

Policy Statement on Deforestation

Scope

This Policy Statement applies to the following commodities: cattle, beef and leather; palm oil; timber, pulp and paper; and soy. It covers upstream and downstream companies in these value chains such as producers, processors, traders, manufacturers, retailers, and financial institutions.

This policy sets out the approach to deforestation for the below products and strategies¹ managed by Federated Hermes Limited and its subsidiaries:

- Real Estate
- Direct Lending
- Infrastructure
- Real Estate Debt
- Private Equity
- UCITS funds within the Federated Hermes Investment Funds plc umbrella
- Equity and credit strategies where Hermes Investment Management Limited is the investment manager.

This policy will be reviewed and updated annually, with oversight by the Federated Hermes Limited Governance Committee.

Definitions

We use the definitions set out in the Accountability Framework initiative² (AFi):

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

Deforestation: Loss of natural forest³ as a result of:

- conversion to agriculture or other non-forest land use;
- conversion to a tree plantation⁴; or
- severe and sustained degradation.

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 communities⁵.
- The customary rights⁶ 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 an important issue for us?

In 2021, we signed the financial sector commitment to eliminate commodity driven deforestation alongside over 30 financial institutions representing a total of US\$8.7 trillion⁷.

Forests are essential to society and our economy. According to the UN Environmental Programme, around 1.6 billion people depend on forests for their livelihood and tropical forests host over 80% of terrestrial species⁸. They also provide critical ecosystem services such as climate and water cycle regulation and soil erosion prevention.

The protection and restoration of forests is vital for climate mitigation and to maintain functioning ecosystems, and in turn underpin the economy and support sustainable livelihoods.

However, deforestation is occurring at an alarming rate. Between 1990 and 2020, around 420 million hectares of mainly tropical forest has been lost, while an estimated 10 million hectares was lost per year during the period 2015-2020⁹.

Land use change is a leading cause of biodiversity loss¹⁰. Forest degradation and fragmentation also significantly jeopardise essential ecosystem services that underlie our economy, increases to human-wildlife conflict^{11,12}, and increases human exposure to zoonotic diseases¹³.

¹ We will continue to assess those products and strategies not in scope.

² Accountability Framework, 'Terms and Definitions' (June 2019)

³ Natural forest refers to a forest that is a natural ecosystem, including primary forests, regenerated (second-growth) forests, managed natural forests and forests that have been partially degraded. For full definition see Accountability Framework, 'Terms and Definitions' (June 2019)

⁴ A tree plantation is a forest predominantly composed of trees established through planting and/or deliberate seeding that lacks key elements of a natural forest native to the area, such as species composition and structural diversity. For full definition see Accountability Framework, 'Terms and Definitions' (June 2019)

⁵ 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.

⁶ We note that different jurisdictions employ different legal systems.

⁷ [Race to Zero \(2021\) Financial Sector Commitment Letter on Eliminating Commodity-Driven Deforestation](#)

⁸ UN Environment Programme, "UNEP and Biodiversity" (September 2020)

⁹ [FAO, 'State of the World's Forests' \(2020\)](#)

¹⁰ [IPBES \(2019\): Summary for policymakers of the global assessment report on biodiversity and ecosystem services of the Intergovernmental Science-Policy Platform on Biodiversity and Ecosystem Services](#)

¹¹ [Michalski F. et al \(2016\) Human-wildlife conflicts in a fragmented Amazonian forest landscape: determinants of large felid depredation on livestock. Animal Conservation Vol. 9: 2, p179-188](#)

¹² [Kumari R. et al \(2019\) Deforestation in India: Consequences and Sustainable Solutions in Forest Degradation Around the World, Edited by Suratman M.N et al.](#)

¹³ [Morand S. and Lajaunie C. \(2021\) Outbreaks of Vector-Borne and Zoonotic Diseases Are Associated With Changes in Forest Cover and Oil Palm Expansion at Global Scale. Front. Vet. Sci., 24 March 2021. Sec. Parasitology <https://doi.org/10.3389/fvets.2021.661063>](#)

