Climate Change – Sustainable Forests and Finance

Thematic Engagement Baseline Report – February 2022

Executive Summary – ***Approved for public disclosure***

SUSTAINALYTICS

a Morningstar company

EXECUTIVE SUMMARY

Climate risks and forest value chains

Climate change continues to be ever-present as one of the largest risks to both the world, investors and companies globally. Meanwhile the understanding of key links between, deforestation, emissions and nature continues to be better understood. With agriculture linked emissions and deforestation experiencing continuous increases, also continues to be the main driver of deforestation, forest fragmentation, and the associated loss of biodiversity. As demand for food and other resources continues to grow, forests are often cleared to make way for new fields and plantations, mostly for commodities, such as cattle, soy, palm oil, timber, etc. Deforestation also significantly exacerbates climate change, currently contributing approximately 24% of all GHG emissions from land-use activities, more than that emitted by the world's entire transport sector.[1]

The complexity of the forest value chain—where a large number of companies are involved across sourcing, trading to processing and consumption, as well as the financiers—represents a challenge to reform. Unless urgently addressed, emissions from agriculture could become the dominant source of global emissions by 2050,[2] while only 3% of climate finance today is currently aimed at forests and land use.

Developments and engagement activities from September to February 2022

This first bi-annual report covers the period of engagement that took place between September to February 2022, following the publication of the baseline report in September 2021. Sustainalytics has been actively pursuing company participation in this initiative, through introductory and initial engagement meetings. The focus of our first engagement calls was on understanding the respective companies' current practices and clarifying their disclosure, advising in relevant cases investor expectations on developing material issues, on climate, nature and deforestation. Many companies were keen to hear an investor's perspective and were receptive to suggestions.

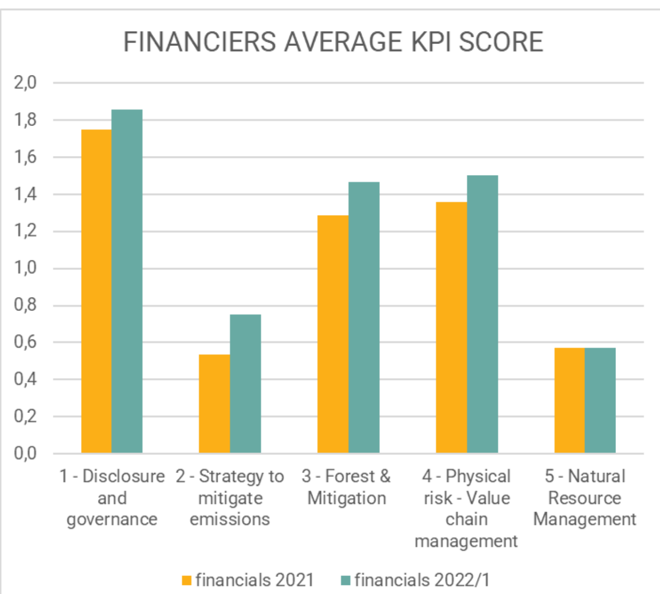


Figure 1 – Graphs showing the average KPI score across the financiers in the value chain, the minimum score being 0, while the maximum score is 3.

Throughout the engagement, Sustainalytics assesses the engaged companies on 5 key performance indicators (KPIs) that cover, Disclosure and governance, Strategy, forests & mitigation, physical risk, Natural resource management. We have observed some improvement in scoring across the board, at this stage it was largely driven by increased disclosure, announcements and commitments in the run-up to and during COP 26 last November, with three companies laying out strategies for reaching climate targets, while another increased the ambition of its science-based target. We have also seen increases in ambition and strategic direction on tackling the issue of deforestation in engaged companies through collaborative efforts, via initiatives such as the **Soft Commodities Forum (SCF)**. This initiative is being driven by the mid-value chain commodities companies to support industrywide change and achievement of targets. In our initial rounds of dialogue, the engagement has continued to further identify key challenges across the value chain, positively with potential solutions developing but yet to be adopted in a more widespread nature. Regarding specific engagement with financiers, Sustainalytics has seen an expansion of portfolio accounting and assessment concerning climate emissions, although largely linked to heavy emitting industries only thus far. We have also seen an increase in interest in updating and improving upon existing deforestation approaches beyond current practices. This is likely driven by the strong anticipation of nature-related disclosure, however, there is also limited clarity at this stage on how to approach such disclosure, that said, one engaged bank noted it was already working to develop this as well as being actively involved in TNFD working groups. This indicates a similar trend to what was seen with TCFD, with a group of early movers setting the benchmark, while the wider industry seeks to learn from the progress of more ambitious peers.

