the market may be reaching its limits.

Internal issues continue to irritate those close to the RSPO and to provide ammunition for its critics. It is essential that certification bodies do a full and proper job of certification and that Accreditation Services International independently verifies the quality of the work done by such certification bodies. There are undoubtedly issues to address here for the RSPO.

On a more positive note, AAK is pleased to see progress in developing a more robust complaints and appeals procedure and looks forward to its implementation in 2017.

In other future developments, we are concerned that the review of RSPO principles and criteria, which is to commence imminently, addresses the weaknesses evident in the current version, and also that RSPO Next does not become another premium niche, raising the bar for the best, but leaving others behind in its wake.

We recognise the importance of RSPO certified sustainable palm oil to feed the growing world population and at the same time to minimise use of land in sensitive areas by taking advantage of the significant yield differentials versus other vegetable oils. However, we are concerned that relatively high additional sustainability and food safety premiums for palm oil (for instance relating to 3MCPD and glycidol), together with potentially lower liquid oil bio-diesel demand in developed markets, may open the door for substitution of palm oil by fully hydrogenated and interesterified soft oils, such as rapeseed oil.

The RSPO's success in many ways has also led to greater scrutiny, which AAK welcomes, but which also lays bare issues which are both urgent and important. We will continue to work within the Board and in standing committees and working groups to move the RSPO forward, to address those issues and develop new solutions.

Tim Stephensen  
Member of RSPO Board



## Smallholders

AAK is very aware that smallholders comprise around 40% of global palm oil production, and likely a similar proportion of AAK's palm oil purchases. Smallholders form a relatively small proportion of RSPO certified production, particularly independent smallholders, and have very specific requirements regarding sustainability. From a social perspective there is a requirement for smallholders, often supporting extended families, to be allowed and assisted to make a reasonable living from the land they farm. At the same time there are issues around land ownership, communal rights, labour (for absentee smallholders for instance), deforestation, burning and development on peat. This is a complex issue. AAK's new approach is to balance these requirements. We are developing a smallholder code of practice, together with Proforest, which will seek to engage with smallholders by

improving livelihoods, and seek to move in parallel to push forward sustainability practices. We will seek continuous improvement as a goal in itself, which may or may not lead to RSPO certification. We are currently discussing with suppliers specific projects to apply this approach in different continents.

Simultaneously we seek to influence the RSPO's approach to smallholder certification during the current strategic review. We will continue to seek support for our approach, which is similar to some others adopted, and to lobby for appropriate changes.

The following article is a personal article from Bob Norman who travelled to Malaysia and India to investigate smallholder projects for AAK.

### ” Oil palm smallholders

Smallholders are referred to with an increasing frequency amongst manufacturers and retailers who all want to give them their support. Smallholders are, of course, extremely important as they contribute to over 40 percent of the oil palm production in Indonesia and Malaysia – and up to 80 percent in other growing regions. We use the term smallholders in a generic way but are all smallholders the same? A recent trip that took me to Malaysia and India illustrates that they clearly are not.

My first port of call was the Johor region of Malaysia where I was to visit collection centers for Fresh Fruit Bunches (FFB) from all the local smallholders. The collection centers are the focal point for about 300 smallholders and provide a route to the mills to process their FFB. Johor, located in the southern part of Peninsular Malaysia, is a four-hour drive from Kuala Lumpur.

Here I visited 2 collection centres, these were not chosen in random but had been part of the first phase of a project coordinated by Proforest. I joined representatives from Proforest's team in the field who explained that the ambition is to improve the livelihoods of smallholder farmers by encouraging improvements in farming practices.

#### [Johor collection centers](#)

The first collection center I visited was run by a Mr. Khamis, who was very pleased to receive us. He explained that very few people from outside the area had shown interest in them. The smallholdings supplying FFB into his collection center had been established for a long time and were being



farmed by families for several generations. They were very set in their ways and their farming practices resulted in very poor yields.

I explained to Mr. Khamis that AAK shared the same ambitions as Proforest – to improve the livelihoods of smallholders and that the reason behind my visit was to look at ways to contribute to the project initiated with Proforest. I was then invited to visit a typical smallholding where the issues were very evident.

