

# Our commitment to tackling deforestation





## Our commitment to tackling deforestation

Federated Hermes Limited is a global leader in active, responsible investment<sup>1</sup>. We are guided by the conviction that responsible investing is the best way to create long-term, sustainable wealth for our clients and their beneficiaries.

We provide specialized capabilities across equity, fixed income and private markets, in addition to multi-asset strategies and proven liquidity-management solutions. Our goals are to help individuals invest and retire better, to help clients achieve better risk-adjusted returns, and, where possible, to contribute to positive outcomes in the wider world. As at 31 December 2021, Federated Hermes Limited had £44.5bn assets under management.

EOS at Federated Hermes is a leading stewardship service provider, advising on approximately £1.2tn of assets as at 31 December 2021. EOS offers a shared service model, engaging on behalf of both Federated Hermes Limited and third-party clients. EOS' engagement offerings enable long-term institutional investors to be more active owners of their assets, through dialogue with companies on environmental, social and governance issues. We believe this is essential to build a global financial system that delivers improved long-term returns for investors, as well as better, more sustainable outcomes for society.

This document sets out Federated Hermes Limited's commitment to tackling deforestation, and the work we have undertaken so far. We use the definitions set out in the Accountability Framework initiative<sup>2</sup> (AFi):

**Deforestation:** Loss of natural forest as a result of;

- conversion to agriculture or other non-forest land use;
- conversion to a tree plantation; or
- severe and sustained degradation.

**Conversion:** Change of a natural ecosystem to another land use or profound change in a natural ecosystem's species composition, structure or function.

**Human rights abuse** associated with commodity-driven deforestation and conversion. These rights include:

- The right to Free, Prior, and Informed Consent (FPIC) of Indigenous peoples and local communities<sup>3</sup>.

- The customary rights of Indigenous peoples and local communities to land, resources, and territory.
- Zero tolerance for threats and attacks against environmental and human rights defenders – the labour rights of workers (including contractors, smallholders, and temporary staff) at the points of production, including from the point of forest clearance to active production, for the highest forest-risk commodities.

### Why is deforestation such an important issue?

Deforestation, conversion and human rights abuses may pose risks to financing and investment activities. These risks could arise, for example, through reputational harm or changing consumer preferences that impact the company or financial institution associated with deforestation, conversion or human rights abuse. It could also come through the imposition of higher costs or fines by governments and regulators.

**Protecting and restoring forests globally is a necessity if we are to achieve global emissions reduction targets and avoid the consequences of severe climate change and biodiversity loss.**

Such activities also pose systemic risks. Protecting and restoring forests globally is a necessity if we are to achieve global emissions reduction targets and avoid the consequences of severe climate change and biodiversity loss. Forests are a natural carbon sink; around one third of all CO<sub>2</sub> released is absorbed by forests each year<sup>4</sup>. Deforestation is releasing carbon dioxide back into the atmosphere and destroying capacity for future natural absorption of emissions. Agriculture, forestry and other land use are responsible for 22% of global greenhouse gas emissions, with half of that percentage coming from deforestation and land conversion driven by commodities including soy, palm oil, timber and cattle<sup>5</sup>.

<sup>1</sup> Federated Hermes Limited includes Hermes Investment Management Limited (HIML) and EOS at Federated Hermes ('EOS'). HIML is authorised and regulated and carries out regulated activities referred to. EOS is a stewardship services provider and does not carry out regulated activity.

<sup>2</sup> Accountability Framework, 'Terms and Definitions' (June 2019)

<sup>3</sup> FPIC is a collective human right of indigenous peoples and local communities to give and withhold their consent prior to the commencement of any activity that may affect their rights, land, resources, territories, livelihoods, and food security. It is a right exercised through representatives of their own choosing and in a manner consistent with their own customs, values and norms.

<sup>4</sup> IUCN, 'Forests and Climate Change' (February 2021)

<sup>5</sup> IPCC, 'Climate Change 2022: Mitigation of Climate Change' (November 2021)

1.25 billion people globally rely on forests for shelter, livelihoods, water, fuel and food security, while more than three-quarters of the world's documented land-based species can be found in forests.<sup>6</sup> They also play an important role in regulating local and global precipitation patterns. Tackling deforestation is therefore an important part of our own net-zero commitment and efforts to limit the systemic risks posed by climate change, as well as to protect human rights and biodiversity.