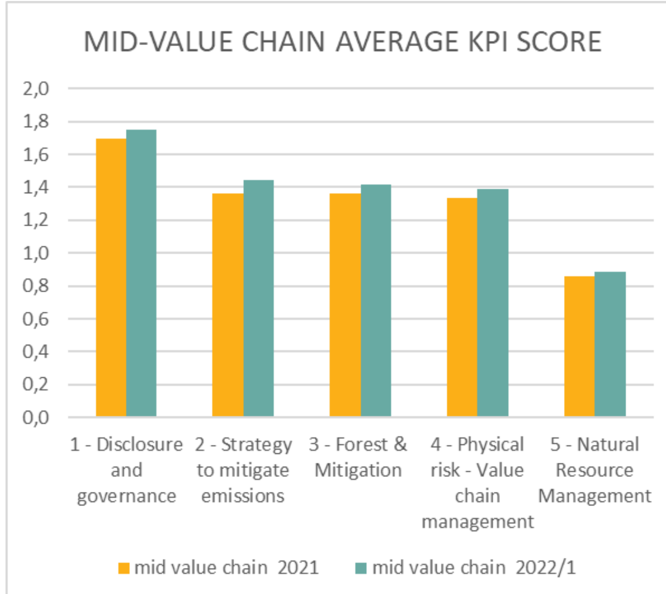
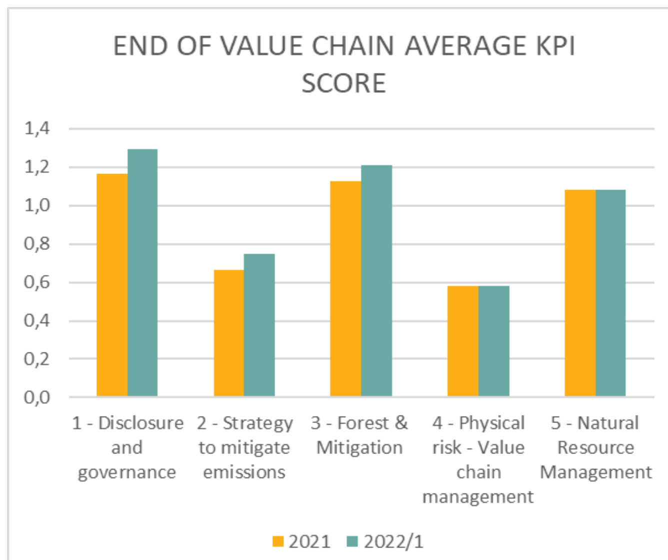


Figure 2 – Graphs showing the average KPI score across the Commodity companies in the value chain, the minimum score being 0, while the maximum score is 3.

In terms of the overall average scores, the financiers have seen a shift from 5.5 to 6.1, while mid-value chain commodities continue to score lowest with an average KPI score of 4.9 an improvement from 4.6, however, this is skewed by the palm oil sector included in the engagement with an average score of 2.25, while those involved in soy and beef show positive movement through the previously highlighted SCF and other individual ambitious programs. While the companies making up the end of value chain group have seen a shift in average score from 6.6 to 6.9, while likely able to learn from those in the middle of the value chain in relation to deforestation, many of these companies face significant challenges in working with their suppliers to reduce scope 3 emissions and hit 2030 targets.



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Looking ahead

The coming six months of the thematic engagement will focus on the second round of engagement sessions where we seek to continue and deepen the dialogue with the companies and wider stakeholders and to enlist the participation of further companies. In particular, the dialogue will be focusing on science-based targets, including targets relating to deforestation and importantly how companies will establish transparent strategies to achieve such targets.

ABOUT SUSTAINALYTICS

Sustainalytics, a Morningstar Company, is a leading ESG research, ratings and data firm that supports investors around the world with the development and implementation of responsible investment strategies. For nearly 30 years, the firm has been at the forefront of developing high-quality, innovative solutions to meet the evolving needs of global investors. Today, Sustainalytics works with hundreds of the world's leading asset managers and pension funds who incorporate ESG and corporate governance information and assessments into their investment processes. Sustainalytics also works with hundreds of companies and their financial intermediaries to help them consider sustainability in policies, practices and capital projects. With 17 offices globally, Sustainalytics has more than 1,200 staff members, including more than 500 analysts with varied multidisciplinary expertise across more than 40 industry groups.

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