

Climate Change – Sustainable Forests & Finance



EXECUTIVE SUMMARY

The Climate Change—Sustainable Forests and Finance Thematic Engagement aimed to address climate-related risks and advocate for emissions reduction across global food systems. The thematic engagement targeted companies across the agriculture value chain – from commodities to retailers, restaurants and the financial sector. The engagement objective focused on companies’ management of decarbonization which should be in line with international disclosure standards and science-based targets aligning with a 1.5-degree pathway or beyond. In addition, companies should integrate their nature-related risks and forestry commitments into risk management, strategic planning, and disclosure.

This summary presents the final report for the Thematic Engagement Climate Change—Sustainable Forests and Finance. The engagement began in September 2021 and concluded in September 2024. This report summarizes the progress made between the timeframe with an update on engagement efforts, high-level insights and outcomes and looking ahead.

UPDATE ON ENGAGEMENT EFFORTS

Between September 2021 and October 2024, Morningstar Sustainalytics has 1767 emails with 1048 outgoing emails and 719 incoming emails, held 114 meetings including 3 in-person meetings in the Netherlands and Singapore, and 1 field trip to Malaysia and Singapore. We also joined 20 company-held events such as annual general meetings (AGMs) and webinars to update company’s ESG and climate progress.

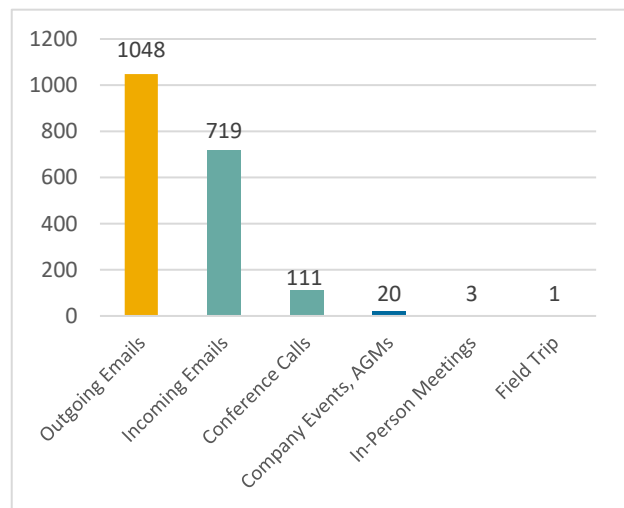


FIGURE 1 - ENGAGEMENT DIALOGUES BETWEEN 1 SEPTEMBER 2021 AND 30 SEPTEMBER 2024

Throughout the past three years, the dialogues shifted from building relationships and developing more ambitious emissions reduction roadmaps to deepening the conversation around companies’ forestry-related policies and due diligence approaches and their preparedness on upcoming regulatory requirements, such as the EUDR, Corporate Sustainability Reporting Directive (CSRD) and others. For the financial sector, besides their financed emissions mapping and portfolio decarbonization, the engagement also explored its sectoral policies and environmental and social risk assessments to eliminate negative impacts. For the soft commodities sector and end-value-chain companies, setting SBTi’s Forest, Land and Agriculture (FLAG) targets, supplier engagement and enhancing traceability were key focus areas. Specifically, the requirement of zero deforestation by 2025 as part of the SBTi FLAG guidance, was the most challenging part for companies to comply with. Nevertheless, we are pleased to see that three companies in the theme have renewed and verified their climate targets by SBTi, which we have cited as leading practices in dialogues with their peers. The implications of the EUDR have also been a focal point in our dialogues. Most companies are confident that they can comply with the regulations, however many highlighted

that further clarifications would be needed from the EU and more work would need to be done on documentation to prove compliance.

One key engagement activity in the past three year is the engagement field trip Sustainalytics conducted to Malaysia and Singapore in March 2024. In addition to an in-person meeting with a Singaporean bank, Sustainalytics and a few investors also visited a palm oil company in Malaysia. We met with experts in climate transition, natural conservation, tree planting and human-animal conflict management. Besides learning their net zero journey experience and natural conservation efforts, we have built up a strong relationship with the companies.