Despite all of these risks, five years after the 2014 launch of the New York Declaration on Forests (NYDF)<sup>7</sup>, a 2019 report found that there was little evidence that the goals were on track, and that the likelihood of achieving the 2020 NYDF targets – including halving tropical deforestation and restoring 150 million hectares of degraded landscapes and forestlands – was close to impossible.<sup>8</sup> Brazil's Amazon rainforest saw record levels of deforestation in the first half of 2022<sup>9</sup> according to the country's Space Research Institute (INPE), which uses satellites to monitor deforestation.

Research launched in June 2022 by the UN Climate Change High-Level Climate Champions and other partners found that just 6% of companies in the food, land and agriculture sectors that have been identified as having the greatest influence on tropical deforestation, and that have set net-zero targets, are taking adequate steps to address deforestation risks<sup>10</sup>.

# 1.25

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By protecting and restoring forests globally, we can achieve 18% of the emissions reductions needed by 2030 to limit average global temperature increases to 1.5°C<sup>11</sup>. According to Afi, the majority of commodity-driven land clearance must be halted by 2025, and all land use change eliminated by 2030<sup>12</sup>.

## Our commitment

The critical role of nature in climate change adaptation and mitigation was recognised at COP26, with a particular focus on forests and sustainable agriculture. Coordinated by the UK government, 130 countries agreed to halt and reverse forest loss and land degradation by 2030<sup>13</sup>.



Our CEO Saker Nusseibeh, CBE, addressed the World Leaders Summit at COP26 on behalf of a group of investors committing to strengthen their efforts to tackle deforestation in their portfolios, as well as those joining the Natural Capital Investment Alliance to accelerate the development of natural capital as a mainstream investment theme.

We signed the commitment to strive to eliminate commodity-driven deforestation from our portfolios, alongside over 30 financial institutions representing a total of US\$8.7tn. This was in recognition of the need for investors to conduct sustained and outcomes-focused engagement with companies in forest-risk sectors and with regulators in order to seek more sustainable production and consumption practices in support of climate goals.

During 2022, in line with our commitment, we are assessing our exposure to deforestation risk through palm oil, soy, cattle (including beef and leather) and timber (including pulp and paper) across a range of asset classes. We will establish a policy to address our exposure, and our approach will be primarily based on engagement. We will continue to conduct advocacy on climate and nature related topics, including deforestation. From 2023 we will disclose our assessment of deforestation risk in our portfolios and our mitigation activities, including engagement. We seek to achieve credible progress in our engagement by 2025. This will mean stepping up engagement on deforestation and continuing to focus on this topic within our vote policy.

<sup>6</sup> WWF, 'Deforestation and Degradation', <https://www.worldwildlife.org/threats/deforestation-and-forest-degradation>

<sup>7</sup> The NYDF is a multi-lateral coalition of governments, companies, civil society and indigenous peoples' organisations, endorsed by over 200 organisations.

<sup>8</sup> Forest Declaration Platform, 'Protecting and restoring forests: 2019 NYDF Executive Summary' (September 2019)

<sup>9</sup> <https://www.reuters.com/business/environment/deforestation-brazils-amazon-hits-record-first-half-2022-07-08/>

<sup>10</sup> Global Canopy, 'Why net zero needs zero deforestation now' (June 2022)

<sup>11</sup> Global Canopy, 'Why net zero needs zero deforestation now' (June 2022)

<sup>12</sup> Accountability Framework, 'The Afi recommends a target date no later than 2025 to eliminate deforestation and conversion in supply chains, June 3 2022, <https://accountability-framework.org/the-afi-recommends-a-target-date-of-2025-or-sooner-to-eliminate-deforestation-and-conversion-in-supply-chains/>

<sup>13</sup> UN Climate Change Conference UK 2021, 'Glasgow leaders' declaration on forests and land use', Nov 2 2021, <https://ukcop26.org/glasgow-leaders-declaration-on-forests-and-land-use/>



## What action are we taking?

### Engagement

EOS offers a shared service model, engaging on behalf of both Federated Hermes Limited and third-party clients. The [EOS Engagement Plan 2022-2024](#) has four priority themes for public markets engagement: climate change action, human and labour rights, human capital and board effectiveness and ethical culture. In addition to the priority themes, we will pursue further engagement in three fast-growing areas: biodiversity, fast fashion, and digital rights. Land use change is one of the key drivers of biodiversity loss, as well as contributing to climate change, and is therefore a highly relevant topic of engagement.