The smallholding was two hectares in size and the trees were approaching 30 years old. They were suffering from a variety of issues ranging from disease, deficiencies in vital nutrients and an overall poor care. The problems did not stem from the farmers themselves but rather from a lack of up-to-date farming techniques. Farmers all over the world are proud and hardworking and strive to produce more out of their land, and these smallholders were no different. All they lacked was some knowledge that would help them make small changes possible.

The second collection center I visited was managed by a Mr. Hairul and he conveyed a very similar situation to Mr. Khamis'. He also had not experienced any external support and was very grateful for my visit. He was passionate about the environment and recounted stories from his childhood. As a boy, he explained, he used to fish in the local river – something he wasn't able to do as a grown man since all fish had disappeared because of pollution.

Sustainability resonated well with him as better farming practices form part of the RSPO standard together with the environment, biodiversity and social element. He also mentioned that his local smallholders were since long established, very set in their way and in need of help in better farming practices.

It immediately became clear that AAK could play an important role in providing access to training for the smallholders – to improve the use of fertilizers and pesticides, general maintenance of the land, water management, and trialing a program to harvest FFB three times a month, instead of twice a month – a technique that has demonstrated an improvement in yield.

AAK has now committed funds to provide training for these Better Farming Practices. A program will be devised and implemented during this year. We are convinced that our contribution to the project will make a real difference to the smallholders in Johor.

### Smallholders in India

Back to the question that was asked initially, are smallholders all the same? I continued my trip and went looking for answers in India.

India is perhaps not the first country that people associate with oil palm production, and rightly so. Despite production being low, consumption of palm oil, however, is high in the country. Therefore, India has to import large amounts and initiatives are being taken to increase local production.

I visited three mills in the Andhra Pradesh region of India and the similarities between them were astonishing. They were all supplied by smallholder farmers and the mills had a direct relationship with the farmers, coordinating collections and deliveries of FFB. Each mill had a dedicated team to provide technical support to farmers and also provided access to high-yielding seedlings.

When visiting the farmers themselves the difference from Johor could not be clearer. The smallholdings in India were relatively new, established 8–10 years ago. The holdings had been converted from other crops, such as mango, so there were no deforestation concerns. There were no peat issues either, nor any water management concerns thanks to optimized irrigation systems. There were no diseased trees and the land was clear and well maintained. Furthermore, there was intercropping with other products like cocoa, and the farms generated their own compost from old fronds and empty fruit bunches collected back from the mills.

There was one major consistency between the farmers in Johor and the ones in India – they all wanted to improve the yields generated from their land. Clearly, there are different baselines and my trip has highlighted perhaps the two extremes. As oil palm smallholders around the world have different needs and requirements, AAK will continue to make a difference and look into ways where we can support them in achieving their own ambitions, and, as a result, introduce them to the first steps towards sustainability.

Bob Norman,  
AAK Smallholder  
Project Manager





# GreenPalm

## – the success story

After eight years of supporting the RSPO by providing an innovative certificate trading system and related support and marketing, the contract of GreenPalm (owned by AAK) with the RSPO has been terminated. GreenPalm will cease to operate as a certificate trading system on 31 March 2017, being replaced by Palmtrace.

It is appropriate to recognise the benefits which GreenPalm has provided to the RSPO, growers, manufacturers and retailers over this period.

### GreenPalm

Certificate trading for RSPO certified suppliers conceived, administered and managed by AAK from 2008 to 2016.

#### Achievements:

- 19 million certificates traded (3.9 million alone in 2015)
- US\$19 million paid to the RSPO, supporting administration and growth
- US\$115 million paid to growers, incentivising further certification
- The only transparent pricing mechanism for RSPO supply chains
- The best access to market for certified independent smallholders, with a separate premium market
- The only access to support certified supply for many manufacturers and retailers
- Direct marketing and helpdesk for RSPO supply chains
- Replaced by the RSPO's own PalmTrace in 2017





## Transition in supply chain

As discussed in the previous report, the operational challenges with sustainability are mostly related to the handling of sustainable segregated palm oil because this oil, by its very definition, requires a separate route through the production process. Because not all of our customer base as yet demands sustainable segregated products (or is prepared to pay for them), we often still have to handle the conventional product as well and thus we are often increasing the number of different components we handle on site.

