



Climate Change – Sustainable Forests & Finance

2021 ANNUAL SUMMARY

– APPROVED FOR PUBLIC DISCLOSURE

Climate Change – Sustainable Forests & Finance Thematic Engagement

Agricultural expansion continues to be the main driver of deforestation, forest fragmentation, and the associated loss of forest biodiversity. As demand for food and other resources continues to grow, tropical and boreal forests are often cleared to make way for new fields and plantations, mostly for commodities, such as cattle, soy, palm oil, timber, coffee, etc. Deforestation also significantly exacerbates climate change, currently contributing approximately 24% of all greenhouse gas (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.

In September 2021, Sustainalytics kicked off a thematic engagement on Climate Change – Sustainable Forests & Finance. Together with a large group of investors, we have embarked on an engagement with major stakeholders in the forest value chain companies in the three focus sectors including financiers, commodity producers and end of value chain companies.

Developments in 2021

While 2021 began with the world still gripped in the midst of the coronavirus pandemic, there was also a first positive step in the field of climate, beginning in January as the US rejoined the Paris Climate Agreement. This was however followed by a stark reminder as to the urgency of the climate emergency with one of the most extraordinary and powerful heatwaves ever experienced by North America hitting the west coast in June, caused by what meteorologists called a “dome of high pressure”, the heatwave extended from California – worsening the drought even as the first wildfires of the season began – all the way up to Canada. Meanwhile, India, China and Europe were being hit by catastrophic floods.

In the run-up to COP26, the Intergovernmental Panel on Climate Change (IPCC) delivered its starkest warning to the world yet, concluding that climate change was unequivocally caused by human activities, and warning that some of the impacts were now inevitable and “irreversible”.³ We also noted activity alongside climate, as the world took to rally and take action on nature while China hosted the Kunming conference on biodiversity and announced a USD 233 m (£170 m) fund to protect biodiversity in developing countries.

Meanwhile, as COP26 came into full swing in November, we saw several commitments globally, with a leading an alliance of 90 countries, including for the first time Brazil, set out new regulatory measures to limit global methane emissions by 30% from 2020 levels by the end of the decade.

The alliance includes two-thirds of the global economy and half of the top 30 major methane emitter countries. Further commitments came from the finance industry, with hundreds of the world's biggest banks and pension funds with assets worth USD 130 tn having committed themselves to a key goal in limiting GHG emissions. Most importantly we saw world leaders agree to a deal that aims to halt and

¹ <https://www.greencimate.fund/stories/forests>

² <https://www.oecd.org/agriculture/topics/climate-change-and-food-systems/>

<https://www.wbcsd.org/Sector-Projects/Forest-Solutions-Group/Forest-Sector-SDG-Roadmap/New-Forests-Mobilizing-finance-for-sustainable-forests-and-the-climate>

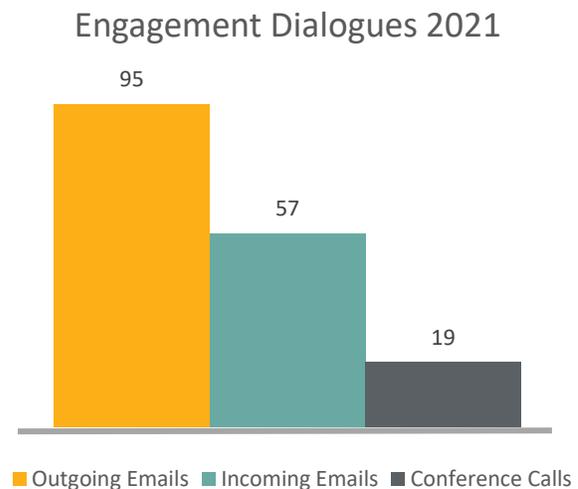
³ <https://www.ipcc.ch/report/ar6/wg1/>

reverse global deforestation over the next decade as part of a multibillion-dollar package to tackle human-caused GHG emissions.

With regards to climate-related disclosure, October also saw the release of the latest TCFD status report, with over 1,000 additional organizations having pledged support for the TCFD recommendations. As of October 2021, the Task Force had over 2,600 supporters globally, including 1,069 financial institutions, responsible for assets of \$194 tn. TCFD Aligned reporting requirements are now in place in several jurisdictions, including Brazil, EU, Hong Kong, Japan, Singapore, New Zealand and the UK.

Engagement Update

The main effort of the engagement in 2021 was to establish the baseline assessment working in collaboration with the investor group to identify 22 companies targeted as part of the project. The baseline assessment was released in September 2021. Following the release, introductory dialogues were held with 13 companies, while bilateral dialogues material to the engagement following on from this were held with 7 of these companies with further dialogues already in place in early 2022. We also connected with several key stakeholders throughout the year including the Science-based target network, Ceres, Sustainable Finance Lab & Forest500.



Company Performance

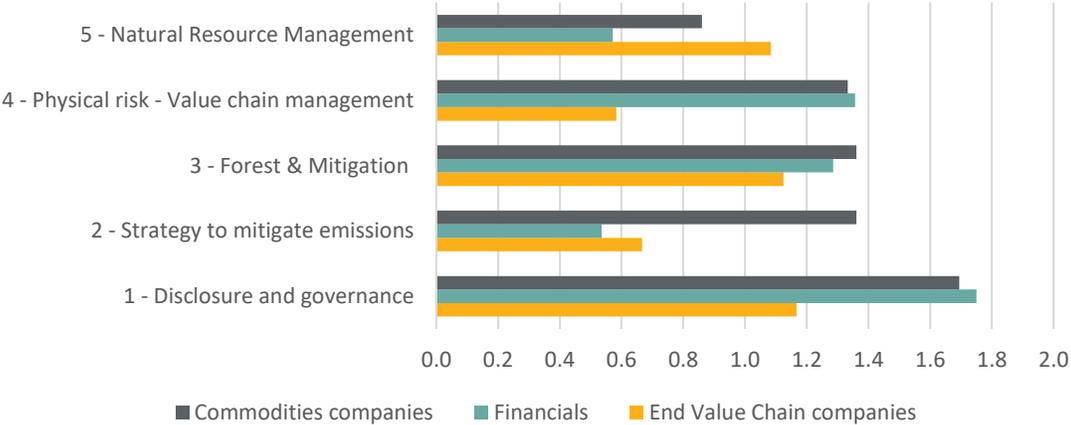
In 2021, Sustainalytics engaged directly or indirectly with a total of seven companies, in the initial months of the engagement with a differentiated approach cognizant of regional variation and companies' level of advancement.

All selected companies were scored on the five key performance indicators (KPIs), which will inform the engagement calls in the next phase of this project. The KPIs cover governance, targets and strategy, practical mitigation on forests, physical risk and natural resource management. Each KPI has a minimum score of zero and a maximum score of three.

Since September 2021, and throughout the dialogue with companies, we have continued to see steady improvement either through disclosure or commitments from companies relating to ongoing intentions concerning climate change.

One aspect increasingly seen, was better disclosure in relation to climate strategies largely in the run-up to COP26 later in the year. Several other companies made commitments relating to the TCFD that we expect to come to fruition early in 2022, with the release of both annual and sustainability reporting. One retailer announced an increase in the ambition of its net-zero targets.

Chart Showing Average Scores per Sector in Value Chain



In dialogue thus far we have also seen a limited approach to tackling deforestation, in particular for the financial sector. Their work has largely been limited to policies of varying strengths and due diligence on clients. Stronger efforts were seen from commodity companies largely aligning around commitments on ending deforestation and conversion by 2030. With strategies in place, work by commodity companies in particular relating to beef and soy, has focused on building traceability and transparency in supply chains utilizing continued rollout of satellite mapping data alongside collaborations with locally-based NGOs and farming cooperatives to better communicate these initiatives. These types of supply chain engagements were also seen across the three customer-facing companies we engaged with, all indicating plans to do so but strategy disclosure concerning this remains limited.

In relation to the upcoming Taskforce on Nature-related Financial Disclosures (TNFD) standard, two of the financial actors we engaged with are aware of and are participating in the development of the taskforce, while the remainder of company dialogues showed limited preparation. Work on TNFD is something that we expect to change and develop throughout 2022.

Case study

In late 2021, one Asia-based banking company had a positive reaction to Sustainalytics' engagement program highlighting the value it provided agreeing to further dialogue in March 2022 following its next reporting cycle. During our introductory dialogue, the company expressed an intention to advance its strategic approach to climate change. Through this, it identified and invited Sustainalytics to participate in its key stakeholder dialogue outreach forming initial input to its overall strategic direction regarding both sustainability and climate change. Here Sustainalytics provided insights and input from its other active engagements relating to long-term targets and metrics, risk management, disclosure and sustainability-linked bonds, and highlighted best practices and innovative approaches in these areas and more. It is excellent to see companies proactively involving Sustainalytics, as an investor representative, for guidance. More importantly, the strategy developments signal deepened engagement in key topics included in this thematic engagement, leading to long-term commitment to tackling the issues involved.



ABOUT SUSTAINALYTICS

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