Investor Policy Dialogue on Deforestation

AN INVESTOR-LED SOVEREIGN ENGAGEMENT INITIATIVE THAT AIMS TO HALT DEFORESTATION

December 2022
Foreword

We are delighted to welcome you to the first progress report of the Investor Policy Dialogue on Deforestation (IPDD). From humble beginnings with a letter to Brazilian embassies in June 2020 calling for action to address deforestation, this collaborative engagement initiative has now grown to encompass three different workstreams and is supported by 67 asset managers and owners from 19 different countries, with more than US$10 trillion in assets under management across equities, debt and forestry assets.

As co-chairs, we are proud of the IPDD’s work to date in highlighting the investment risks to portfolios from failure to halt deforestation in critical regions of the world. Deforestation sits at the heart of climate, biodiversity and food and water security – and poses an ever-growing financial risk. Agriculture, forestry and land use account for 22% of global greenhouse gas emissions, and half of that comes from land use change and tropical deforestation and degradation. Any chance of limiting warming to 1.5 degrees Celsius requires a transformation of the way land is used for food, fibre, and fuel. According to the Accountability Framework Initiative, commodity-driven land clearance must be halted by 2025, and all land use change eliminated by 2030. At the country level too, the loss of critical ecosystems such as the Amazon or the rainforests in New Guinea and Borneo would be disastrous for local rainfall patterns, national agricultural production, biodiversity, and the rights of indigenous peoples and local communities.

Given the criticality of managing forest-related assets sustainably, the IPDD’s focus has been on raising awareness and the need for action, with engagement efforts at senior levels with the governments of Brazil, Indonesia and consumer countries. We have also raised our concerns with other key stakeholders in these, and other regions, who themselves play a critical role in helping IPDD to realise its goal.

While we believe we have made advances across these different workstreams, we are painfully aware that progress remains unacceptably slow, and not commensurate with the urgency and scale of the challenge. The ultimate proof of impact is a decrease in deforestation, which we have yet to see on a material scale. As we have heard across issues of climate, the UN sustainable development goals, and on nature and biodiversity, this really is the decade for action if we are to avoid the worst effects, and unfortunately the window is fast closing. We therefore urge readers to join our collaborative engagement effort or support other groups making the case for accelerated action to stem deforestation.

We hope you find the report useful and look forward to briefing you on further progress in the years to come.

Jan-Erik Saugestad, CEO, Storebrand Asset Management and IPDD Co-Chair

Graham Stock, Partner, RBC BlueBay Asset Management and IPDD Co-Chair

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This report provides an overview of the Investor Policy Dialogue on Deforestation (IPDD), a collective investor engagement undertaking dialogue with governments and related stakeholders on the issue of deforestation, and its activities and progress achieved since its formalisation in 2020.

The report was compiled from interviews with IPDD members and the secretariat, access to IPDD material and insights into the activities conducted, as well as broader desk-based research.

The report firstly outlines the rationale for addressing the issue of deforestation (Section 2), before setting out the investment case for action (Section 3). Exploring why collaborative initiatives are critical when addressing systemic risks such as deforestation, the report then details the IPDD’s governance and origins, as well as key learnings and progress (Section 4). This is followed by an overview of the workstreams comprising the IPDD’s work to date (Sections 5, 6 and 7) before finally setting out overall reflections and next steps (Section 8).
Executive Summary

The Investor Policy Dialogue on Deforestation (IPDD) is an investor-led sovereign engagement initiative that aims to halt deforestation in some of the world’s most biodiverse, carbon-absorbing biomes. Deforestation is a critical issue. It sits at the heart of climate, biodiversity and food and water security – and poses an ever-growing financial risk. Ending deforestation and implementing natural climate solutions can provide a third of the solution to meeting the Paris climate target, at the same time as halting biodiversity loss. More than half of global GDP is dependent on nature and the services it provides, and forests are essential to commodity supply chains and economies across the globe. Yet deforestation continues at a relentless rate, with the tropics losing 11.1 million (m) hectares (ha) of tree cover in 2021, including 3.75m ha of primary forest, the type of forest most critical to limiting global heating and biodiversity loss.2

Deforestation represents a systemic risk

Financial institutions have a fiduciary duty to act in the best long-term interests of their beneficiaries. Continued deforestation directly affects future economic prosperity and represents a systemic risk – that is increasingly material financially – to investment portfolios and clients’ funds and assets. Many investors are exposed indirectly or directly to deforestation through global supply chains containing forest-risk commodities such as soy, beef, palm oil and others. Sovereign and fixed income investors increasingly consider deforestation as something that impacts the creditworthiness of a country or investment. It is in investors’ best interests to support a transition to more sustainable policies and practices in a way that conserves and restores forests and protects local communities and livelihoods. Investors believe favourable conditions for investment and lower levels of deforestation can co-exist.

Deforestation: loss of natural forest as a result of: i) conversion to agriculture or other non-forest land use; ii) conversion to a tree plantation; or iii) severe and sustained degradation

Why investors need to focus on policy and dialogue

Deforestation is an issue that cannot be solved by any one group alone. Collective action across society using a holistic, multi-stakeholder approach is required. Dialogue with governments, who can create an enabling policy environment to support a transition to more sustainable practices, is key to making this happen.

While investor efforts to address energy consumption and transportation policy already exist, a strategic investor focus on deforestation at the national policy level has been missing until now. The IPDD addresses this gap.

The Investor Policy Dialogue on Deforestation (IPDD)

The IPDD undertakes dialogue with government-related authorities and associations, industry and trade bodies, and other stakeholders. The aim is to ensure the long-term financial sustainability of investments, by promoting sustainable land use and forest management, and respect for human rights. The IPDD involves:

- Voicing concerns about deforestation to governments
- Supporting governments to continue to make gains in tackling deforestation while also providing conditions favourable to investment – thereby showing it is possible to have both sustainable finance
- Encouraging governments to reverse recent trends where deforestation is rising
- Engaging with governments to provide investor perspective on the policies, regulation and decision-making processes relevant to investors
- Providing advice to governments on sustainable finance
- Demonstrating to governments the value attached to preserving natural assets and discouraging potentially unsustainable land use
- Raising awareness around deforestation within investor community

IPDD’s Current Focus

Brazil

Brazil has often been the country with the most primary forest loss. In 2021, more than 40% of global tropical primary forest loss occurred in Brazil (1.5m ha).6

Indonesia

Indonesia’s downward trend in deforestation continued for a fifth year in 2021, with the rate of primary forest loss falling 25% compared to 2020.7

Consumer Countries

An increasing amount of deforestation-related regulation is being enacted and debated in countries and regions such as the UK and EU. IPDD sees this as a critical space in which to voice investor perspectives and expectations.
Palm oil, soy, cattle and timber, pulp and paper are the most common commodities associated with deforestation, but others include rubber, cocoa and coffee.

Forests and native vegetation contribute significantly to climate change mitigation, biodiversity protection and food and water security and support many livelihoods, indigenous peoples and local communities.

Reaching a net-zero economy means deforestation has to end. Commitments to address deforestation are growing.
More than half of the world’s GDP is dependent on nature and its services, and increasing evidence shows how important nature is to financial stability at both a macro-level and the level of individual financial institutions.

Forests are essential to the global economy

As a major biome covering around a third of the Earth’s habitable surface, forests play a crucial role in climate change mitigation, biodiversity protection and food and water security. One of the most biodiverse ecosystems globally, forests are home to 80 percent of terrestrial species, store carbon and are a key part of the global water cycle. Despite this, deforestation continues, increasing by 12 percent between 2019 and 2021. Brazil accounted for 40 percent of primary rainforest loss in 2021, with the Democratic Republic of Congo, Bolivia, Indonesia and Peru making up the remainder of the top five, together releasing the equivalent of India’s annual fossil fuel emissions.

Key drivers of deforestation

- More than two-thirds of tropical deforestation is driven by unsustainable production of palm oil, soy, cattle products (including beef and leather) and timber, pulp and paper
- Further drivers include illegal logging, fires, mining, infrastructure and crop expansion

Direct deforestation risk is associated with several economic sectors, most notably the following:

- Agriculture: soy, cattle products (beef and leather), palm oil, cocoa etc.
- Logging in natural forests
- Timber plantations, pulp and paper mills, rubber plantations
- Mining
- Infrastructure and energy (such as roads, railways, ports, dams, transmission lines, etc.)
- Oil and gas installations and pipelines

Indirect deforestation risk is prevalent in the following supply chains, due to their use of forest risk commodities:

- Food and animal/fish feed: beef, soy, palm oil, cocoa etc.
- Cosmetics and cleaning products: derivatives of palm oil, soy, coconut oil etc.
- Paper products and packaging: pulp and paper.
- Clothing and footwear: cellulose-based viscose, leather, rubber.
- Furniture, building materials: tropical hardwoods.
- Vehicle and tyre producers: metals, leather, rubber.
- Publishing: pulp and paper.
- Transportation (land, sea, air): producers and consumers of biofuels based on palm oil or soy.
- Energy: heating/electricity generation based on palm oil, soy, wood pellets.
- Metal industries and technology: metals and minerals.