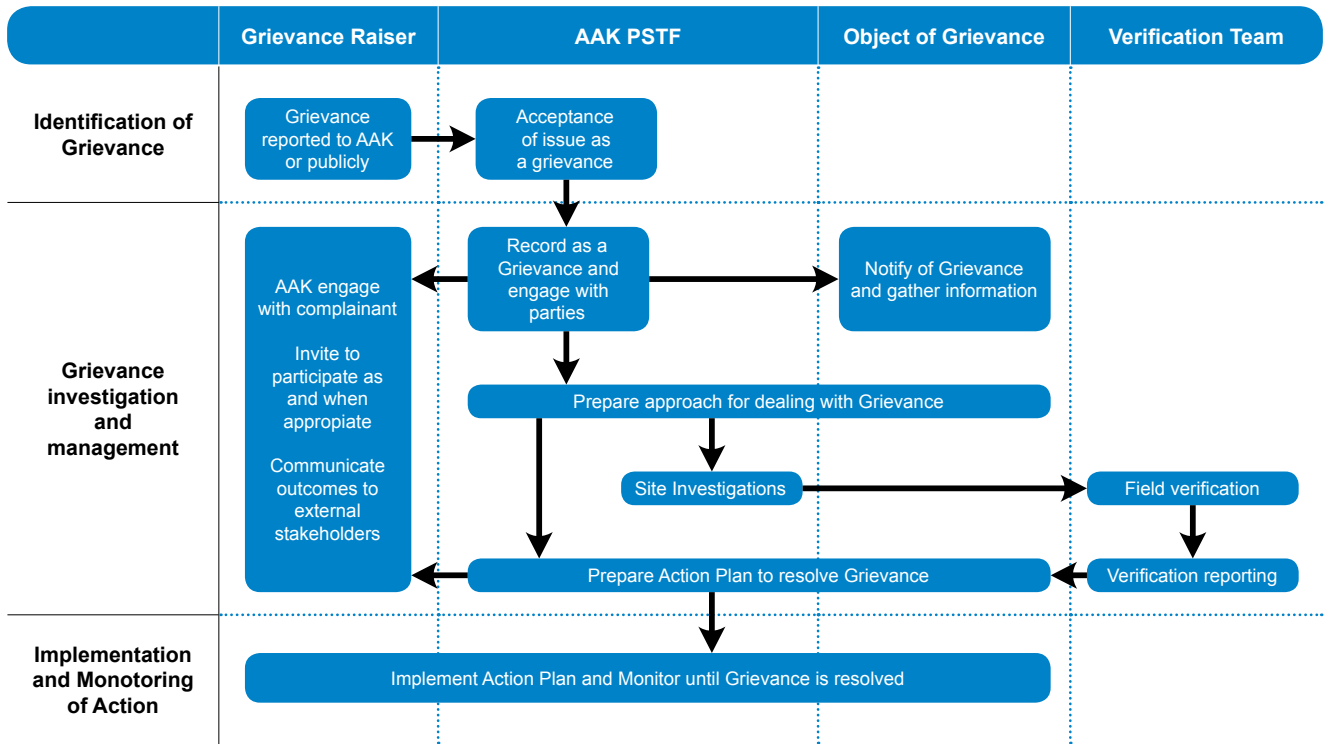
During 2016 we have continued to increase our range of offerings of sustainable segregated palm products. In particular we have been able to improve our offer on palm kernel oil-based material from our Zaandijk site in the Netherlands offering a range of products as an SG alternative. In addition, we have invested in additional tank capacity at our site in Karlshamn, Sweden and have been able to introduce a number of new SG materials there. As each component affects a number of finished products we have increased the range of available products substantially.