HIGH-LEVEL INSIGHTS AND OUTCOMES

According to Figure 2, KPI 1 disclosure and governance continues to score the highest among all KPIs. We have observed steady progress on KPI 2 (Strategy and Targets) and KPI 4 (Physical risk – Value chain management). Companies are disclosing further information regarding its strategy to meet their climate ambitions and their analysis on climate-related physical risks. KPI 5 on natural resource management is still the most challenging to improve on, especially for end value chain companies and financials due to complex value chains and portfolios. KPI 3 has proven to be the second most challenging as we still see some gaps in companies’ current forestry-related commitments and policies. With the emerging attention on nature and upcoming regulatory requirements such as the EUDR, companies should further enhance its forestry-related due diligence and policy implementations.

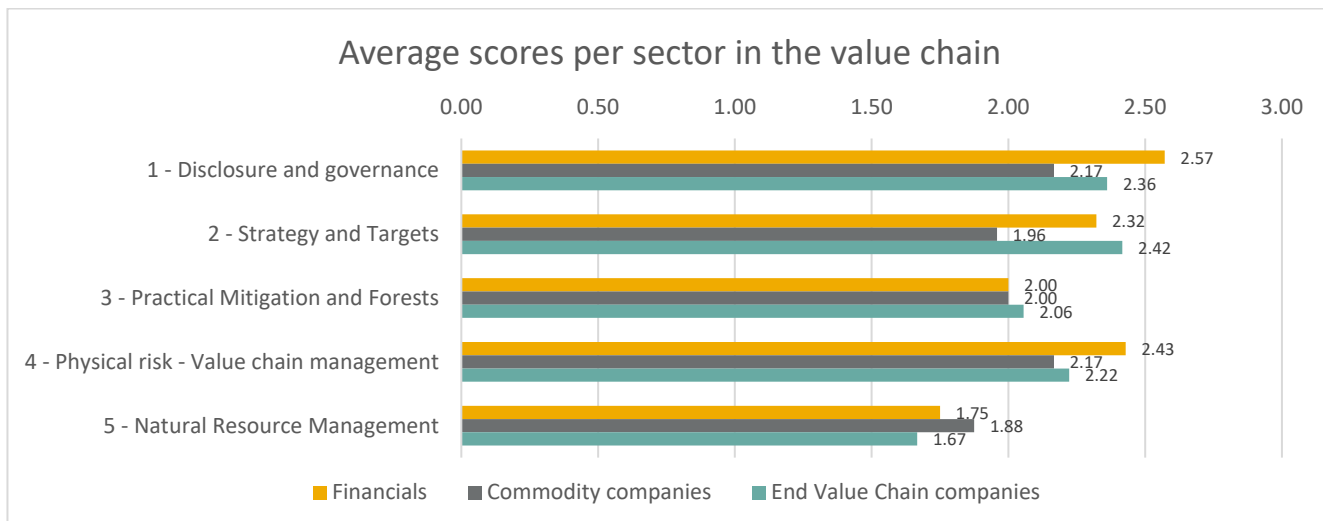


FIGURE 2 - AVERAGE SCORES PER SECTOR IN THE VALUE CHAIN

In terms of insights by sectors, for financials, KPI 2 shows the biggest progress over the three years of engagement. This is driven by various net zero initiatives, e.g., Net Zero Banking Alliance (NZBA) and Glasgow Financial Alliance for Net Zero (GFANZ), as six out of seven financials we engage with have already set targets and strategies for portfolio-based emissions reductions. KPI 3 and 5 continues to be the most challenging ones and therefore, we encouraged them to strengthen their sectoral policies, as well as expand their risk assessment to consider not only the project but also the clients’ profile and potential impacts across supply chains. Some banks have mentioned that they are reviewing relevant policies to ensure alignment with their nature and biodiversity related commitments.