Adapted from source: https://engagethechain.org/investor-guide-deforestation-and-climate-change, August 2022

1 The Network for Greening the Financial System (NGFS) published a statement in March 2022 saying it was of the view, based on scientific evidence summarised by the IPBES, that “nature-related risks, including those associated with biodiversity loss, could have significant macroeconomic implications, and that failure to account for, mitigate, and adapt to these implications is a source of risks for individual financial institutions as well as for financial stability.” See: https://www.ngfs.net/en/communique-de-presse/ ngfs-acknowledges-nature-related-risks-could-have-significant-macroeconomic-and-financial
Impacts of Deforestation

Climate change

Forests absorb and store greenhouse gas emissions, while deforestation releases further emissions. According to the Intergovernmental Panel on Climate Change (IPCC), reducing deforestation is one of the most effective ways to mitigate climate change. Protecting forests at scale will play a critical part in being able to meet net-zero emissions by 2050, limiting global temperature increase to a rate at which life on the planet can continue to survive, offering, along with other nature solutions, 37 percent of the climate solution.

Agriculture, forestry, and land use account for

22% of global greenhouse gas emissions, with half coming from land use change and tropical deforestation and degradation.

The mitigation potential of reduced deforestation is about

1/3 of total global GHG emissions (IPCC).

Nature and biodiversity

Large-scale deforestation is one of the key contributors to biodiversity loss, as well as desertification and soil erosion. More than half of the world’s GDP – $44tn of economic value generation—is moderately or highly dependent on nature and ecosystem services (such as rainfall, water supply, pollinators and disease and pest control). Construction, agriculture and food and beverages are the largest highly nature-dependent industries. More than 1.6bn people are dependent on forests for their livelihoods.

Social impacts

Intensive deforestation can lead to the loss of livelihoods and homes for indigenous groups and local communities, and is also linked to human rights violations, modern slavery and low wages. An article by Global Canopy refers to human rights violations of local and indigenous communities affected by forest clearing, and of workers involved in producing forest-risk commodities, while a 2021 study in One Earth reports that NGOs and scholars have identified exploitation of labourers in the Brazilian Amazon in illegal deforestation hot-spots.

Growing concerns – and commitments

Tackling deforestation provides an avenue for acting on climate, biodiversity, food security and human rights issues all at once. However, protection of forests varies by country, as do definitions of legal and illegal deforestation. While most countries globally took legislative and policy actions to try reverse loss of forest cover in 2021, Africa and South America were still losing forest area, and while more than half of the world’s forests were under long-term management plans, less than 20 percent of forests in South America, Oceania, and Africa were protected in this way.

The Glasgow Leaders’ Declaration on Forests and Land Use – where 141 governments covering 90 percent of the world’s forests agreed to halt and reverse deforestation by 2030 – was seen as a key breakthrough at the COP26 climate summit in Glasgow. The signatories included Brazil and Indonesia, the first two counterparts for the IPDD’s engagement efforts. However more urgent action is needed. The majority of commodity-driven land clearance and deforestation must be halted by 2025 to reach net-zero.

In December 2022, COP 15 under the Convention on Biological Diversity will convene governments from around the world in Montreal, Canada to agree to a new set of goals for nature over the next decade through the Convention on Biological Diversity post-2020 framework process. These goals will likely have clear expectations for businesses and financial institutions to disclose biodiversity impacts, for example. Further deforestation regulation from consumer regions including the UK and EU will continue to impact investors, companies and producer countries.

Agriculture and food security

Agricultural productivity is affected when deforestation causes the loss of biodiversity and ecosystem services, soil degradation and disruption of hydrological cycles. Following a 2021 Nature study showing deforestation could reduce rainfall, negatively impacting crop yields and agricultural revenue in Brazil, Chain Reaction Research reported the beef and soy industries in the Southern Amazon region were at potential risk of almost US$20bn in productivity losses due to Amazon deforestation. In the northern state of Rondônia, which lies within the legal Amazon, the start of the rainy season has already shifted by 11 days during the past 30 years, while in areas without heavy deforestation, the onset has not changed significantly.

Recent global turbulence, including conflicts, COVID, supply chain disruption and increasing extreme weather events, has also demonstrated how closely intertwined the global economy and food security are with climate and nature. Climate-linked disasters caused USD$108bn in crop and livestock production losses in developing countries between 2008 and 2018.

Deforestation and forest degradation release more than

8 gigatons of CO₂ equivalent in the atmosphere each year – more than half of what it absorbs.
Deforestation increasingly represents a long-term, financially-material portfolio risk, with investors, companies and countries exposed to ongoing deforestation facing increasing financial, regulatory, reputational and supply chain risks.

Financial institutions have a fiduciary duty to act in the best long-term interests of their beneficiaries, while acting within the parameters of client mandates.

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Investors want to support a transition to deforestation-free practices so they can continue to invest in companies exposed to forest-risk commodity supply chains and in countries where these commodities are produced.

Deforestation as an investment issue is rising up the agenda. Investors are realising addressing deforestation is a key part of meeting 2050 net-zero targets.
Deforestation as a Long-Term, Financially-Material Risk to Portfolios

As financial institutions with a fiduciary duty to act in the best long-term interests of their beneficiaries, investors recognise ESG considerations or sustainability matters increasingly represent long-term market risks which must be accounted for more strategically. Escalating deforestation in countries with important, at-risk biomes such as Brazil, along with concerns about weakening environmental and human rights policies and enforcement, are creating uncertainty about the conditions for investing in or providing financial services to these countries.

Investor exposure to deforestation risk can occur either by financing clients or holdings directly connected to deforestation risk through production or processing of forest-risk commodities, or financing those which procure forest-risk products or financing those that finance these activities or commodities. These risks pose potential material financial impact for financial institutions, corporates and governments. Companies exposed to potential deforestation in their direct operations and supply chains will face increasing difficulty accessing international markets.

At the sovereign level, the risks are macro-economic. Deforestation threatens to disrupt ecosystem services and undermine productivity across a range of sectors, jeopardising growth directly and indirectly through potential loss of access to export markets – as a result of the inability of local companies to meet consumer country and regional regulations and standards relating to finance, ESG factors, deforestation and human rights, for example.

At the corporate level, these risks can be subdivided into:
- Reputational
- Regulatory and legislative (leading to fines or increasing costs)
- Operational
- Market (changing consumer preferences)
- Physical (more droughts or fires and fewer ecosystem services can lead to reduced crops, increased costs)

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[Diagram: ESG Risks, Supply Chain Risks, Finance Sector Risks, Environment, Operational, Social, Regulatory, LITIGATION, Market, Governance, Reputational]

Source: IPDD, March 2021
A growing number of investors are working to identify their portfolio-wide exposure to deforestation risk. IPPD members were among the first to have a deforestation policy that addressed soy, cattle, pulp and paper and palm oil. Investors have also launched biodiversity-focused engagement programmes engaging with companies exposed to soy procurement, timber, cocoa, natural rubber and beef, as well as having a dedicated engagement programme for palm oil producers.

Despite this, of the 675 companies involved, only 36% had a no-deforestation policy.

The accelerating climate and nature transition, and associated incoming policy and demand shifts, could drive permanent value loss across food and agriculture sectors with an impact equivalent to USD$150 billion in losses to investors if investors do not act now to protect value.

A 2022 study by the Accountability Framework initiative and non-profit CDP found that 211 disclosing companies identified nearly US$80bn in forest-related risk, while 267 companies identified that the cost of responding to forest-risk was close to US$7bn.

With the SFDR principal adverse impacts regime requiring extensive ESG disclosures, and due diligence regulations in UK and EU just around the corner, acting on deforestation is fast transforming from a ‘can do’ to a ‘must do’. As regulatory scrutiny intensifies, we expect to see deforestation-related bans affecting corporate revenues and reputations.

Emine Isciel, Head of Climate and Environment, Storebrand Asset Management

Governments should not be managing their natural resources like forests to degrade them. Doing so negatively affects their future economic prosperity. Rather governments need to ensure sustainable management in order to reap the economic, environmental and social benefits into perpetuity.

My-Linh Ngo, Head of ESG Investment, RBC BlueBay Asset Management

We’re not just looking at investing in forests or expecting to extract a return from the immediate impact of this work; it’s broader, it’s about the systemic risk to our portfolios from deforestation and tackling that and raising awareness.

Graham Stock, Emerging Markets Sovereign Strategist, RBC BlueBay Asset Management, co-chair of IPPD

Sovereign bonds may be deemed high risk if rising deforestation trends continue

Along with financial, political, and economic risk, ESG risk is embedded in the credit rating of a country, which may affect access to and the cost of capital. While deforestation is not the single driver, it is an important driver of the overall assessment of sustainability in a country.