As we have worked on this we have also had to consider our route for getting these components from our suppliers in South East Asia to our sites in Europe. As our range of materials become more complex and diverse, traditional shipping methods are less effective and we need to look at alternative methods of shipping. Obviously, any changes to shipping methods also have to be managed at our receiving sites in Europe and we are currently looking at ways to handle this.

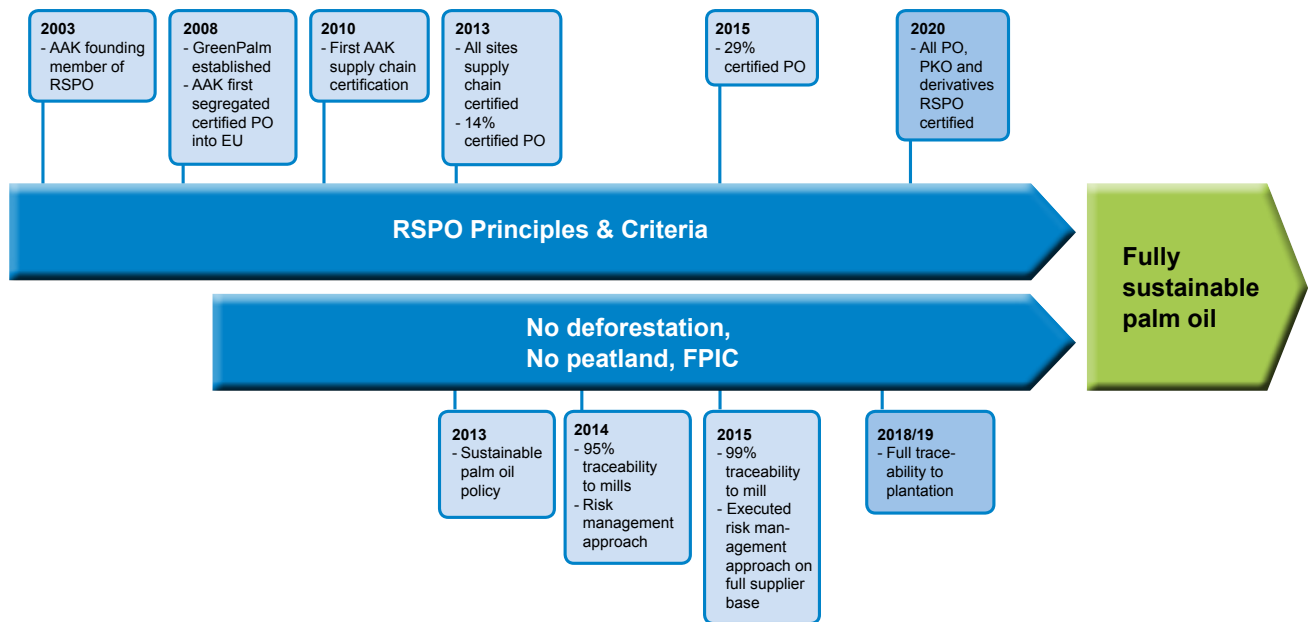
An important part of the supply chain role is to try to anticipate future demand. This applies especially to SG material. This has been a particularly demanding task in 2016 as the volatile market has affected customer demand, and some limited material availability in the second half of the year has made accurate forecasting of paramount importance to ensure we do not disappoint any of our customers.

The transition to a fully segregated offering continues to be very demanding in the short and medium term as we continue to widen our offer of fully segregated sustainable options, thus increasing operational complexity significantly. However, we continue to make progress where there is customer demand and know that ultimately the pressure will ease significantly once the transition is complete.