Agriculture, Forestry, and Other Land Use are responsible for 23% of global greenhouse gas (GHG) emissions¹⁴. Of all natural habitats, forests are the largest terrestrial carbon sink (~45% of terrestrial sequestration)¹⁵, absorbing around one third of all CO₂ emissions every year¹⁶. Continued deforestation could also lead to a release of carbon which may be irrecoverable¹⁷. Halting deforestation is thus necessary to ensure a trajectory that is aligned with the Paris Goal of limiting warming to 1.5°C¹⁸, and tackling deforestation is therefore an important part of our own net zero commitment.

Forests provide jobs for an estimated 86 million people and support the livelihoods of hundreds of millions more¹⁹, as well as upholding ecosystem services ensuring global food security and being a valuable source of new medicines²⁰.

Deforestation linked to expansion of agribusiness has been linked to widespread human rights abuses in the form of illegal land grabbing and violence²¹.

Agriculture is responsible for 80% of global deforestation²², with the non-circular production of key commodities including beef and leather, palm oil, pulp and paper, soy and timber being responsible for a significant proportion of forest conversion²³. Large-scale commercial agriculture, primarily cattle ranching and cultivation of soya bean and oil palm, accounted for 40% of tropical deforestation between 2000 and 2010²⁴.

Given links to both climate change and biodiversity loss, deforestation presents a systemic risk for financial markets and may limit our ability to create enduring, responsible wealth for our clients and their beneficiaries. Deforestation and associated human rights violations linked to agricultural production may present financially material risks to financing and investment activities through operational, supply chain, regulatory, litigation and market risks. 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. We believe such risks should be addressed as part of our fiduciary duty to maximise long-term financial returns on investment on behalf of our clients. We recognise the urgency of addressing deforestation exposure in our portfolios.

Our commitment

We believe that climate change and biodiversity loss pose systemic risks to financial markets. We therefore take the view that contributing to efforts to eliminate deforestation is an outcome that is fundamentally in the long-term financial interests of our clients and therefore part of our fiduciary duty. Our goal is to drive change in the real economy.

As the agricultural production of beef and leather, palm oil, pulp and paper, soy and timber is a major driver of deforestation, we committed to assess the exposure of our portfolios to deforestation risk for these forest risk commodities. Informed by this analysis and in line with our goal to drive change in the real economy, we identified public policy advocacy and engagement with our assets as key levers to drive real-world impact on levels of deforestation. This is supported by annual assessment of our potential exposure to deforestation risk across our equity, credit and infrastructure portfolios, with ongoing due diligence in our real estate, private equity and direct lending portfolios. Our real estate debt team seek to incorporate relevant expectations into loan agreements.

We report annually on our assessment of commodity-driven deforestation risk and mitigation activities across our portfolios.

We are committed to reporting credible progress in addressing agricultural commodity-driven deforestation²⁵ in our portfolios by 2025, recognising the long term and systemic risks this presents to the companies producing, sourcing, transporting and using these commodities, or those financing these activities. For the avoidance of doubt, portfolio managers are expected to make portfolio and investment decisions in line with fiduciary duty and their specific investment mandate.

We will increase investment in nature-based solutions (NbS) for clients. As NbS seeks to address environmental and societal issues, it has the potential to be a significant investment opportunity for clients. NbS have the potential to impact on people, and Indigenous peoples and local communities (IPLCs) who are dependent on the landscapes in which these are implemented. We will seek to respect and uphold the rights of IPLCs and promote locally appropriate, equitably distributed, positive social impact.