In 2021, we published a white paper, [Our Commitment to Nature](#), which set out our engagement priorities and expectations for sustainable land use. Our white paper highlighted the extent to which investors' and companies' current approaches to nature are unsustainable. It made the business case for action and outlined how investor engagement with companies is a key route by which biodiversity loss can be halted and reversed.

**We set out our expectation that companies that source palm oil, soy, beef, leather, pulp and paper, among other relevant commodities, must urgently commit to clear timelines for eliminating deforestation from their supply chains.**

We also delved deeper into the sustainable food systems theme through an EOS Insights series<sup>14</sup>. This highlighted how the food system is currently a principal driver of biodiversity loss, even though biodiversity and ecosystem services underpin farming and food production. Food producers need to eliminate deforestation from their supply chains, shift to regenerative agricultural practices to preserve soil health, arrest pollinator species decline, and transition to more sustainable product portfolios.

**We expect companies to communicate a clear strategy for how a deforestation-free supply chain will be achieved.**

We continue to call on companies to commit to having a net-positive impact on biodiversity throughout their operations and supply chains by 2030 at the latest. We expect this goal to be accompanied by strong governance, effective measurement, an impactful strategy, and regular disclosure.

One of the key spotlight issues we focused on in our white paper was deforestation. We set out our expectation that companies that source palm oil, soy, beef, leather, pulp and paper, among other relevant commodities, must urgently commit to clear timelines for eliminating deforestation from their supply chains. The commitment should cover all commodities, regions and suppliers, including indirect suppliers<sup>15</sup>. We expect companies to communicate a clear strategy for how a deforestation-free supply chain will be achieved through implementation measures, monitoring, independent verification, and collaboration. Companies that can achieve traceability of commodities back to source will be best placed to achieve a deforestation-free supply chain.

For example, EOS has been engaging with a major commodity trader on accelerating its efforts to tackle deforestation associated with soy production in South America. We asked the company to bring forward its time-bound deforestation and conversion-free commitment from 2030 to 2025 in order to align them with current best practice and its peers, and to continue to improve its disclosure related to deforestation, including a more transparent and sustainable soy supply chain. We will continue to engage with the company on accelerating its no deforestation commitment timeline.

Engagement on nature-related issues is growing, and we are working in collaboration with others in the industry to strengthen and streamline approaches, including as co-chair of the Engagement Working Group within the Finance for Biodiversity Foundation. With a small group of investors, we are also working to establish a Nature Action 100 initiative, which would facilitate collaborative engagement with companies that have the greatest impact on biodiversity.

<sup>14</sup> Federated Hermes Limited, 'From farm to fork', July 13 2021, <https://www.hermes-investment.com/uk/en/institutions/eos-insight/stewardship/from-farm-to-fork-key-challenges-for-global-food-systems/>

<sup>15</sup> Ceres, The Investor Guide to Deforestation and Climate Change (2020)





## CASE STUDY

DBS



EOS's engagement with DBS dates back to 2011 on executive pay. We began engaging with DBS on palm oil financing in January 2019. We urged the bank to demonstrate that its palm oil lending criteria are updated to meet the latest Roundtable on Sustainable Palm Oil (RSPO) standard for all borrowers. The bank acknowledged its awareness of the latest RSPO standard and confirmed its new borrowers were asked to demonstrate alignment with no deforestation, no peat and no exploitation (NDPE) or equivalent. The bank has supported companies that undertake good ESG practices, including those complying with existing national and international certification standards.

**We urged the bank to demonstrate that its palm oil lending criteria are updated to meet the latest Roundtable on Sustainable Palm Oil (RSPO) standard for all borrowers.**

As at February 2020, the bank's palm oil lending policy had not changed but the head of sustainability confirmed it was committed to working with existing customers who refinance their existing loans on achieving RSPO certification. In March 2021, we were pleased to learn that

DBS raised its ESG standards for the palm oil sector. The bank raised the mandatory requirements and restrictions that apply to all its lending relationships. It now encourages customers to apply NDPE policy throughout the supply chain. Besides NDPE commitments, the bank also accepts RSPO certification as demonstration of good industry practices. Customers are requested to achieve full RSPO certification via a time-bound action plan that is communicated to DBS.

**The bank also pledges not to knowingly finance companies that are involved in high-carbon stock forests, planting on peat, or planting without securing both the legal right and community support to use all the land involved.**

The bank also pledges not to knowingly finance companies that are involved in high-carbon stock forests, planting on peat, or planting without securing both the legal right and community support to use all the land involved. We will monitor DBS' progress in implementing the sustainable palm oil policy for all its lending relationships.