# Grievance flow chart



# Towards sustainable palm oil





# Key next steps for AAK

In 2017 AAK will

- pursue its overall objective of 100 percent traceability to mill origin for palm oil, palm kernel oil and derivatives
- risk assess new suppliers and continue to keep risk assessment updated on existing suppliers
- identify mills most at risk of non-compliance with the AAK Sustainable Palm Oil Policy
  - identify those origins where there is significant risk of policy non-compliance
  - continue the geospatial risk assessment for the whole supply base
  - continue the mill verification of higher-risk mills
  - focus greater scrutiny on higher-risk mills, including field-based verification
- follow up on identified non-conformities/non-compliances and ensure closure as soon as possible
- proactively manage any potential grievance issues
- continue to increase our active engagement with suppliers to ensure policy compliance, including targeted workshops with supplier mills
- further develop a palm oil smallholder support project, as we believe making a real difference with smallholders is at least as important as raising the bar for the top performers, with a potentially more significant impact on palm oil sustainability



## AAK Group Policy: Sustainable Palm Oil

Sustainable sourcing of raw materials is part of the backbone of our strategy. Raw material sourcing is also an area where we want to make a clear difference, to the environment and to the local communities where the raw materials are grown and harvested.

Just as it is vital for us to obtain the right raw materials, we place equal emphasis on sustainable growing and procurement. Our Supplier Code of Conduct includes a requirement for all raw material suppliers and their supply chains to adhere to fundamental UN Global Compact principles of labour and human rights, environmental protection and anti-corruption, and to national laws in the country in which the supplier conducts its activities.

AAK recognizes that palm oil is the world's leading vegetable oil in terms of production volume and consumption. Palm oil is also the most efficient vegetable oil with a production volume per hectare almost six times greater than the volume produced per hectare for rapeseed and ten times greater than for soy. Hence, it is a very critical raw material in feeding an ever-growing global population. Therefore, producing palm oil sustainably is of utmost importance to all of us. AAK is committed to its role in supporting the move towards full sustainability in the palm oil industry.

Specifically, AAK makes the following commitments:

- AAK is a founding member of RSPO, the Roundtable on Sustainable Palm Oil. We continue to be very engaged in the RSPO, and its Board. AAK recognizes RSPO certification as the only established and stable systematic organization and standard for sustainable palm oil. RSPO is not perfect. However, it is important to have one well-established recognized system rather than a series of individual systems and organizations, which add complexity and might prevent progress towards a fully sustainable palm oil supply chain. AAK is committed to increasing the volume of RSPO-certified raw material that it purchases, with the ultimate objective to achieve RSPO certification of all palm oil, palm kernel oil and derivatives purchased.
- We also see a need for further progress towards full sustainability in the palm oil supply chain, beyond the current RSPO certification requirements. AAK is therefore also committed to sourcing palm oil that has been produced **without deforestation or destruction of peatland, and where plantation development only takes place with the free, prior and informed consent (FPIC) of any affected local community.**
- AAK's policy is to ensure full traceability in our palm oil supply chains. This means having **traceability to mills** and **traceability to plantation level**. Traceability is fundamental to our risk management-based assessment and as the basis for assuring supplier compliance with the requirements in this and related policies.
- More than 40 percent of the global palm oil production comes from smallholders. AAK recognizes that smallholder inclusion in the palm oil supply chain is a key issue requiring action on a number of fronts. AAK's policy is to initiate projects which encourage and support smallholders to make practical, stepwise changes to best practice that will support smallholders towards achieving RSPO certification, and to work within the RSPO to improve smallholder access to RSPO certification.