¹⁴ IPCC, 'Climate Change and Land' (2020)

¹⁵ Food and Land Use Coalition (2021) *Why Nature? Why Now?*

¹⁶ IUCN, 'Forests and Climate Change' (February 2021)

¹⁷ Goldstein, A., Turner, W.R., Spawn, S.A. et al. Protecting irrecoverable carbon in Earth's ecosystems. *Nat. Clim. Chang.* 10, 287–295 (2020)

¹⁸ IPCC, 'Climate change widespread, rapid, and intensifying' (2021)

¹⁹ FAO, 'State of the World's Forests' (2020)

²⁰ FAO, 'State of the World's Forests' (2020)

²¹ Global Canopy, 'Forest 500: The companies ignoring the human cost of deforestation' (2021)

²² WWF, 'Living Planet Report' (2020)

²³ World Economic Forum, 'How much is deforestation due to agricultural activities?' (2021)

²⁴ FAO, 'State of the World's Forests' (2020)

²⁵ We refer to deforestation as the loss of natural forest resulting from: conversion to agriculture or other non-forest land use; conversion to a tree plantation; or severe and sustained degradation.

Advocacy

We recognise that as investment managers we have an opportunity and a responsibility to help address market-wide and systemic risks in the long term financial interests of the investors we serve. 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 recognise the need for systemic change to address deforestation globally. We work with investors and other stakeholders to call on governments to adopt and enforce policies to provide an enabling environment to prevent and halt illegal deforestation and, where necessary, curb legal deforestation.

Public markets – integration and engagement

In addition to our ESG integration processes, we use a range of data sources to assess which of our investee companies²⁶ are exposed to forest-risk commodities and whether they are managing the associated risks and impacts appropriately. This exposure analysis is completed annually and shared with the investment teams. The outcomes of this analysis are taken into account in our engagement prioritisation.

EOS at Federated Hermes is a leading stewardship service provider. EOS offers a shared service model, engaging on behalf of both Federated Hermes Limited and third-party clients. EOS' engagement plan identifies the key themes and related sub-themes for engagement focus. The plan includes climate change action as a priority theme and biodiversity as an expanding, fast-growing theme for engagement. 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.

EOS expects companies that source palm oil, soy, beef, leather, timber, pulp and paper, among other relevant commodities, to urgently commit to clear timelines for eliminating deforestation from their supply chains by 2030 at the latest. The commitment should cover all commodities, regions and suppliers, including indirect suppliers²⁷. 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.

EOS holds the company's 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 assess companies using a wide range of frameworks and benchmarks, including the Transition

Pathway Index. We also recommend votes against directors of companies that have high risks of deforestation in their value chain, in accordance with the Forest 500 benchmark²⁸.

Real Estate

The real estate and construction sector has an impact on deforestation due to its dependence on timber as a raw material. Therefore, for our Real Estate business, it is one of our priorities to assess our exposure to deforestation risk and potential impacts on deforestation, and to take steps to reduce this.

We have assessed our Real Estate fund and asset management activities for exposure to deforestation risk. In terms of forest-risk commodities, we have identified exposure to pulp and paper and timber. The latter is material for our business as it is widely used in construction and fixtures/fittings. In terms of our activities, our developments and major refurbishment projects are at highest risk of exposure to deforestation due to the amount of timber sourced. This assessment has informed our deforestation policy for Real Estate.

Commitments:

1. New developments and major refurbishments:

- a. As timber is the most material 'forest-risk' agricultural commodity for our Real Estate portfolio, we mandate that all timber and wood products used for structural work and fittings in our new developments and major refurbishments must only come from legal and sustainable sources, which must be verified by certification.
- b. We commit to tracking the source of all the timber and wood product used in our developments and major refurbishments to ensure it is certified by 2025. This will be actioned by implementing a supply chain due diligence process.
- c. We commit to pilot innovative materials or practices that could reduce deforestation by 2025 in our developments and major refurbishments.
- d. We will engage our design teams, contractors, sub-contractors and suppliers on further ways to minimise our exposure to deforestation risk.

2. Management of existing assets:

- a. For management of existing assets, we have exposure to pulp and paper. Therefore, we commit to introduce guidelines for our property managers on how to reduce the risk of exposure to deforestation by end 2024.