The correlation between negative performance on a single issue such as deforestation and a higher cost of capital for a sovereign is not stable, but investors believe it is important to draw attention to the potential negative impact on debt service capacity. The multiple transmission channels could include slower economic growth, lower exports and tax revenues and higher spending on climate change mitigation.

The regulatory environment is also evolving in a way that drives up the cost of capital for sovereigns that underperform on ESG metrics. Financial institutions will need to comply with increasingly onerous standards if they are to call their funds ‘green’ or ‘sustainable’. Likewise, governments that want to issue ‘green’ or ‘sustainable’ bonds will face increasing scrutiny of their alignment with international frameworks and the overall ambition of their policies on environmental matters.

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The regulatory landscape, particularly in consumer countries, has been changing rapidly, elevating this as a risk area for financial institutions and their clients. EU financial regulations such as the SFDR and the related EU Taxonomy are forcing investors to take ESG-related risks, including biodiversity, into consideration. Deforestation-specific regulation in the UK, and under development in the EU, will affect the importing of commodities associated with deforestation. Given companies domiciled in these regions may be multi-nationals, this will increasingly have a global impact.

Future regulation may also include more incentives for allocating capital to positive activities – e.g. mandatory reporting on biodiversity through the Taskforce on Nature-related Financial Disclosures will allow investors to identify risk and redirect capital. Mandatory reporting of biodiversity impacts by businesses, and alignment of financial flows with biodiversity targets, are also example requirements proposed in the draft Post-2020 Global Biodiversity Framework. Ultimately, current and future regulation will force investors who are not currently addressing the issue to integrate deforestation into their decision-making process.
How Governments are Addressing Deforestation

**EU**

**Sustainable Finance Disclosure Regulation**
- Disclosure requirements for sustainability risks and how ESG factors are being addressed in the financial services sector (Climate & Company).

**Taxonomy regulation**
- Provides a reference framework with definitions of sustainable activities, which other sustainable finance instruments (such as the SFDR) can reference.

**Deforestation-free Products Regulation**
- Limits the import of forest-risk commodities, and the placing on the market or exporting of products containing them. Commodities include palm oil, beef, timber, soy, cocoa, coffee, rubber, maize, other livestock (pigs, sheep, goats, and poultry), charcoal, and paper products, as well as derived commodities such as leather, chocolate, and furniture. Amongst others

**UK**

**Law**

**UK Environment Act 2021**
- Prohibits businesses from using illegally produced forest-risk commodities. Commodities being considered for inclusion within scope are cattle (beef and leather), cocoa, coffee, maize, rubber, palm oil, and soy.

**COLOMBIA**

**Action**

Colombia commits to halving deforestation by 2025.
- In 2019 Colombia announced ambitious goals to halve deforestation by 2025 and to launch large-scale programmes in support of forest conservation and ethnic groups. At COP26 in 2021, Norway, Germany and the UK provided results-based-payments to be reinvested in innovative actions to catalyse further the impactful progress Colombia is achieving for its forests.

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**Momentum Growing Across the Financial Sector**

Investors are increasingly committed to addressing deforestation, and broader climate targets are mandating action on deforestation too. Further examples include:
- COP 26: The Commitment on Eliminating Commodity-Driven Deforestation was also signed by 33 financial institutions, representing US$8.7tn of capital, committing to actively work to eliminate commodity-driven deforestation impacts (for palm oil, soy, beef and leather, pulp and paper) in their portfolios by 2025
- Connected initiatives or commitments such as Finance for Biodiversity and Nature Action 100+
- Recently updated Race to Zero v3 criteria including a requirement to make finance consistent with climate resilient development – including ending deforestation and conversion of other natural ecosystems and respecting biodiversity,

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A collective and multi-pronged approach is necessary for systemic issues

The Investor Policy Dialogue on Deforestation (IPDD) is a collaborative investor initiative set up to coordinate a public policy dialogue on halting deforestation

IPDD engages with governments, regulators, and other relevant stakeholders to support them to tackle deforestation and create enabling environments for sustainable supply chains
Collective Action Towards an Enabling Environment for Tackling Deforestation

Over the years collective action on deforestation has evolved from environmentalism and civil society to include the perspective of investors engaging with corporates and finally, policy makers. IPDD provides this final missing link (see Figure 3).

Figure 3

Source: https://www.tropicalforestalliance.org/en/collective-action-agenda August 2022

No One is Going to Solve this Alone

Multipronged and multi-stakeholder engagement strategies are required for complex issues that touch on all aspects of life and society. Tackling deforestation is a case in point – it requires multiple parties to work together to find solutions that sustainably conserve these resources, while considering the impact on livelihoods and local and indigenous communities.

Investors have long been engaging with corporates on ESG-related matters. In recent years though, it has become clear that voluntary action from a few will not be enough to move the market at scale. The private sector alone cannot create the systemic change needed to ensure sustainable finance. Given forests are a public good, and thus the responsibility for their oversight lies with governments, it is critical investors engage more directly with policymakers on forest-positive policy and enabling regulatory environments that will help companies, and entire industries, act more responsibly.

The London School of Economics and Political Science encourages this approach and highlights the specific role sovereign bond investors can play, such as supporting the issuance of bonds that integrate incentives for reducing deforestation.43 The In Brief State of the World’s Forests report also cites the importance of various policy responses including decoupling agricultural commodities from deforestation, REDD+, integrated landscape approaches and the strengthening of governance and legality, including around supply-chains.44

Source: The Investor Policy Dialogue on Deforestation

Sovereign engagement is something complementary to company engagement – companies alone can’t change systems, they need enabling environments... regulations and policy enforcement can change how companies are operating in a country ... This is the role of governments to create the enabling environment for sustainable finance.”

Jan Erik Saugestad, CEO of Storebrand Asset Management, and IPDD Co-chair

I’ve participated in webinars alongside representatives of the indigenous communities in Brazil – I’ve never done that in my day job researching government bonds. This demonstrates the breadth of the coalition that exists on this topic and how we bring something new that wasn’t there a few years ago.”

Graham Stock, RBC BlueBay Asset Management, Co-chair IPDD and Brazil workstream
A holistic perspective is vital when looking at deforestation. The issue cannot be defined by a single organization. The problem impacts each stakeholder differently in their local geographies.

Magdalena Kettis, Active Ownership Director, Responsible Investment, Nordea Asset Management

A diverse set of investors, one message

IPDD has been key to establishing deforestation as a material investment issue – and creating the space, priority rating and momentum for others to get involved. Reasons for engagement include:

- While there is a broad coalition across society working on this issue, investors are coming at deforestation from a specific angle – that of financial risk
- Investors are also demonstrating that deforestation is a risk for the growth outlook of a country in which it takes place, affecting that country’s standards of living and future prosperity
- Engagement means staying involved and talking to those affected, rather than ignoring the issue, and in this case, coordinating an ongoing public policy dialogue
- Supporting governments to continue to make gains in tackling deforestation, or reverse recent trends where deforestation is rising, while also providing conditions favourable to investment can help show it is possible to have both
- Engaging with governments creating regulation is key to ensure the investor perspective is included

Tackling deforestation is increasingly recognised as a material investment issue – and creating the space, priority rating and momentum for others to get involved. Dialogue encourages adoption and implementation of regulatory frameworks that ensure sustainable use of forests, native vegetation and human rights.

Producing countries workstreams (Brazil, Indonesia) focus on the supply side, while the Consumer Countries workstream addresses the demand side of the issue. Other countries where deforestation is an issue, and where investors have a voice via mechanisms such as an equity market or bond issuance, may become the focus of future workstreams.

Working Groups

The IPDD engages with policymakers, regulators, politicians and relevant government authorities, industry associations and other relevant stakeholders (which may include companies, civil society, academia or the media), both domestic and foreign. Dialogue encourages adoption and implementation of regulatory frameworks that ensure sustainable use of forests, native vegetation and human rights.

Producing countries workstreams (Brazil, Indonesia) focus on the supply side, while the Consumer Countries workstream addresses the demand side of the issue. Other countries where deforestation is an issue, and where investors have a voice via mechanisms such as an equity market or bond issuance, may become the focus of future workstreams.

Goverance

From an organisational and governance perspective (see Figure 4), there is a Management Committee comprised of initiative co-chairs, co-chairs of working groups, country lead investors, and the Tropical Forest Alliance

The Management Committee sets the strategy and direction of the work of the IPDD, with input and support from the wider supporting investor members and the various formal country workstreams. Each country workstream has its co-chairs represented in the Management Committee and has specific engagement objectives and work programmes.

The formation of country workstreams and the appointment of co-chairs requires the approval of the Management Committee. The Tropical Forest Alliance (TFA), an initiative hosted by the World Economic Forum, provides secretariat support, with the Principles for Responsible Investment (PRI) involved in a Supporter role.