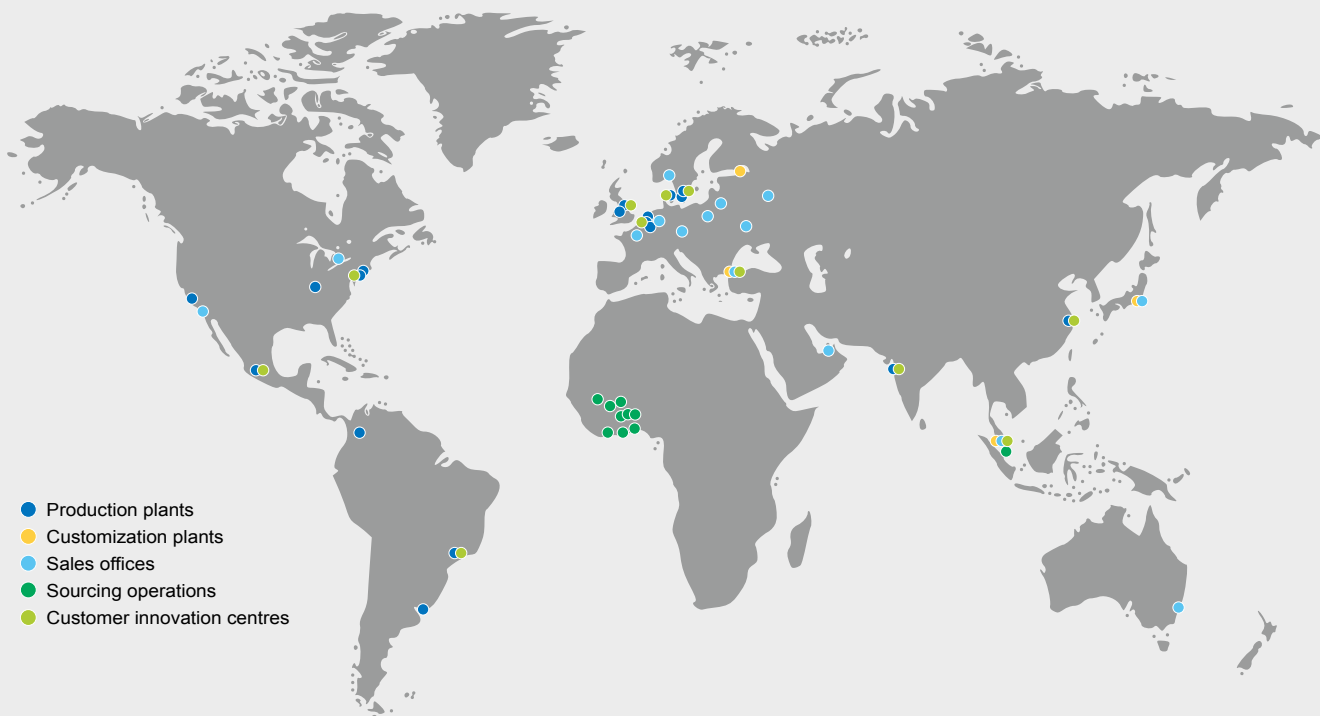
- Our selection and approval criteria for palm oil suppliers is based on RSPO membership, signing and committing to our Supplier Code of Conduct and this Sustainable Palm Oil policy, and our general questionnaire and requirements relating to quality management, food safety, environment, social and other issues. Our mechanisms for implementation of these commitments include supplier engagement at different levels. We also conduct site-based assessments of our suppliers and their supply chains regularly, including with external third-party assessors.
- This policy applies to all palm oil, palm kernel oil and their derivatives at all origins.

If AAK becomes aware of a supplier violating or breaching AAK's Supplier Code of Conduct or these policy commitments, AAK will take appropriate action to investigate the issue within the framework of our grievance process, and will seek to work with the supplier to resolve it. If no adequate resolution can be found, AAK will terminate commercial relations with the supplier.

AAK will regularly communicate progress relating to the implementation of this and related policies in its Progress report on sustainable palm oil.

Yours faithfully,  
AAK AB (publ.)

Arne Frank, President and CEO  
January 2017



# The first choice for value-adding vegetable oil solutions

We develop and provide value-adding vegetable oil solutions in close collaboration with our customers, enabling them to achieve long lasting business results.

We do so through our in-depth expertise in oils & fats within food applications, working with a wide range of raw materials and broad process capabilities.

Through our unique co-development approach we bring together our customers' skills and know-how with our capabilities and mindset. By doing so, we solve customer specific needs across many industries – Chocolate & Confectionery, Bakery, Dairy, Special Nutrition, Foodservice, Personal Care, and more.

AAK's proven expertise is based on more than 140 years of experience within oils & fats. With our headquarters in Malmö, Sweden, 20 production facilities and customization plants, and sales offices in more than 25 countries, our more than 2,800 employees are dedicated to providing innovative value-adding solutions to our customers.

So no matter where you are in the world, we are ready to help you achieve long lasting results.



Explore more at  
[www.aak.com](http://www.aak.com)

We are AAK – The Co-Development Company.