We continue to hold the chair or other responsible directors accountable through voting recommendations where we believe companies' actions are materially misaligned with the goals of the Paris Agreement, and/or where companies are not responding sufficiently to the risks and opportunities posed by climate change. We include a particular focus on companies that are involved in activities that are clearly incompatible with limiting global warming to safe levels, such as causing deforestation and the expansion of coal-fired power. We assess companies using a range of frameworks and benchmarks, including the Transition Pathway Initiative (TPI),<sup>16</sup> the Climate Action 100+ benchmark,<sup>17</sup> Forest 500<sup>18</sup> and others.

In 2021, EOS recommended voting against directors at companies that were failing to address deforestation risks, including at Yakult Honsha, Li Ning Company, and WH Group<sup>19</sup>. EOS recommended voting against the lead director at a public commodity trader in 2022 due to concerns that the company had failed to adopt a net-zero target, had a deforestation timebound commitment that lagged industry best practice, and had failed to mitigate human rights impacts in its agricultural supply chains. We welcomed the company's updated no deforestation commitment, which was brought forward to 2025, and was announced prior to the annual meeting in response to investor concerns.

### Advocacy

We recognise that as investors we have an opportunity and a responsibility to help address market-wide and systemic risks. We engage constructively with regulators and policymakers globally – both individually and through collaborative initiatives – to address environmental, social and other market failures that may prevent the financial system from operating in the best interests of its ultimate asset owners.

### We are part of the Global Canopy Aligned Accountability project, which seeks to bring together existing data sets on deforestation and package it in a more usable way for financial market participants.

We are working as part of the PRI Sustainable Commodities Practitioners Group to explore how the Financials sector can effectively address deforestation by sharing best practice to enhance our own approach and support our peers in advancing theirs. The Group has covered topics such as engagement and deforestation policies. We are also involved in the signatory group for the Eliminating Commodity-Driven Deforestation commitment, which has similar goals.

We are part of the Global Canopy Aligned Accountability project, which seeks to bring together existing data sets on deforestation and package it in a more usable way for financial market participants. The main objective is to develop a comprehensive, collaborative, and open database on corporate performance on deforestation, aligned with the Accountability Framework, which will provide standardised data. We are supporting this project to refine the development of the database and ensure its relevance for end users.

We are a supporter of SPOTT, which aims to increase transparency in commodity sectors to promote sustainable production and trade. We are also members of the Investors Policy Dialogue on Deforestation (IPDD) in Brazil and will be seeking to deepen our engagement with this network over the year ahead. The IPDD seeks to reverse the trend of deforestation in the Amazon rainforest, engaging with relevant government authorities and associations to promote sustainable land use and to improve company disclosure and management of the various ESG risks associated with soy and cattle.

<sup>16</sup> The Graham Institute, TPI: the toolkit, <http://www.lse.ac.uk/GranthamInstitute/tpi/the-toolkit/>

<sup>17</sup> Climate Action 100+, Net Zero Company Benchmark, <https://www.climateaction100.org/progress/net-zero-company-benchmark/>

<sup>18</sup> Forest 500, <https://forest500.org/>

<sup>19</sup> Yakult Honsha, Li Ning Company and WH Group are not FHL Holdings. EOS will engage with Yakult Honsha, Li Ning Company and WH Group on behalf of third party clients only.





We are signatories to the Finance for Biodiversity Pledge and currently co-chair the Public Policy Advocacy working group within the Finance for Biodiversity Foundation. In this working group we are actively collaborating with peers to influence the outcome of the 15th meeting of the Conference of the Parties to the Convention on Biological Diversity (COP15), taking place in December. For instance, we participated in international negotiations on biodiversity in Geneva in March 2022 and presented the group's position ahead of COP15 to the Coalition of Finance Ministers for Climate Action.

We are also co-leading the policy advocacy workstream of the Natural Capital Investment Alliance, which will be identifying key policy asks ahead of COP15.

### Investment

We integrate ESG considerations and engagement insights into our investment processes in all of our products, and across all asset classes.

As responsible investors, we take a holistic approach that integrates material ESG considerations and engagement insights, alongside traditional performance factors, into all of our investment products. This allows our fund managers to assess an assets potential to deliver long-term sustainable wealth whilst actively mitigating ESG risks and capturing the investment opportunities arising from these considerations.

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ESG issues are prioritised at the sector level and we look at material areas of concern for each of the sectors and industries, with an overlay of material ESG issues by region. Relevant ESG issues – whether macroeconomic risks, thematic focus of the investment strategy or those specific to that company – are then considered on a company-by-company basis, with implications for both inclusion and weighting in an investment portfolio, as well as engagement.