In terms of mid-value chain company's KPI performance, KPI 3 and 5 score high because commodity companies have mostly conducted nature-related risk assessments, such as High Conservation Value (HCV) and High Carbon Stock (HCS), and often have better forestry-related commitments and strategies in place. One key topic with commodity companies is the implication of the EUDR. While most companies are confident that they can meet European regulatory requirements, it is still unclear from the EU side what documentation is needed to prove the alignment. Companies with higher certification rates and traceability find themselves well-prepared compared to their peers.

Due to complicated supply chains, end-value chain companies face challenges in assessing their scope 3 emissions and nature-related risks. Nevertheless, our engagement has encouraged the companies to leverage their purchasing power, such as publicly disclosing their responsible sourcing policies and supplier expectations, to influence suppliers to comply with higher environmental and social standards and disclose further data across supply chain.

LOOKING AHEAD

This report marks the last report for the Climate Change – Sustainable Forests and Finance Thematic Engagement. All the engagement dialogues with the current 22 companies have been transferred to the ongoing Biodiversity and Natural Capital Thematic Stewardship Programme. As climate and biodiversity topics are inextricably connected, we believe we will continue to drive systemic impacts with companies across the agricultural value chain by focusing on biodiversity and nature together. In addition, if you seek more engagement dialogues to drive further decarbonization impacts with high emissions industries, our Net Zero Transition Stewardship Programme will be ideal to serve your needs.

Although this engagement has ended, there are various activities that investors can follow:

- **Nature Action 100 and PRI Spring:** These are two collaborative investor engagement initiatives currently available for investors to sign up to address deforestation and nature-related issues with other like-minded investors.
- **COP16 Colombia – Biodiversity:** Countries will have to show the alignment of their National Biodiversity Strategies and Action Plans with the Global Biodiversity Framework.
- **COP29 Azerbaijan – Climate Change:** Focusing on climate finance, this COP is focusing on aligning financing expectations to the actual decarbonization goals.
- **The EUDR:** The regulation will come into effect by the end of 2024. As of now, there are still some areas of concern and companies are still working hard to ensure compliance. It is worthwhile to follow up on how companies are responding to the regulation.
- **US Election Results:** With the US election coming up, the results will shape climate and sustainability-related strategies differently. Investors should keep an eye on the development.

In addition, Morningstar Sustainalytics is pleased to invite you to join our engagement trip to Brazil in October 2024. The trip will be focused on deforestation and biodiversity, and we plan to hold in-person meetings and site visits in São Paulo and Brasília. The overall objectives of this trip are to foster deeper, more nuanced understandings of the Brazilian deforestation and biodiversity context among both investors and companies, foster a space for new connections and potential solutions to further mitigate

deforestation and biodiversity risks and impacts, share the viewpoints and expectations of stakeholders, and enhance relationships between companies and institutional investors via face-to-face meetings.

If you have any questions regarding the engagement trip, the Biodiversity and Natural Capital Stewardship Programme, Net Zero Transition Stewardship Programme or any other engagement services, please feel free to contact our team.

About Morningstar Sustainalytics

Morningstar Sustainalytics is a leading ESG data, research, and ratings firm that supports investors around the world with the development and implementation of responsible investment strategies. For more than 30 years, the firm has been at the forefront of developing high-quality, innovative solutions to meet the evolving needs of global investors. Today, Morningstar Sustainalytics works with hundreds of the world's leading asset managers and pension funds who incorporate ESG information and assessments into their investment processes. The firm also works with hundreds of companies and their financial intermediaries to help them consider material sustainability factors in policies, practices, and capital projects. Morningstar Sustainalytics has analysts around the world with varied multidisciplinary expertise across more than 40 industry groups. For more information, visit www.sustainalytics.com.

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