While the IPDD deliberately does not prescribe how investors should act on the insights gained from the sovereign dialogues, these will clearly input into individual views and actions. Insights gained could impact investor’s expectations of how countries and companies manage deforestation risks, how a company’s own lobbying activities affect deforestation, how investors vote at shareholder meetings or encourage investors to lead deforestation-focused shareholder resolutions.

All investors’ decisions that relate to the countries that participate in the engagement initiative shall be part of each institution’s own decision-making process. Investors cannot (and do not) collectively make investment or divestment decisions. While some investors have historically chosen to divest at certain points, they report this has been considered one step in an ongoing process of engagement – an escalation in action when the risks are too high to stay invested or desired progress has not been achieved.

Figure 4: Governance of IPDD

Management Committee
Co-chairs of IPDD Working Groups, Country Lead Investors, Tropical Forest Alliance (Secretariat)

IPDD Brazil
Co-chairs:
RBC BlueBay Asset Management
Storebrand Asset Management

IPDD Indonesia
Co-chairs:
Church Commissioners for England
Robeco Asset Management

IPDD Consumer Countries
Co-chairs:
Brandywine Global
Legal & General Investment Management

Full list of IPDD Members available on page 59

Source: IPDD, 2022

While some investors have historically chosen to divest at certain points, they report this has been considered one step in an ongoing process of engagement – an escalation in action when the risks are too high to stay invested or desired progress has not been achieved.
Key Elements of the Engagement Model

- **Structured**
  - Robust governance and operating models
  - Secretariat ‘engine’ with deep knowledge and relationships
  - PRI-supported

- **Adaptive**
  - A large membership offers many different roles and ways of being involved
  - Work programme can remain responsive and adaptive given skills and high membership

- **Collaborative**
  - Members support each other with different strengths and perspectives

- **Inclusive and diverse representation and strengths**
  - Different investor types and asset classes
  - Different country representation by investors includes strong local voice as well as multi-national and international organisations
  - Different members bring different strengths – e.g. languages, relationships

- **Mutually beneficial**
  - Awareness raising and mutually beneficial style of engagement improves understanding of the issue (sovereigns and investors learn from each other, different types of investors learn from each other)
  - Partnership model with high trust

- **Educational**
  - Investors learn from each other and from external organisations (government, academia, civil society) to improve understanding of the issue
  - Investors offer educational opportunities
  - Each workstream has two streams: engagement with policy makers, internal education (includes learning from academia and civil society)
The Origins of the IPDD

Investors have been engaging on deforestation for more than a decade, with an initial focus on palm oil and Asia expanding to include other soft commodities driving deforestation in Brazil. During this time, investors realised the limitations of corporate action in isolation, and that an enabling policy and regulatory environment was essential.

In 2020, following the significant 2019 Amazon fires, a network of international investors contacted the Brazilian Embassy in their home countries to raise concerns about the upcoming fire season and deforestation, using a letter drafted by Storebrand Asset Management with the support of PRI. The 34 signatories included investors whom were shareholders or investors in companies which had exposure to deforestation originating in soy and cattle production, as well as investors in sovereign bonds from Brazil. The letter stated clearly the financial institutions saw deforestation and the associated impacts on biodiversity and climate change as systemic risks to their portfolios.43

In response, the Governor of the Central Bank of Brazil met with the group. This meeting, along with widespread media coverage and growing visibility of deforestation as an issue, was a catalyst for subsequent dialogues held to elevate and advance investor concerns. An expectation of next steps, and a genuinely high level of ambition from the signatories of the original letter, created a cumulative upswell of interest.

Given the positive traction gained, and the recognition that ongoing dialogue was needed, it was evident that formalising investor efforts would be beneficial. IPDD’s remit offered a different and specific angle on which to engage, one which many parties could get behind. Sovereign engagement, and a collaborative approach between investors, were the missing links IPDD provided.

Coming at the problem with different perspectives proved immensely helpful. Equity investors traditionally engaged with corporates on technical issues such as traceability and data soon realised their sovereign and fixed income investor counterparts held insights and relationships necessary for dialogue at a sovereign or policy level. Meanwhile, sovereign bond investors were encountering growing ESG and deforestation-related risk in their portfolio, and they appreciated the historical knowledge equity investors held and their connections with organisations such as the PRI.

Learnings from IPDD’s Engagement Model

It is rare that different investor types and asset classes come together on a single topic – but deforestation is an issue that speaks right across the economic spectrum. Engagement is considered critical and responsible for all asset classes, however engagement with sovereigns can be challenging,47 with longer timelines and the need for more flexibility (given the complex, changing landscape of stakeholders) and transparency (so as to avoid being misinterpreted as lobbying, for example) than engaging with corporates and corporate bond issuers.47

Investors involved describe the IPDD model as positive and constructive, one that works hard to promote awareness amongst policymakers about the risks of deforestation and the position of institutional and other investors, share best practices, and encourage governments to acknowledge the value in halting deforestation. The response from sovereigns has been very encouraging, and investors also report significant interest in this dialogue from clients, journalists and civil society.

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A collective model brings a plethora of skills and perspectives to the table

While there is significant complexity involved in this type of engagement, its inherently collaborative nature makes it possible. Work programmes benefit from different investor knowledge bases, relationships and diverse regional perspectives. Different members can lend their skills – from language proficiency to sector- or country-specific expertise – to the areas that suit them best.

Mutual respect, benefit, and trust forms the basis of the dialogue

Engagement offers valuable learning for both sides. Investors can offer governments valuable insights, such as success factors for green bonds, how the EU Taxonomy is being applied, or the trajectory of regulation from other countries which may impact key trading commodities. Meanwhile, investors say they better understand the challenges governments face, and the nuances of deforestation issues in Brazil and Indonesia. This learning continuously informs workstream work programmes, as well as identification of key stakeholders.

Table 3. Sovereign bondholder engagement: a mutually beneficial process

<table>
<thead>
<tr>
<th>VALUE CREATED</th>
<th>FOR INVESTORS</th>
<th>FOR SOVEREIGN ENTITIES</th>
</tr>
</thead>
<tbody>
<tr>
<td>Exchanging information</td>
<td>• Clarify sovereign performance on credit-relevant ESG issues</td>
<td>• Understand growing investor ESG appetite, peer best practice</td>
</tr>
<tr>
<td></td>
<td>• Evaluate government ESG strategy, clarify public policy</td>
<td>• Appreciate how ESG integration in bond valuations may affect demand, borrowing costs</td>
</tr>
<tr>
<td></td>
<td>• Emphasise stakeholders’ partnership role</td>
<td>• Address investor misconceptions</td>
</tr>
<tr>
<td>Improving transparency</td>
<td>• Encourage better ESG-relevant data disclosure</td>
<td>• Demonstrate good governance through openness to dialogue, potentially improving investability</td>
</tr>
<tr>
<td></td>
<td>• Enhance risk assessment</td>
<td>• Develop regular information process to underpin bond issuances</td>
</tr>
<tr>
<td></td>
<td>• Contribute to more efficient, accessible capital markets</td>
<td></td>
</tr>
<tr>
<td>Creating opportunities</td>
<td>• Build long-term issuer relationships</td>
<td>• Strengthen long-term investor loyalty</td>
</tr>
<tr>
<td></td>
<td>• Meet client ESG demand, expectations</td>
<td>• Preserve/secure long-term capital flows, market access</td>
</tr>
<tr>
<td></td>
<td>• Solicit investments that contribute to real-world outcomes e.g. funding environmental, social or SDG-related goals</td>
<td>• Optimise funding costs</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Explore mechanisms to fund SDG-related commitments, tap new capital sources</td>
</tr>
</tbody>
</table>

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A ‘prototype’ or model for sovereign engagement: Governments play a key role in promoting and supporting sustainable business practices by creating a level playing field for companies to uphold environmental practices. This model is an approach for sovereign engagement which could be applied to other topics, such as coal or energy.

Maintaining a distinctive investor focus: There are many different perspectives and solutions for tackling deforestation proposed by various actors in civil society. The IPDD aims to convey a clear signal from the private sector as long-term investors in a country.

The value and visibility of a single voice: Co-ordinating and aligning messaging and insights has helped investors ‘speak’ with one voice and be heard in complex environments with competing priorities. This adds another voice and level of legitimacy to the calls to halt deforestation. Engagement with individual investors may also otherwise not be a priority for sovereigns that are included in major bond indices.50

Finding common ground among investors: As with any group of investors, there will be different motivations for joining the IPDD, as well as differing views on strategies and solutions. It has been important to establish and focus on shared objectives. The IPDD cannot and does not prescribe the actions investors should take following the IPDD engagement.

Defining impactful but achievable objectives: The drivers of, and solutions for, sustainable forest management are multifaceted. The IPDD prioritises solutions and asks which are practical, achievable, measurable and appropriate for the stakeholders engaged with. Solutions must be sustainable domestically and avoid international financial dependence.

Locally-specific solutions and appropriate investor representation: While deforestation can have global, regional and local impacts, solutions have to be local and context-specific. This is reflected in the creation of discrete but complementary country workstreams. The IPDD does not seek to infringe upon sovereignty or democracy. Workstreams include domestic investors to ensure this perspective is clear.

Seeking a balance between transparency and trust: While the group will seek to be as open as possible to demonstrate and measure progress, there will be a level of transparency appropriate to facilitating open and honest dialogue. A balance will need to be sought between the two.

Focusing on systemic stewardship: The IPDD’s workstreams have helped improve awareness and support for deforestation among investors. While the IPDD discusses deforestation, it does not seek to infringe on sovereign or democratic decisions, but rather works with them to identify and pursue mutually beneficial solutions.

Structure: Members of the IPDD cite the importance of a robust governance and operating model when structuring a collaborative engagement on a systemic issue. A secretariat is the engine that keeps it going – and must have depth of knowledge, legitimacy, the right approach and the right interface and connections.

““

We have great expectations of course! Instead of a one-on-one engagement, this is a big group of investors from all over the world who share the same concerns. A collaboration of this scale sends a very strong message to the governments with whom we interact: deforestation is a problem that impacts a wide range of focus areas. IPDD is committed to positive change to ensure there is an enabling investment environment”

Magdalena Kettis, Active Ownership Director, Responsible Investment, Nordea Asset Management

Progress

1. Significant progress has been made in terms of awareness-raising and identifying and meeting with key stakeholders. Refer to pages 40-41 + 48-49

2. A clear message has been conveyed to governments that financial market participants and investors consider deforestation to pose investment-relevant, material risks and may affect access to capital markets.

3. IPDD has helped demonstrate government engagement adds value.

4. The group has created a space for, and added weight to, the efforts of other stakeholders in these countries who share investors concerns about deforestation risks.

By all parties sharing insights and perspectives, it has been possible to identify shared objectives, barriers and potential solutions with relevant stakeholders both inside and outside the country.

5. IPDD has raised general awareness, including broader investor awareness about the issue of deforestation risk.

The IPDD coalition has nearly doubled in size in two years. It provides a forum for more coordinated and direct engagement for investors. The IPDD also provides a basis for additional country workstreams to develop. IPDD’s public engagement, including media coverage and press releases alerting other investors about key engagements, has helped highlight unsustainable land use and encouraged other stakeholders to proactively engage and collaborate.
A Strong Model for Future Engagements Focused on Crucial Forests

Brazil has the largest primary rainforest of any country, but also some of the world’s highest rates of global forest loss, savanna, wetlands. In 2021 alone, it lost 2.90m ha of natural forest, equivalent to 1.70Gt of CO2 emissions. The country is one of the largest producers of forest-risk commodities such as soy and beef, as well as timber, pulp and paper, palm oil and cocoa. Drivers of deforestation extend beyond agriculture to include illegal logging, fires, mining, infrastructure and crop expansion. Crop expansion may be driven by land speculation whereby forests are cleared to create pasturelands for cattle, which is then sold and converted to cropland for commodities such as soy. Deforestation, along with forest fires, will impact the country’s ability to harness its forestry assets in the future for sustainability and finance initiatives such as carbon financing, or meet its Paris Agreement obligations.

Deforestation in Brazil

“[The Amazon and Cerrado] are [two] of our planet’s most important stores of carbon, freshwater and biodiversity — and also major food production centers, especially of soy and beef.”

Finance for a Forest-Positive Future: the transition to sustainable cattle and soy production report from the UN’s Innovative Finance for the Amazon, Cerrado and Chaco (IFACC) initiative.

Deforestation in Brazil
The Amazon is the world’s largest tropical forest, covering 5.5m square kilometres (2.1m square miles), an area larger than the EU. It plays a key role in the global carbon cycle and hemispheric hydrological systems, as well as regional and global economic activity. Home to 30m people, including 1.6m from more than 400 different indigenous communities, the forest also contains a third of known plant and animal species on land.

Sixty percent of the forest is in Brazil. The Brazilian Amazon is almost 19 percent cleared and may be approaching a tipping point of 20 – 25 percent clearance, which could lead to a significant, sudden decrease in rainfall in the southern and eastern parts of the basin, triggering a transition toward a non-forest ecosystem. This would have serious consequences for climate change and biodiversity, as well as affecting agricultural sectors and water supplies in cities.

The Cerrado is the most biodiverse tropical savanna in the world, and South America’s second largest biome, with an area larger than Western Europe, covering nearly a quarter of Brazil. The savanna stores vast quantities of carbon and is a key water supply for much of Brazil. Nearly half of the Cerrado has been cleared and converted to mostly pasture and farmland for cattle and soy production.

The Pantanal is the one of the world’s largest freshwater wetlands, with part of it covering millions of hectares in Central Western Brazil. It is home to a diverse range of flora and fauna, and plays an important role in climate stabilisation and purification of water.

Deforestation Trends

- Deforestation has been accelerating since 2019, following an upward trend since 2012
- Prior to 2012, deforestation had gone through a period of steep decline since the mid-2000s
- Deforestation in the legal Amazon for the January – June period in 2022 was the highest since DETER data collection began in 2015, increasing by 10.6 percent compared to the same time period in 2021, according to Brazil’s National Institute for Space Research (INPE)

Source: http://terrabrasilis.dpi.inpe.br/app/dashboard/deforestation/biomes/

In 2021, agriculture contributed to nearly 28% of Brazil’s GDP, according to the University of Sao Paulo.

Cattle and soy are amongst the drivers of deforestation in Brazil’s most at-risk biomes

Soy
Soybeans are the most valuable export product for Brazil, and the country produces and exports more soy than any other nation, accounting for nearly one-third of global production. Half of this is grown on 18.2m ha in the Cerrado, and by the end of the decade, another 7.2m ha is expected to be farmed for soy – 2.2m ha of which will involve clearing native vegetation.

Cattle products
Brazil ties with the United States for the title of the world’s largest exporter of beef. Although nearly three-quarters of Brazilian beef is produced for domestic consumption, international demand is expected to grow 35 percent over the next two decades, driven by fast-growing exports to China. Brazil also exports leather. Cattle ranching drives about 90 percent of deforestation in the Amazon as a whole, and 70 percent in the Cerrado, largely through conversion to pasture and via the cattle industry’s demand for soy-based feeds. More than two-thirds of Brazil’s 218m herd, the world’s second largest after India, were raised in the Amazon and the Cerrado.

Changing consumer preferences and growing financial risk
International demand for deforestation-free products is growing, supported by upcoming regulatory change in consumer countries. Downstream companies are starting to exclude Brazil or specific Brazilian suppliers from their purchases in response to deforestation concerns. These changes may also increase the cost of capital for these sectors, creating further financial risk for investor portfolios such companies sit within.

Opportunities exist for more productive and intensive practices using low productivity pasturelands without further clearing of native vegetation. There is an estimated 18m ha of pastureland suitable for soy in the Cerrado– more than twice the area needed for soy expansion to 2030.
The Investor Policy Dialogue on Deforestation

In Brazil, regulation changes according to the Biome. The Brazil Forest Code, the law which defines land use requirements and obligations in Brazil, requires relevant properties within the Legal Amazon to maintain 80 percent of the area of the property as legal reserves, while in the Cerrado or Amazonian savannah, relevant properties are only required to maintain 35 percent within legal reserves.66

Proposed legislative changes

IPDD Brazil is monitoring the progress of the following bills currently under consideration.

PL 2159/2021 – Environmental Licensing

While there is a need to improve the environmental licensing process by simplifying existing procedures, there are concerns that deregulation (via a general law that disregards established regulatory frameworks) could lead to the loosening of environmental regulations, as presented in the Environmental Licensing bill (PL 3729). This goes against global trends, including financial regulations. While bank regulations on environmental, social and climate risks have been strengthened in Brazil, banks cannot replace environmental agencies. Less rigorous regulation and enforcement will result in greater environmental risks for banks and investors.

PL 2633/2020, PL 510 – Land Regularisation

These two bills, which aim to change regularisation of land tenure and ownership in public areas, may encourage new occupations and illegal deforestation of public forests. While PL 2633/2020 maintains the dates of the current law and does not give amnesty to invasions after 2011, changes to PL 510 could authorise the regularisation of occupied areas up until 2014. The legislation may also aggravate agrarian conflicts since it only brings benefits to medium and large occupants of public lands and does not change the situation of small farmers. It could lead to the regularisation of properties with areas between 400 to 1,500 hectares without an inspection to verify the legal requirements of occupation, exploration and effective culture. Since 2009, Brazilian legislation already allows the landholding regularisation of small producers (areas which may reach 440 ha) to be made without the need for field inspections.

IPDD Brazil Objectives

Five specific desired outcomes inform activities and enable evaluation of progress. Against each outcome, investors have identified stakeholders and specific objectives to be addressed.

1. Significant reduction in deforestation rates, i.e. showing credible efforts to comply with the commitment set down in Brazil’s Climate Law, article 19.
2. Enforcement of Brazil’s Forest Code.
3. Reinforcement of Brazil’s agencies tasked with implementing environmental and human rights legislation, and avoidance of any legislative developments that may negatively impact forest protection.
4. Prevention of fires in or near forest areas, in order to avoid a repetition of fires like in 2019.
5. Public access to data on deforestation, forest cover, tenure and traceability of commodity supply chains.

IPDD Brazil Workstream Activity

IPDD Brazil has seen significant success in terms of gaining greater engagement and increasing awareness on such a complex issue, particularly given the many stakeholders and dynamics involved.

IPDD Brazil has established an open dialogue and met with government-related entities and associations, demonstrating a responsiveness on behalf of the government to the investors’ concerns. Dialogue also involves other stakeholders who themselves are interacting with the Brazilian government. Stakeholder meetings have been held with members and groups within the federal government, congress, embassies, state governments and key financial organisations and companies, as well as with members of academia and civil society. IPDD Brazil has identified functions and departments which understand the severity of the issue and are working hard to address it and has also supported these groups by connecting them to each other. The group has been encouraged by actions such as the Brazilian Central Bank launching a new sustainability agenda in September 2020, and the National Treasury of Brazil indicating in 2021 that it was developing an ESG framework and providing investment funds and rating agencies with more data on ESG topics.

IPDD co-chair Graham Stock of RBC BlueBay Asset Management was formally invited by the Ministry of the Environment in Brazil and the Brazilian Central Bank to speak for the IPDD group at the announcement of a national carbon market in Rio de Janeiro. Mr Stock outlined how deforestation was contributing to increasing fiscal risk to the country and noted it would be difficult to attract investment to the carbon market, and meet the country’s broader commitments under the Paris Accord, if deforestation was not tackled effectively. Mr Stock’s comments were widely publicised in Brazilian and international media.

The IPDD’s intervention and positioning on deforestation in Brazil does not seek to infringe on sovereignty and is not intended to be seen as interference. Rather, investors are looking to convey to government and its debt management office specifically, as well as the Central Bank, that how the country manages critically important natural resources such as forests can risk their ability to secure external funding to support their domestic efforts. While investors and the different governmental functions or individuals might differ over the best approaches and solutions, the underlying impetus to preserve the rainforest to ensure financial resilience is apparent. The group will remain focused on working towards the desired outcomes in 2023.

In the space of just two years, IPDD has gone from a concept to a recognised and valued initiative. Recognition of this was evident in May 2022, when IPDD co-chair Graham Stock of RBC BlueBay Asset Management was formally invited by the Ministry of the Environment in Brazil and the Brazilian Central Bank to speak for the IPDD group at the announcement of a national carbon market in Rio de Janeiro. Mr Stock outlined how deforestation was contributing to increasing fiscal risk to the country and noted it would be difficult to attract investment to the carbon market, and meet the country’s broader commitments under the Paris Accord, if deforestation was not tackled effectively. Mr Stock’s comments were widely publicised in Brazilian and international media.

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Addressing climate and environmental risks and the great challenges that come with them demand a global effort. Values such as information sharing, coordination, and the promotion of a better understanding of environmental and climate-related issues are highly welcome. Central banks should work, within their mandates, to induce the conditions for developing sustainable finances in the financial system. This includes the best practices related to sustainable finance, greater availability of resources for sustainable enterprises, and better management of social, environmental and climate risks.”

Roberto Campos Neto, President of the Central Bank of Brazil
Engagements with National Government
Engagements with Legislative
Engagements with Embassies
Engagements with Subnational Governments
Engagements with other relevant stakeholders

MAIN BILLS IPDD BRAZIL ARE FOCUSING ON

<table>
<thead>
<tr>
<th>Bill Number</th>
<th>Description</th>
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<tbody>
<tr>
<td>PL 2159/2021</td>
<td>Environmental Licensing</td>
</tr>
<tr>
<td>PL 2633/2020, PL 510</td>
<td>Land Regularisation</td>
</tr>
<tr>
<td>PL 191/20</td>
<td>Mining in Indigenous Lands</td>
</tr>
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Proposed deregulation could lead to loosening of environmental regulations. Previously known as PL 3729/2004.

Bills aim to change regularisation of land tenure and ownership in public areas, and could encourage new occupations and illegal deforestation of public forests. Changes to PL 510 could authorise the regularisation of occupied areas up until 2014, for example.

Establishes conditions for mining and use of water for electricity generation in Indigenous Lands, among other things, which could increase deforestation.

IPDD BRAZIL DESIRED OUTCOMES

1. Significant reduction in deforestation rates, i.e. showing credible efforts to comply with the commitment set down in Brazil’s Climate Law, article 19.
2. Enforcement of Brazil’s Forest Code.
3. Reinforcement of Brazil’s agencies tasked with implementing environmental and human rights legislation, and avoidance of any legislative developments that may negatively impact forest protection.
4. Prevention of fires in or near forest areas, in order to avoid a repetition of fires like in 2019.
5. Public access to data on deforestation, forest cover, tenure and traceability of commodity supply chains.

Brazil

Photo by The Nature Conservancy
Indonesia has made significant progress in the past decade on decreasing deforestation rates. Public policy has been a key contributor to this success, along with civil society and investor engagement, and companies and producers moving towards more sustainable production. However, deforestation remains a risk to be mitigated, with agriculture and forest-risk supply chain commodities, primarily palm oil, being principal drivers. IPPD Indonesia provides investors with a united avenue to voice concerns and better understand and support current progress.

Deforestation occurs within the legally defined ‘Forest Zone’, 64 percent of the country’s entire land area which is largely intended to remain under permanent cover of natural or planted forest, and in areas outside this zone, typically referred to as Other Use Areas (Areal Penggunaan Lain, APL), which are intended for conversion to non-forest uses, including palm oil. In the past decade, more deforestation has taken place inside the Forest Zone than outside it, and nearly half of...
In Indonesia, the general progress and moment is very good, they are decreasing active deforestation processes over time. The Indonesia working group is not just about palm oil and palm oil policy, but much more broadly about deforestation, land use planning, and also the inclusion of deforestation as criteria in green bond issuance... so IPDD Indonesia is also moving more into being technical advisors as investors – on topics such as what we’re expecting in terms of sovereign bond issuance, whether green bonds, ESG bonds, green sukuk bonds.

Peter van der Werf, Senior Engagement Manager, Robeco, IPDD Indonesia Co-Chair

From 2002 to 2021, Indonesia lost 9.95 Mha of humid primary forest, making up 36% of its total tree cover loss in the same time period. Total area of humid primary forest in Indonesia decreased by 11% in this time period.

We are supporting the efforts of the Indonesian government in reducing deforestation, and in doing so signal to governments globally that the international flow of capital supports the sustainable development agenda

Olga Hancock, Deputy Head of Responsible Investment, Church Commissioners for England, Co-Chair IPDD Indonesia

Historically, deforestation has largely been driven by agriculture and by the logging industry. Palm oil and timber are part of the supply chains in many emerging and developed markets, and the production of palm oil underpins global food systems. However, commodity-production-driven deforestation has declined significantly during the past decade.

Palm oil
Indonesia and Malaysia produce more than 90 percent of the world’s stock of palm oil. Investors have been engaging on palm oil since 2012, amid growing consumer awareness about detrimental environmental impacts when palm oil is not produced responsibly or sustainably. In 2018, the European Parliament voted to ban the use of palm oil in biofuels by 2020. Palm oil remains a sector of key economic importance for Indonesia, employing about 12 percent of the country’s workforce (16.3m people), so sustainable solutions and ongoing engagement is important. Encouragingly, the Decade of Progress - Reducing Commodity Deforestation in Indonesia and Malaysia report states the sector is transitioning towards intensification and efficiency-based growth models, with declining planting rates and rising productivity. Large producers have also committed to avoiding deforestation and burning peat.

Timber
Pulp and paper exports are an important source of foreign exchange for Indonesia, and their production also contributes to livelihoods within the country. Unlike palm oil, Indonesia’s production of pulp and paper only accounts for a small part of global outputs.

The methods behind this data have changed over time. Be cautious comparing old and new data, especially before/after 2015

The right policies can tackle the problem
The amended Indonesian constitution explicitly mentions environmental protection and forest management, and the country has historically established strong environmental policies. Indonesia has shown it is possible to rapidly bring down rates of deforestation and provides a good example of how government policies can drive this. When governments create an enabling environment, companies respond in a positive way.

Palm oil
A policy shift away from expansion growth to yield enhancement has started to transform the palm oil sector, which has responded to government regulation and shifting market demand with more responsible production and sourcing. Examples of policy that encouraged this shift and slowed the pace of licensing and development include:

- The Moratorium on new licenses in primary forest and peat, enacted in 2011 and made permanent in 2019
- The three-year Moratorium on new plantation development in forested areas of Indonesia’s state managed Forest Zone, enacted in 2018 until 2021
- The establishment in 2015 of the Badan Pengelola Dana Perkebunan Kelapa Sawit (BPDPKS), which collects Crude Palm Oil (CPO) export levies to fund investments in replanting and other yield enhancement programs, among other uses.

Civil society organisations encouraged private sector action and reinforced government policy by monitoring corporate policies. Consumer country government regulation also introduced incentives and demand forces to encourage change, while the financial sector helped show capital markets and consumers were demanding more sustainable practices and certified materials.

Growing sustainability differentiation and certification was also reflected in the establishment of membership-based sustainability associations, including the Roundtable on Sustainable Palm Oil (RSPO) and the Forest Stewardship Council (FSC). The RSPO is working to help educate and certify sustainable palm oil producers, including smallholders. While smallholders account for about 40 percent of land used for palm oil production, less than 1 percent are certified.
A further example of growing transparency is the online platform SPOTT, developed by ZSL (Zoological Society of London), which scores palm oil producers, along with timber and pulp and natural rubber producers, against ESG metrics and supply chain indicators.66

Forest-positive policy
Additional government interventions and initiatives included forest fire mitigation, the social forestry programme, restoration of peatlands, and increased enforcement against environmental violations. In addition, recognition of customary forest and community-based forest management has grown.64

The government has consistently pursued Sustainable Forest Management (SFM), which considers the following three aspects: inclusive economic development, social impact and environmental impact. Many policies and regulations support SFM and further reduction of deforestation, and these are consolidated within the recently launched Forestry and Other Land Use (FOLU) Net Carbon Sink 2030, an initiative very much aligned with Indonesia’s Nationally Determined Contribution (NDC) commitment. This, and the Government’s Long-Term Strategy for Low Carbon and Climate Resilience 2050, indicate Indonesia is aiming for net positive impact, meaning there will be planned deforestation afforestation (creating new forests where there were no trees before) and reforestation (planting trees in a forest where trees have been decreasing).

IPDD Indonesia Origins and Objectives
IPDD Indonesia aims to work constructively with relevant government authorities, financial market regulators and other stakeholders to encourage and enhance existing policies that contribute to the systematic and sustainable management of Indonesia’s forest assets, promote good social and environmental governance, and reduce financial risks arising from deforestation and land degradation. Given the vital role and importance Indonesia’s forest assets play in achieving Indonesia’s NDC, the group seeks to support the government in ensuring climate targets are met.

Engagement began initially in response to the proposed Omnibus Legislation of the Indonesian Government in October 2020, which is currently being redrafted. The workstream was formalised in January 2021 with a broader agenda of supporting legislation and other policies that tackle deforestation. The focus is on topics investors find important and which are also meaningful to the Indonesian government, such as capital allocation.

The engagement is founded on a principle of mutual respect, benefit and trust. Investors want to better understand the Government’s objectives and plans for achieving them, as well as how these objectives will be framed within their financial system and plans for sustainable finance. Investors are also able to share more about investors’ experiences with other frameworks, such as the EU taxonomy, with counterparts.

Climate Solutions
Indonesia was one of 171 countries that ratified the Paris Agreement 2017, pledging to keep global temperature rise below 2°C and strive to keep global temperature rise at 1.5°C. Indonesia set its own NDC, with associated implementation programmes and national development priority actions, aiming to reduce 29 percent of its emissions below its Business as Usual (BAU) scenario with only domestic efforts and 41 percent with international aid by 2030 through its forestry, energy, agriculture, industry and waste sectors.

Avoided deforestation will be key to meeting the NDC. As part of Indonesia’s Long-Term Strategy for Low Carbon and Climate Resilience 2050, and the FOLU Net Carbon Sink 2030, a set of strategic measures to reduce around 140 million tons of CO2e by 2030 from the FOLU sector have been successfully prepared and are now starting to be implemented on the ground.

Sustainable finance
Investors want to encourage sustainable finance and reinforce positive ESG impacts in sovereign ratings. The Financial Services Authority (Otoritas Jasa Keuangan or OJK) issued the Indonesia Green Taxonomy 1.0 in 2022, an initial step towards greening the finance sector.67 In 2014, the Financial Services Authority launched a Roadmap for Sustainable Finance in Indonesia.68 Financial innovations since then include the development of sustainability ratings in the stock market and the Sustainable and Responsible Investment Equity Index (SRI-KEHATI), which benchmarks the sustainable practices of companies in the Indonesian stock market. The country has an SDG bond framework, and recently issued the first sovereign green USD bond from Asia.69

IPDD investors are excited about the country’s growing focus on sustainable finance and look forward to engaging more on this area of opportunity.

IPDD Indonesia Workstream Activity
A key measure of success achieved to date is the investors’ message being heard by key stakeholders. During the past two years, the group has met with Ministries that have a stake in the issue, as well as many Indonesian ambassadors, and the financial markets regulator and the Indonesian Stock Exchange. The group has also met with a large number of other stakeholders, including multilateral institutions, banks, NGOs and academics. Topics discussed have included:

- The importance of sustainability to sovereign and other investors into Indonesia
- Actions taken by all levels of Indonesian government to address and reduce deforestation
- What the Indonesian government can do with regards to deforestation
- Exchanges around sustainability reporting and development of taxonomies
- Growth and development of carbon markets.

IPDD Indonesia’s workplan remains focused on current and new engagements and will also continue to encourage the ongoing integration of ESG factors into financial legislation in a manner that upholds the highest standards. Members of the IPDD Indonesia workstream see the positive dialogue held so far as genuine progress towards the collaborative and holistic approach being increasingly taken to this issue globally. The final quarter of 2022 will see IPDD meeting with a number of ministries, trade association bodies and domestic investors.

Engaging on the Ground
In October 2022, IPDD Indonesia members and co-chairs travelled to Jakarta to meet with government authorities and other stakeholders to discuss sustainability partnerships with key stakeholders in the country and share investor perspectives on ESG and deforestation. Indonesia’s successes in reducing deforestation over the past few years are significant and investors seek to support the government in ensuring that its climate targets are met. The visit was hosted by the TFA South East Asia Team.

Apart from government-related and other stakeholder engagements, IPDD also participated in the signing of a Memorandum of Understanding (MoU) between the Indonesia Business Council on Sustainable Development (IBCSID) and the Indonesia Stock Exchange (IDX). The parties involved will seek to support the implementation of sustainable investment in Indonesia through capacity-building provisions and knowledge sharing. The dialogue aims to:

- Provide guidance on ESG reporting standards endorsed by foreign institutional investors, with a special focus on climate and natural capital
- Conduct capacity building for listed companies related to the preparation of the Sustainability Report;
- Organize knowledge sharing sessions aimed to highlight the importance of reducing deforestation in Indonesia and other related topics according to the agreement of the parties.

A second MoU was signed with the Indonesian Chamber of Commerce and Industry (KADIN) on supporting their Regenerative Forest Business Sub Hub. The scope of this partnership includes:

- Facilitating policy dialogue related to sustainable forest management practices;
- Development of business models related to the forestry sector which has opened up opportunities for multi-business-based licensing;
- Providing guidance and feedback on financial instruments for several forestry businesses and share ESG reporting best practices.

IPDD’s constructive dialogue with Indonesian authorities has led to concrete progress in advancing partnerships with local actors. In 2023, IPDD will continue its activities in meeting with ministries, trade association bodies and domestic investors.
The Indonesia working group aims to work constructively with, among others, relevant government authorities and financial market regulators to promote social and environmental governance and to reduce financial risks arising from deforestation and land degradation. Additionally, given tropical forests’ vital role in Indonesia’s nationally determined contribution (NDC), the group seeks to support the government in ensuring its climate targets are met.

Since IPDD Indonesia’s inception, members have been engaging with various government and non-state actors in the country. Non-governmental organizations, civil society, and academia have also been in dialogue with IPDD, providing educational support and knowledge sharing sessions for the group to inform their work. Investors seek to continue engaging and constructively collaborating with relevant authorities in their mutual goal of reducing deforestation in Indonesia.
Workstream Summary

FOCUS COUNTRIES:
Consumer regions (US, UK, EU, China)

FOCUS:
Regulation in consumer countries (demand-side)

DATE OF FORMALISATION:
July 2022

CO-CHAIRS:
Brandywine Global and Legal & General Investment Management (LGIM)

Stakeholder mapping and work programme for key regions are under development

Focus:
Regulation in consumer countries

As recognition of the value of nature to the global economy rises, there is increasing momentum behind deforestation-free trade and procurement regulation. Regulations in different regions have overwhelmingly similar aspects, but there are some key differences. For the most part, key commodities generally included are beef, timber, pulp and paper, palm oil and soy. Others such as rubber, cocoa and coffee are only included in some. Different definitions or levels of deforestation are also applied.

Regulatory Landscape

Deforestation continues at an alarming rate and expansion of agricultural land is largely provoking it. We at the EU know that deforestation solutions will only come from engaging all actors, assuming responsibilities and finding ways that work for all. We welcome the commitments made by President elect Luiz Inácio Lula da Silva at Sharm el Sheikh regarding his ambition on zero deforestation and his determination to combat illegal deforestation and we reiterate the offer of the EU to cooperate on this endeavour.

The EU is facing its own responsibility as a relevant global consumer of commodities associated with deforestation promoting legislation on deforestation. We also welcome initiatives as the IPDD investor led engagement in Brazil. This first progress report reminds us all that the challenge is still great and that we should all increase our ambitions to find lasting and effective solutions to this global issue.”

Ignacio Ybáñez, Ambassador of the EU Delegation to Brazil

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Complementing Brazil and Indonesia Workstreams: the Demand Side of the Equation

While substantial progress is being made in the two initial workstreams in producing countries, the investors involved in the IPDD recognise it is also important to engage on the demand side – i.e. in countries that consume products from regions with high rates of deforestation.

This workstream will consider how the regulatory environment can help tackle commodity-driven deforestation, given the increase in deforestation-related regulation currently being debated and passed in consumer countries. Further priorities include international harmonisation, scope, roadmaps and timelines towards implementation and enforcement and monitoring.

As investors, we’d like to share our perspective on illegal deforestation. The practice can create a material risk both for producer and consumer countries, and environmental, social, economic, and financial costs can mount the longer it goes unaddressed. Illegal deforestation can also be associated with spurious labour practices and remains a significant contribution to country-level GHG emissions. There is a positive opportunity for investors to partner with policymakers, non-governmental organizations, and broader civil society to tackle these systemic risks.”

Reina Berlien, Head of ESG, Brandywine Global Investment Management
European Union Regulation

Five EU policies (currently part of legislative proposals) focus on enhancing transparency regarding deforestation and will help investors and financial regulators to identify commodity-driven deforestation via the mandatory disclosure of reliable data about deforestation in companies’ supply chains.

**Corporate Sustainability Reporting Directive (CSRD)**
- Defines disclosure requirements for companies
- Reporting requirements will include sector specific and sector agnostic standards about material environmental impacts, risks and opportunities; and will include companies’ own operations and relevant parts of upstream and downstream value chain
- Deforestation and other environmental and social risks largely placed in supply chains are material for many sectors and needs to be reflected in mandatory disclosure requirements

**Sustainable Finance Disclosure Regulation (SFDR)**
- Requires financial institutions to explain how they are addressing ESG factors
- Reporting financial institutions must disclose what share of their investee companies have specifically indicated sustainability issues (under the ‘principal adverse impacts’ (PAI), or the impacts of investment decisions and advice that result in negative effects on sustainability factors
  - Examples of environmental PAIs which are mandatory to report include GHG emissions, carbon footprint, fossil fuel exposure and waste levels. Others are only voluntary

**EU Taxonomy Regulation**
- Provides a reference framework with definitions of sustainable activities, which other sustainable finance instruments (such as the other EU regulations shown here) can refer to
- In the Regulations, delegated acts, environmentally material economic activities relevant, among others, to sustainable land use and deforestation, are identified and criteria defined to assess their ‘substantial contribution’ and ‘significant harm’ to six environmental objectives (1) climate change mitigation; (2) climate change adaptation; (3) the sustainable use and protection of water and marine resources; (4) the transition to a circular economy; (5) pollution prevention and control; (6) the protection and restoration of biodiversity and ecosystems
- Further criteria related to forestry and agriculture is being published in 2022 by the EU Sustainable Finance Platform
- Taxonomy could potentially provide the basis for companies to identify environmental due diligence areas

Source: Climate & Company

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**Consumer Country Regulation**

Deforestation-free Products Regulation (Draft)

**Corporate Sustainability Due Diligence Directive (Draft)**

**Environment**

**EU LEGISLATION:**
- Corporate Sustainability Reporting Directive (Draft)
- Sustainable Finance Disclosure Regulation (SFDR) (Draft)
- EU Taxonomy Regulation

**Environment**

**EU LEGISLATION:**
- Deforestation-free Products Regulation (Draft)
- Corporate Sustainability Due Diligence Directive (Draft)

**Company Activity**

**Outside-in (risk)**

**Upstream**

**Investor Activity**

**Data + Transparency**

**Sustainable finance**

**Engagement + Capital Allocation**

**Inside-out (impact)**

**Downstream**

**Environment (6 environmental objectives)**

**EU LEGISLATION:**
- Sustainable Finance Disclosure Regulation (SFDR) (Draft)
- EU Taxonomy Regulation
Deforestation-free Products Regulation

- European Parliament voted on September 13, 2022 to strengthen the draft law proposal, widening the scope of forest-risk commodities that companies will be obliged to undertake due diligence on to verify they have not been produced on deforested or degraded land, nor contributed to human rights violations.

- In addition to the commodities already proposed by the Commission – palm oil, beef, timber, soy, cocoa and coffee – the proposed scope now also includes rubber, maize, other livestock (pigs, sheep, goats, and poultry), charcoal and paper products, as well as derived commodities such as leather, chocolate and furniture.

- Additional improvements aligned with the IPDD’s desired outcomes include:
  - More robust definitions of deforestation and forest degradation, ensuring greater protection of forests from agricultural and logging practices.
  - Stronger protection of human rights, especially the rights of Indigenous Peoples and Local Communities, including the right to free, prior and informed consent.
  - Extending the law to cover European financial institutions who will face additional requirements to ensure their activities and portfolios do not contribute to deforestation.

- Members of the IPDD say that as the EU regulation process moves forward, strong and continuous partnership and collaboration with producer countries is welcome, as well as support for smallholder farmers to adapt to geolocation requirements, guaranteeing a robust and inclusive process.

- Members also note that while the proposed regulation demonstrates advances in forest protection, other ecosystems such as grasslands and wetlands remain under threat. However, Parliament’s approval of a review clause that would allow the Commission to widen protection to all natural ecosystems in the coming year is a positive sign.

Corporate Sustainability Due Diligence Directive

- Obliges large companies operating in EU markets to exercise due diligence about human rights and environmental impacts across their entire value chains.

- Aims to prevent actions which cause environmental degradation, such as deforestation.

- Could stop certain products related to destruction of ecosystems from entering the EU market.

Sources: Climate & Company, and Duncan Brack, Environmental policy analyst and adviser.

UK – UK Environment Act 2021

- Schedule 17 focuses on forest-risk commodities linked to commercial activities.

- Prohibits businesses from using illegally produced forest-risk commodities (i.e. must comply with local laws from producing countries).

- Commodities being considered for inclusion within scope are cattle (beef and leather), cocoa, coffee, maize, rubber, palm oil and soy.

- Secondary legislation to come will cover implementation and timelines, along with commodities and businesses in scope.

- Due diligence obligation will only apply at present to UK businesses, and their supply chains, over a certain size.

Source: Helen Bellfield, Policy Director at Global Canopy.

US - SEC proposal for climate-related disclosures

- Incorporates climate-related risks and material impacts.

Federal Reserve Vice Chair for Supervision Michael S. Barr announced in September 2022 that the Federal Reserve would provide guidance to large banks on how to identify, measure, monitor and manage the financial risks of climate change, and would launch a pilot micro-prudential scenario analysis in 2023 to assess long-term, climate-related financial risks facing these institutions.
The myriad of sustainability challenges resulting from the interrelationships between climate change, biodiversity, food and water security and human rights increasingly represent systemic market risks. By focusing on deforestation, investors can address all of these macro issues. They can use their influence to encourage governments to do more to stop deforestation. This will accelerate the transition to sustainable supply chains, in which land acts as a carbon sink and biodiversity and food security is protected and restored. Doing so is crucial to protect against potential material loss of value, manage escalating risks and prepare for forthcoming regulations. It also provides solid evidence that investors are playing their part in contributing to the UN Sustainable Development Goals (UN SDGs).

The establishment of the IPDD signals a shift and widening in the level and nature of investor stewardship efforts. IPDD’s intervention is contributing constructively to the discussion and helping to ensure deforestation is an important feature on governments’ agendas. Investors believe the breadth and quantity of engagement so far demonstrates the value of such a collective model, for both investors and sovereigns alike, and reflects the growing awareness around the market and financial institution risks posed by deforestation. The ultimate goal and fundamental driver of IPDD’s efforts is of course a reduction of deforestation rates on the ground. The IPDD will continue to use its collaborative influence and convening power towards this aim, and in doing so expects to expand the learnings investors are gaining from this strategic engagement, adding to the knowledge and toolkits available to them when seeking to engage on systematic ESG/sustainability issues.

The IPDD provides one of the first examples of collective investor engagement with sovereigns on a particular issue. It is already proving itself to be a model that could and should be applied to other efforts where investors need to lend their voice.