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Our investment teams regularly interact with the relevant sector or regional lead within EOS to better understand the ESG issues within their investment universe, and also discuss specific companies with the relevant engager. Such interactions can help the portfolio manager discern whether a particular ESG issue is material or not, something which cannot always be gleaned from raw ESG research data. Therefore, we believe that to implement a credible and successful ESG integration approach, it is of utmost importance that engagement information is part of the ESG information universe.



## CASE STUDY

## Biodiversity Equity Fund



In Q1 2022, we launched our Biodiversity Equity Fund. The team at Federated Hermes Limited has extensively researched the major regional and global threats to biodiversity and have defined six themes for the Fund: land pollution, marine pollution and exploitation, unsustainable living, climate change, unsustainable farming, and deforestation. These discrete themes contain businesses which help mitigate the loss of, or provide solutions to, the specific biodiversity risks they bear. Each of these themes has multiple sub-verticals that are aligned to specific UN Sustainable Development Goals (SDGs).

Deforestation is arguably the most familiar theme to most investors within the Biodiversity Equity Fund (BDEQ). There is a clear and accepted body of evidence that the most biodiverse regions on land map onto forest lands. We cite the UN FAO 2020 study for this assertion<sup>20</sup>, and note that this is supported by our work with the Natural History Museum, whose Biodiversity-Intactness Indicator establishes similar results.

Within our deforestation investment theme, we focus specifically on the deforestation from non-farming uses. We identify businesses which: (i) directly prevent deforestation, (ii) reduce the intensity of timber use in existing product markets, or (iii) sustainably manage forest assets. Outlined below are three investment names which assimilate into these three classes:

#### Natura

The world's largest B-Corp, and a beauty and personal care brand, serving 200m customers globally. Natura sources 38 feedstocks which are exclusive to the Amazon, through 33 local indigenous communities. This creates a viable economic case for c. 2m hectares of forest land being left in situ. Furthermore, the business runs two not-for-profit forestry tracker services which allow third party names to monitor their own impact on deforestation.

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#### Trex

A market leader in the manufacture of wood-alternative composite decking, made from a c. 50:50 blend of recycled polyethylene and waste wood. This product competes with and displaces the incumbent virgin timber decking. We estimate that in 2020 the business helped to prevent the felling of 57,000 trees through its displacement of virgin timber decking.

#### Stora Enso

A true champion of sustainable forestry management in the paper and pulp market. We credit Stora Enso for their best-in-class risk mitigation (with a principally European footprint, with 99% Forest Stewardship Council certification), and commitments to restoration projects, particularly in the Brazilian Atlantic Rainforest (a Veracel joint venture).

We also affect deforestation indirectly through our farming theme, with all investments contributing to more resource conscious farming methods and approaches. We argue that the increase in yield from existing land – be that through precision agriculture, animal health, soil fertility or vertical farming – does materially help to reduce the need for virgin farmland in the farming supply chain which would otherwise bear considerable deforestation risk.

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Federated Hermes will continue to work towards meeting our commitments on deforestation as outlined above, as well as continuing our advocacy and engagement on this important topic.

<sup>20</sup> Food and Agriculture Organization of the United Nations, 'State of the World's Forests' (2020)



**The value of investments and income from them may go down as well as up, and you may not get back the original amount invested.**

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## Federated Hermes

Federated Hermes is a global leader in active, responsible investing.

Guided by our conviction that responsible investing is the best way to create long-term wealth, we provide specialised capabilities across equity, fixed income and private markets, multi-asset and liquidity management strategies, and world-leading stewardship.

Our goals are to help people invest and retire better, to help clients achieve better risk-adjusted returns, and to contribute to positive outcomes that benefit the wider world.

All activities previously carried out by Hermes Investment Management are now undertaken by Federated Hermes Limited (or one of its subsidiaries). We still offer the same distinct investment propositions and pioneering responsible investment and stewardship services for which we are renowned – in addition to important strategies from the entire group.

## Our investment and stewardship capabilities:

- **Active equities:** global and regional
- **Fixed income:** across regions, sectors and the yield curve
- **Liquidity:** solutions driven by four decades of experience
- **Private markets:** real estate, infrastructure, private equity and debt
- **Stewardship:** corporate engagement, proxy voting, policy advocacy

For more information, visit [www.hermes-investment.com](https://www.hermes-investment.com) or connect with us on social media:  