3. We will disclose progress against these commitments annually.

²⁶ This excludes certain securities which we will not apply ESG data to: cash, FX, CDS that is short on the underlying, index or pooled product, sovereign, and ABS, CLOs and CDOs issued by companies.

²⁷ Ceres, 'The Investor Guide to Deforestation and Climate Change' (2020)

²⁸ Forest 500, <https://forest500.org/>

Infrastructure

As part of its overall ESG integration approach, the infrastructure team has a set of sustainability-focused expectations and guidance for portfolio companies, based on the EOS Engagement Plan and stewardship model. This guidance informs the team's day-to-day engagement with infrastructure portfolio companies on matters across governance, environmental and social topics and annual strategic asset management priorities. It further supports investment assessments at acquisition stage.

The infrastructure team's guidance includes clear expectations and best practice information related to deforestation. The team is committed to deepening its due diligence and engagement where potential deforestation risk exists, which is more likely to be in supply chains (particularly in the transport sector such as freight services for timber or passenger transport services with food retail) than in direct operations of portfolio companies.

As of 2022, the infrastructure team undertakes an annual assessment of potential deforestation exposure in its current portfolio to highlight potential areas for further investigation, engagement and improvement. To the extent construction or development activities are undertaken at assets, we are further aware that land use and building materials present key areas of potential focus for engagement with portfolio companies.

The infrastructure team's stewardship and key performance indicator (KPI) reporting to investors includes reporting on exposure to deforestation and progress where risks, actions taken or best practices displayed are material at asset or portfolio level.

Direct Lending

Our Direct Lending team have a series of steps in their investment process to mitigate exposure to deforestation. The first is an exclusion process. The team will not engage with or provide loans to companies that have 5% or above direct revenues (at borrower level) from any of the following business activities below:

- **Conservation restrictions:** removal of primary or high conservation value forests; deforestation of tropical rainforest; damage to UNESCO World Heritage Sites; damage to wetlands registered by the Ramsar Convention; damage to critical natural habitats.
- **Palm oil:** cultivation and production of palm oil that is not certified as sustainable.

For those potential investments not impacted by the list of exclusions, analysis of potential investments is undertaken to form a comprehensive view of existing and potential ESG risks. The team has developed a framework of ESG-related questions which provides baseline guidance and ensures a consistent best practice approach to ESG components. This includes a question on whether the company is exposed to deforestation in its operations, supply chain or financing and if so whether it has a commitment or policy in place to reduce or remove its contribution to deforestation. The analysis and risk assessment of ESG components are included in a dedicated section in each investment proposal presented to the Private Debt Investment Committee and reviewed at each annual portfolio review. They also inform the ESG rating assigned by the team to each potential investment which is tabled to the Committee as part of the credit research of the potential investment.

Private Equity

The private equity team integrate deforestation risk analysis into the investment process. New direct co-investments in sectors identified as high risk by Global Canopy²⁹ are subject to enhanced due diligence. The team assess whether companies in such sectors have exposure to the following high-risk forest commodities: cattle, beef and leather; palm oil; timber, pulp and paper; and soy. If the company has exposure to one or more of these commodities, more detailed due diligence and risk analysis is conducted to inform the environmental score assigned to the company. This environmental score impacts investment decision making, and in some cases may preclude investment due to the financial risks associated with investing in a company that is unlikely to be able to adapt to a net zero world.

Real Estate Debt

From 2024, our Real Estate Debt team will seek to include (subject to negotiations) an expectation in loan agreements that all timber and wood products used for structural work and fittings and major refurbishments should come from legal and sustainable sources, which should be verified by certification. Due to lack of reporting, we are not currently able to monitor borrowers' alignment with this expectation.

²⁹ Global Canopy, 'Eliminating Commodity-Driven Deforestation: Finance Sector Roadmap' (2022)

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, where possible, to contribute to positive outcomes that benefit the wider world.

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 or connect with us on social media:

