



DOMINI IMPACT INVESTMENT FOCUS ON FORESTS INTRODUCTORY REPORT SERIES

2021

THE FOCUS:

Domini has initiated our forest focus, which seeks to identify and implement solutions to deforestation and forest degradation and model a means for investors to steward and enhance forest value, as is appropriate in our role as a fiduciary.

THE CHALLENGE:

Investors must establish and successfully carry out solutions to deforestation. Increasing deforestation and inadequate reforestation are substantial contributors to climate change, topsoil loss, and the biodiversity crisis, among other threats to investors and society.

Through conventional practices, investors contribute to the worsening of this profound environmental change that poses systemic environmental risks with potentially adverse impacts on their holdings across all asset classes.

THE GOAL:

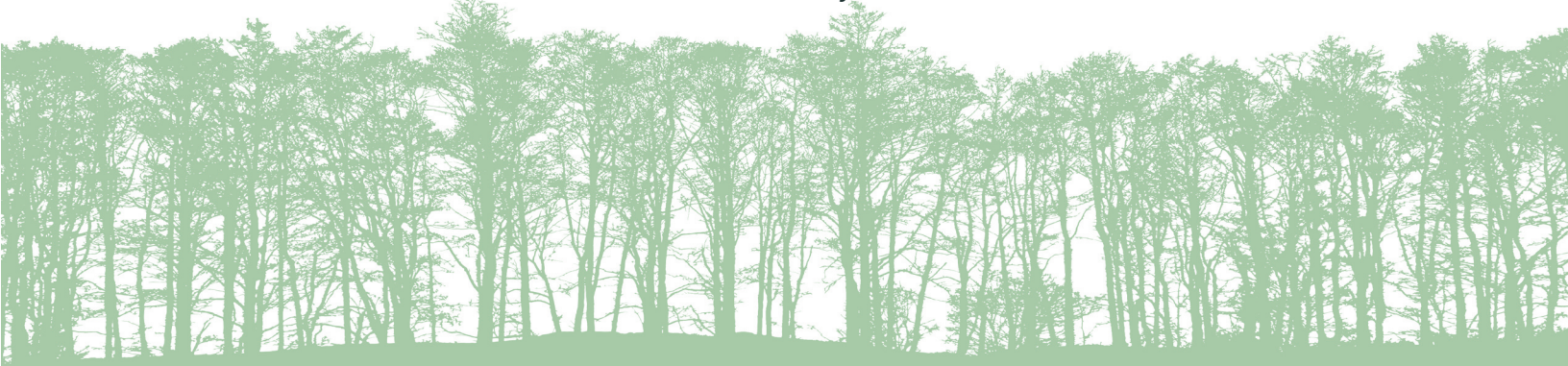
To align the interests of investors along with other stakeholders in forest-related ecosystems in ways that preserve and enhance the long-term value that forests create.

This reporting series provides insight into our project development, how we value forests, and our risk exposure. We share findings from our research and work, including our understanding of forest system dynamics, the systemic structures that must be shifted to create positive outcomes, and our leverage to create change.

SERIES MODULES:

1. **Introduction: Forest Systems Solutions**
2. **Domini's Forest Beliefs and Principles**
3. **Introduction: Forest Value**
4. **Why We Can Act: Consensus and Effectiveness**
5. **Why We Must Act: Relevance and Uncertainty**
6. **Envisioning the Forest System: Tactics and Targets**

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OVERVIEW

Domini Impact Investments has prioritized addressing the global challenge of deforestation and reforestation and the systemic risks it poses. Unsustainable dynamics can cause dire and unpredictable disruptions in the systems that underlie our investments and must be addressed at a systemic scale. Forest-related systemic risks and opportunities are key to our investments: they are directly related to our ability to address climate change as it is estimated that deforestation is responsible for 15 percent of all greenhouse gas emissions, while reforestation can be a major carbon sink.¹ We seek to improve current dynamics to create stable, prosperous conditions for our portfolios.

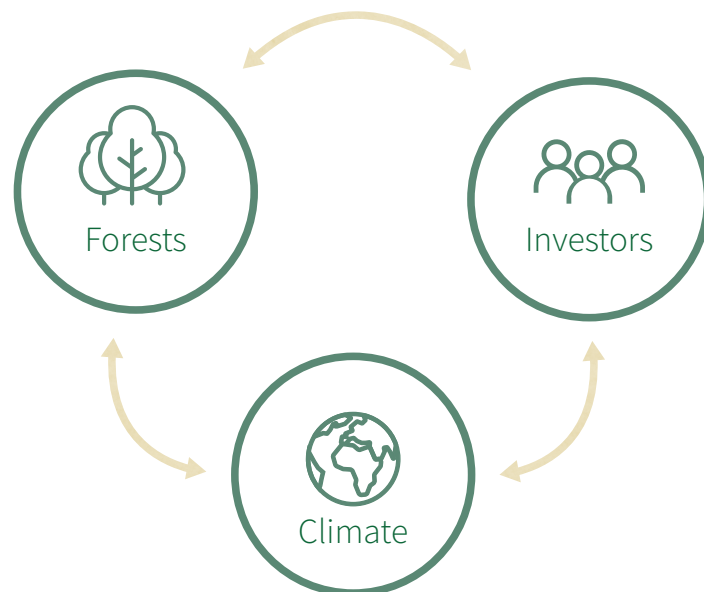
To account for and manage these potential risks and rewards, Domini is exploring an intentional, integrated program of solutions creation. The traditional tools of finance cannot contend with the current degree of disruption and uncertainty implicit in today's risks, which are without historical precedent, as discussed below. A systemic approach is necessary to comprehend the complexities of today's challenges.

In 2017, Domini began this pilot project because continued deforestation is becoming a macro-risk that affects investments across asset classes. Current investment practices have the potential to exacerbate these disruptions and adversely affect macro-systems. As part of the investor community, we can help address the dynamics causing deforestation and promote reforestation to augment the health of our portfolios and of these systems we rely on to create value.

GENESIS OF A NEW APPROACH

At Domini, we have always understood that our investments have impact and taken steps to create positive effects. Yet, as economies and societies become more complex and interconnected, so do macro-risks. Our management of these risks must therefore also evolve. As the financial crisis of 2008 demonstrated, management of portfolio-level risks are no longer enough in today's interconnected world. The financial crisis posed non-diversifiable risks that affected all asset classes. Climate change creates similar non-diversifiable systemic risks, as do other challenges such as rising inequality, technological disruptions, and biodiversity loss.

In 2018, as our initial foray into this territory, we created an Investment Belief Statement that delineated our understanding of investors' relationship to systemic risks such as climate change, water, community wealth creation and biodiversity. Initial work we did in these focus areas clarified our need to develop a robust theory of change and focus in-depth on a single area of systemic risk. Consequently, in 2019 we concentrated solely on forest-related risks and rewards to thoroughly develop our system analysis and action framework.



THEORY OF CHANGE

In our initial work, we found that a key source of unsustainable dynamics in forests-related investments is a focus on short-term value extraction at the expense of long-term value creation. Although investors can perpetuate this dynamic, they can also take responsibility for finding pathways to positive change. This approach to value is reflected in our policies and practices, including our Investment Belief Statement, investment standards, key performance indicators, engagements, and approaches to evaluation of investment risks and opportunities.

We believe that investors, including ourselves, can catalyze change in ways that supplement traditional investment practice through the intentional adoption of activities that seek to manage systemic risks and rewards. For forests, we have mapped a range of possible interventions based on tactics' potential effectiveness and impact targets.

Our tools broadly fall into the following categories:

- Allocation of assets
- Setting of investment standards and discussion of processes
- Communication of data and case studies of risks and reward opportunities
- On-going engagement with a broad range of corporations and providers of investment opportunities
- Collaboration with peers
- Support for public policy, governance, and enforcement
- Development and amplification of best practice
- Creation of metrics to measure and act on indicators of forest-system health

These tactics help to create alignment of interests among stakeholders within forest systems and creation of new linkages between these actors. Our project hypothesizes that interventions that do this will shift dynamics within the global forest system.

GOALS

Our overall goals for systems change, below, are based on our Forest Beliefs and Principles, found in **Report 2**.



GOALS FOR INVESTORS

Investors recognize, account for, and steward the forests as sources value in their portfolios and sources of climate stability.



GOALS FOR CORPORATIONS

Corporations steward and enhance forests to enhance the long-term stability of their own operations.



GOALS FOR THE GLOBAL FOREST SYSTEM

Sustainable and positive reinforcing dynamics exist between forest systems and investors and corporations, halting and reversing forest loss and degradation.

1. WWF Website, "Forest Habitat" Accessed at <https://www.worldwildlife.org/habitats/forest-habitat>. WWF (webpage). Accessed at <https://www.worldwildlife.org/habitats/forest-habitat> on September 11, 2020.

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The Adviser's evaluation of environmental and social factors in its investment selections and the timing of the Subadviser's implementation of the Adviser's investment selections will affect the Fund's exposure to certain issuers, industries, sectors, regions, and countries and may impact the relative financial performance of the Fund depending on whether such investments are in or out of favor. The value of your investment may decrease if the Adviser's or Subadviser's judgement about Fund investments does not produce the desired results. There is a risk that information used by the Adviser to evaluate environmental and social factors, may not be readily available or complete, which could negatively impact the Adviser's ability to evaluate such factors and Fund performance. **The market value of Fund investments will fluctuate and you may lose money. DSIL Investment Services LLC, Distributor 9/22**

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To guide the development of our forest focus, Domini developed investment beliefs and effectiveness principles. Domini's general Investment Beliefs Statement (IBS) (below) provides a framework for all our investment policies and practices, while our Forest Beliefs and Principles codify the explicit basis for this work.

Our forest beliefs express our understanding of the foundational value of forests for investors and society and our fiduciary and ethical obligations to preserve and enhance that value. They acknowledge forests as a potential source of systemic rewards and risks across asset classes and recognize that our investment decisions will necessarily impact these risks and rewards either positively or negatively.

Our effectiveness principles guide the development and implementation of the Forest Focus. The principles are intended to serve as useful guides amid complex situations, while at the same time remaining practical and useful; to inspire us to specific action, while allowing us to change as circumstances evolve; **and to serve as benchmarks against which our actions and outcomes can be evaluated.**



FOREST BELIEFS

1. Societies and economies, and therefore businesses and investments, are built on stable environmental and climate systems.
2. Forests provide significant value to investors and corporations, including as a crucial part of the climate system.
3. Investors' policies and practices can impact forests both positively and negatively.
4. Corporations and investors must act to measure, preserve, and enhance the value they receive from forests.



FOREST FOCUS EFFECTIVENESS PRINCIPLES

1. Base our investments, engagements, and other operational decisions on a holistic understanding of the corporate and investor dependence and impact on the long-term value and services from forests.
2. Work to create a positive system dynamic that enhances the value of forests systems.
3. Identify and monitor our direct and indirect impacts on forests, considering both positive and negative effects.
4. Share our principles and process with investors, investees and the financial community to promote holistic, long-term policies and practices regarding forests.

DOMINI'S INVESTMENT BELIEFS

At Domini, we believe that investments made today will shape tomorrow. We therefore apply environmental and social standards to all our investments. In doing so, we seek to capture sources of opportunity and risk often overlooked by conventional financial analysis. Our evaluations also provide us with insight into the quality of corporate management teams, which is a key component of future success.

OUR BELIEFS

1. Investments have systems-level impact on finance, society and the environment. Investors have an ethical obligation to acknowledge these consequences.
2. Investors that strengthen the resilience and integrity of these critical systems create lasting value. Investors that fail to do so cause harm.
3. Long-term investment performance depends upon the above principles.

OUR OBJECTIVES

1. To serve our clients' financial well-being while preserving and enhancing the environment and society through responsible asset management.
2. To measure and report our financial, societal and environmental impacts.

OUR STRATEGIES

1. As investors, we participate in the capital markets using financial, social and environmental standards in all of our investment decisions.
2. As owners, we engage with issuers, civil society organizations and policy makers to create financial, environmental and societal value.
3. As neighbors, we seek to help build strong, sustainable communities by directing capital to where it is needed most.

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In this report, to explain Domini's focus on creating solutions for forests, we illustrate the value that society and the global economy receive from forest ecosystems, both at the local landscape level and on a planetary scale.

RELATIONSHIP TO FORESTS

Forests are as entwined with humanity as lianas, the woody vines that comprise a large volume of the vegetation in a tropical rainforest. Home to 300 million people, including 60 million Indigenous inhabitants^{1,2}, forests provide food and resources, as well as recreation, rest, and reflection, for millions more. Accounts of forests as places of both beauty and natural wealth stretch back to the Epic of Gilgamesh.

Forests are vital to the planet's habitability. Through cooling themselves by the absorption, filtration, and respiration of water, **forests stabilize local climates**. Tropical forests, the most biodiverse biome, provide habitat to between half and three quarters of species. By cycling nutrients, **forests enrich soil**, and protect it against flood. The largest forests impact global movement of moisture, heat, and carbon. **They are crucial to Earth's climate system**, sequestering huge amounts of carbon dioxide. This carbon-storage capacity is key to mitigating climate change.

DIRECT VALUE FROM FORESTS

From Brazil nuts to mahogany to oxygen, forests directly meet human personal, economic, and environmental needs. **Forests provide clean water, food, and medicine**. They keep the air around them cool and moist, maintain intact hillsides and soil, and prevent drought and flooding. **A healthy forest is a source of balance**.

The values forests provide to humans are known as ecosystem services. Ecosystem services fall into four categories:



Provisioning services, as in direct production of timber, fruit, and other products.



Cultural services such as ecotourism.



Regulating services that stabilize environmental conditions, such as air purification and maintenance of soil fertility.



Supporting services that underlie ecosystems, such as habitat and nutrient cycling.

See the table on page 2 for a list of these forest services.

The services provided by forest ecosystems are a subset of the global ecosystem services and are by one estimate to be worth US\$125 trillion per year.³ More than 1.6 billion people rely on forests for their livelihoods to some extent and 10 million are directly employed in forest management or conservation, according to the United Nations.^{4,5}

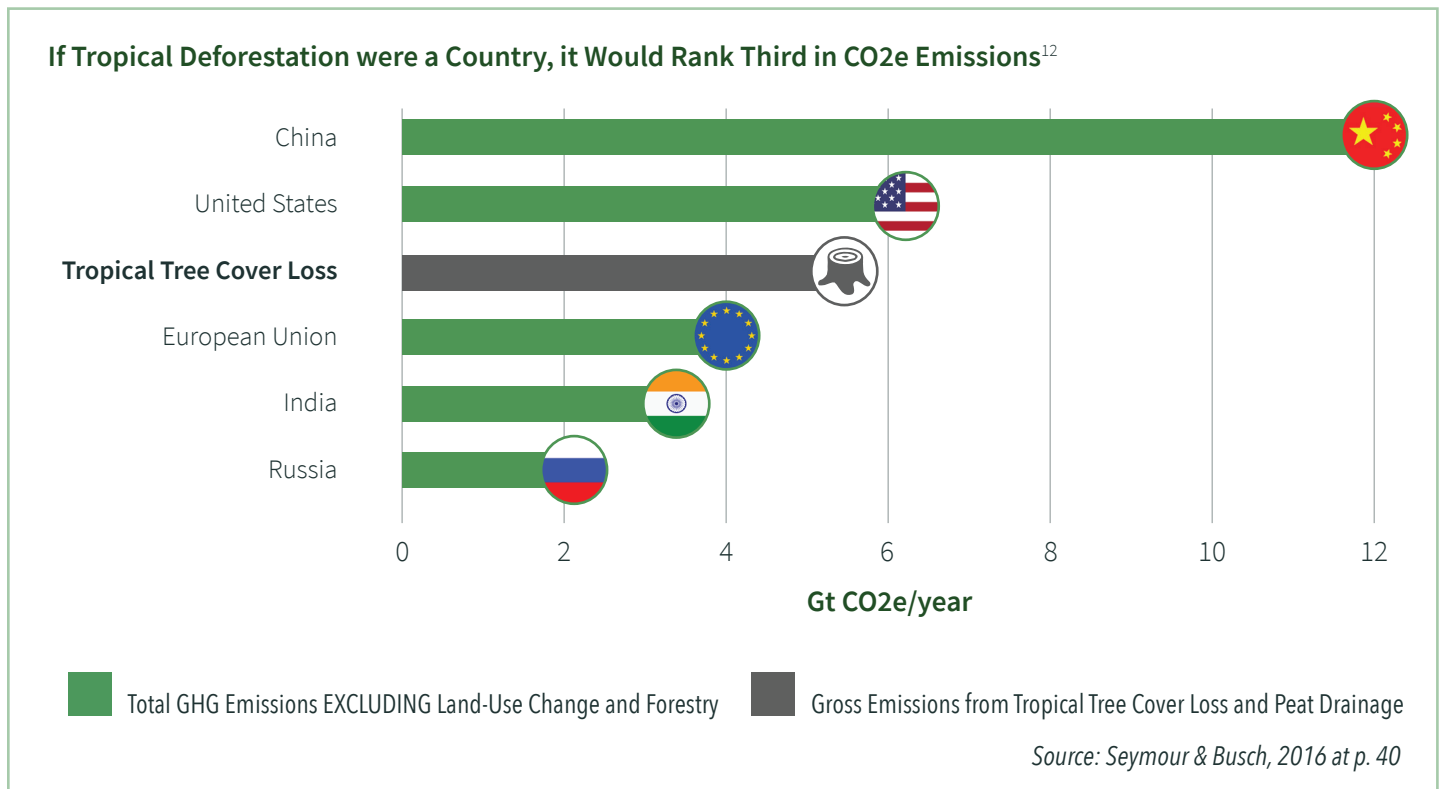
FOREST SERVICES

Forests are sources of immense value. Ecosystem services, listed here, are linked to numerous environmental, social, and economic areas, including sustainable agricultural systems, human health, and climate change, that affect value in many different industries. (Adapted from Costanza et al. [2017]).⁶

Ecosystem Service	Service Description	Example
Provisioning Forests are sources of many goods, including food, water, and wood.	Production of food by forests	Forests contribute about 2% of the global GDP through timber production and non-timber products, the latter which alone supports up to 80% of the population in many developing countries. ⁷
	Fresh water from forests	
	Wood, fiber, and ornamental resources	
	Genetic resources	
Regulating Healthy forests stabilize the environmental quality around them in many ways, from moderating temperature and rainfall to protecting from disease and natural disasters like flooding and landslides.	Air quality regulation/prufication	Insects provide at least US\$57 billion in services to the U.S. economy each year, mainly through pollination. ⁸
	Climate regulation	
	Natural harzard/disaster and water regulation	
	Water purification and waste treatment	
	Erosion prevention	
	Soil formation and fertility	
	Pollination	
	Biological control of pests and disease	
Supporting Forest are responsible for some of the most basic processes that underlie other Earth systems, like ensuring nutrients are recycled and providing a home for most of the world's species.	Nutrient cycling	“Without biodiversity, no ecosystems. No ecosystems, no biomes. No biomes, no living regulator of all the cycles of carbon, nitrogen, oxygen, carbon dioxide and water”- Johan Rockström ⁹
	Habitat, biodiversity	
Cultural Forests are a key part of humanity's cultural imagination and a space for rest and rejuvenation.	Recreation and eco-tourism	
	Cultural diversity, spiritual and religious values	

MACRO VALUE: FORESTS AND CLIMATE STABILITY

Forests sequester huge amounts of carbon dioxide, a greenhouse gas. The boreal forest is the most intact ecosystem on the planet and alone holds one-third of the world's terrestrial carbon.¹⁰



Forests' proven capacity for carbon capture could be a powerful solution to climate change, but currently an estimated 15% of all greenhouse gas emissions result from deforestation.¹² In the tropics, degradation (industrial and fuelwood logging and shifting cultivation) accounts for up to 40% of forest's total carbon emissions.¹³ But a report by World Wide Fund (WWF [formerly World Wildlife Fund]), the International Union for Conservation of Nature (IUCN), and Climate Advisors found that, "if just twelve forest countries, including Brazil and Indonesia, meet their existing forest goals this should cut annual global climate emissions by 3.5 gigatonnes in 2020 – equivalent to the total annual emissions from India and Australia put together".¹⁴ Forests have the potential to produce net negative emissions, while also providing developmental and environmental benefits, for example, silt-free water to power hydro-electric dam generation.

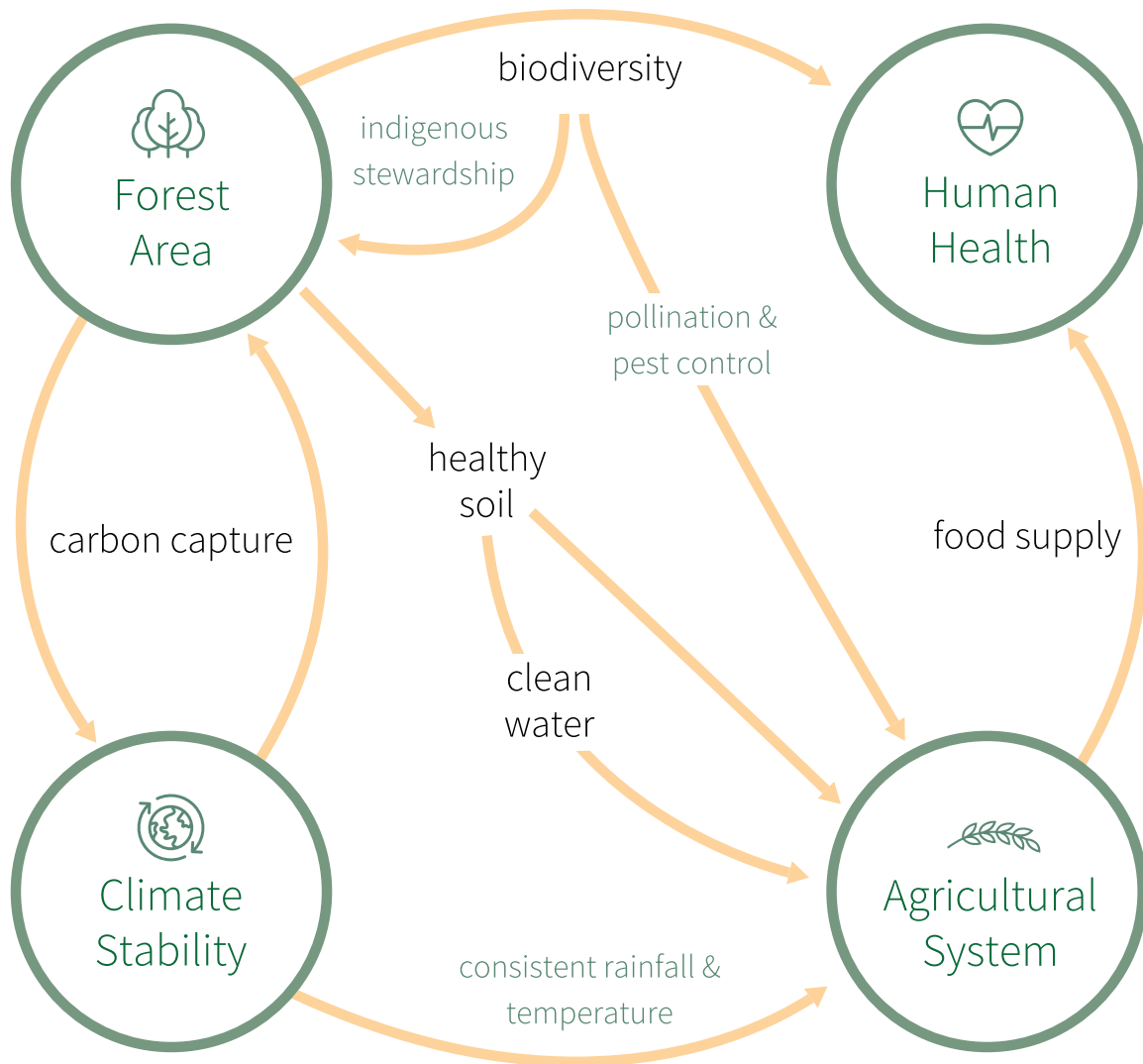
THREATS TO FORESTS' VALUE

FOREST AREA: According to WWF, every minute, an area of forest equivalent to 27 soccer fields is lost, with a total loss of 18.7 million acres annually.¹ The Amazon has lost at least 17% of its cover in the last half century through clearing, often for grazing land and vast soybean farms. In Indonesia, another biodiversity hotspot home to orangutans, rhinos, and tigers, key islands have lost 85% of their forest due to conversion to oil palm plantations. Indeed, most forest loss is driven by just four commodities: 1) palm oil for food, personal care products, and biofuel, 2) soy for animal feed and biofuels, 3) cattle, and 4) wood and pulp products.¹⁵

The concentration of species in forests means forest loss contributes to today's recent population sizes with vertebrate species overall declining 60% from 1970 through 2014.¹⁶ Most affected by current extinctions are South and Central America, principally due to the region's vast forest loss.¹⁷

AGRICULTURE: Agricultural yields are highly dependent on the clean, sediment-free water and stable climate supported by forests. Forests also harbor vital pollinators. Wild insects pollinate more crops than honeybees.¹⁸ In addition, insectivorous animals like bats and birds provide pest control, thereby improving harvests' quality and size.

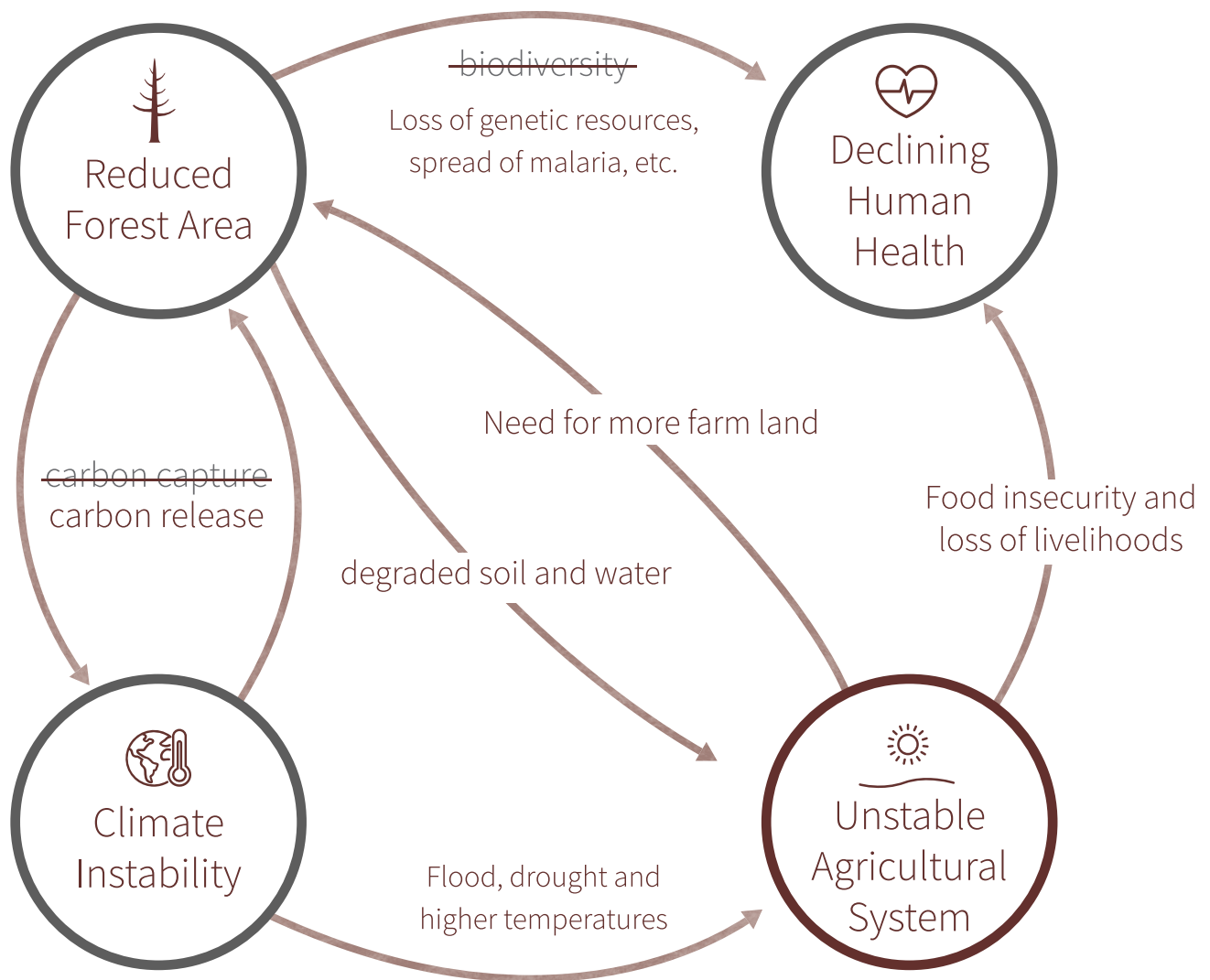
Today, 75% of the world's food comes from just a dozen crops and five animal species, leaving supplies vulnerable to pests or disease that may sweep through large areas of monocultures.¹⁹ With yields expected to fall due to climate change, and the world's growing global population faces a potential food crisis. Forest loss imperils the food supply by undermining soil health, rainfall, and natural disease protection.



Forest Value-Creating System

Stores of value and their interplay with forests in a series of self-regulating feedback loops: enhancing one node enhances the others, i.e., more stable climate leads to better and more predictable agricultural yields, reducing pressure on forest cover clearance. This leaves more forest to sequester CO₂, improving climate stability.

HUMAN HEALTH: Fruits, roots, nuts, and other forest foods are key nutrient sources in many diets and may serve as food “safety nets” in times of scarcity, but forests’ major contribution to human health is as a source of both traditional and modern pharmaceutical medicines. One-quarter of all pharmaceuticals and nearly fifty percent of cancer drugs are derived from genetic compounds found in forests.²⁰ Forests, by stabilizing soil and preventing erosion, also protect human settlements from destruction by landslides and floods. On the flip side, forest-clearing, especially via burning, causes deadly air pollution and is linked to higher incidences of malaria and other diseases.²¹



Forest Value-Destroying System

At present, we are trapped in a negative reinforcing dynamic. Unchecked deforestation is the third-largest source of carbon emissions after coal and oil contributing to climate instability and threatening to push the Earth into a “hothouse state,” jeopardizing the global agricultural system. Loss of forests is driving species extinction, and undermining human and ecosystem health.

VALUE AT RISK

The looming threats of climate change and extinction crises, coupled with continued deforestation and inadequate forest-protection policies in enforcement in key nations including Brazil and Indonesia, are deepening concern about crossing a planetary boundary that could tip Earth’s climate into a hothouse state.²² This renewed urgency is spurring the need for proven mitigation solutions like forest preservation and reforestation. Humanity needs forests, because they underlie the ecosystems in which we live and upon which we depend for food, materials, and crucial services.

Endnotes

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Domini's forest focus seeks to address the challenge of global deforestation and reforestation. We answer two questions relating to factors that enable us to address this issue: consensus on its importance and our experience and expertise in this area.

 **Consensus** - Has this challenge been subject to widespread analysis resulting in a reasonable global consensus as to its importance in the maintenance a stable, sustainable, and productive environment and society?

 **Effectiveness** - Do we have the experience, expertise and resources to achieve material, positive impact?

 **Relevance** - Is this challenge material to our investment decision-making and returns across all asset classes?

 **Uncertainty** - Do this challenge's fundamental uncertainties require the application of tools beyond those of traditional risk management—i.e., beyond portfolio diversification, hedging techniques, etc.?

See Report Section 5 for the answer to the Relevance and Uncertainty questions

CONSENSUS

Has this challenge been subject to widespread analysis resulting in a reasonable global consensus as to its importance in the maintenance a stable, sustainable, and productive environment and society?

Forests are a valuable, indeed invaluable, resource for human well-being.








Forests are directly tied to global climate systems, serving as a carbon sink and regulating heat and moisture. Their loss is changing global rainfall and temperature patterns, with potentially dire consequences for agricultural productivity. Spurred by advancing climate change, investors, NGOs, corporations, and governments are seeking avenues to slow or reverse deforestation. The four forest-risk commodities, palm oil, cattle, soy, and wood and paper products, are primary targets for forest initiatives, as they contribute to forty percent of tropical deforestation.¹

Investors recognize that value and the need for its preservation. Investors have joined with others to help preserve the value that forests provide in assuring sustainable returns.

Although with little follow up in practice, fifty-three companies including institutional investors have pledged to eliminate deforestation in their operations and supply chains by 2020 as part of the 2014 New York Declaration on Forests. The declaration was signed by over 190 national and subnational governments, multinational companies, Indigenous communities, and nongovernmental organizations who seek to end forest loss by 2030.

A “no-deforestation” goal (#15) was adopted in 2015 as part of the UN Sustainable Development Goals (SDGs). This goal's underlying target number two stipulates that “by 2030, [countries should] promote the implementation of sustainable management of all types of forests, halt deforestation, restore degraded forests and substantially increase afforestation and reforestation globally.”

Investors are increasingly aligning themselves with the SDGs. Forests' impact is explicit or implicit in seven of these 17 goals. This overlap highlights how crucial forests are to the attainment of the sustainable development necessary for a stable and prosperous 21st century. The following table highlights the many linkages between forests and the SDG.

SDG RELATIONSHIP TO FORESTS		
Forest Impact Area	Related SDG	
Forest cover and management as it relates to global biodiversity	Goal 15, Life on Land	
Carbon sequestration	Goal 13, Climate Action	
Protection of rural and Indigenous livelihoods and traditional ways of life	Goal 1, Reducing Poverty Goal 10, Reducing Inequalities	 
Biodiversity as a source of disease control and medically-useful compounds	Goal 3, Good Health and Well-being	
Impact on agricultural viability and food security and as safety net sources of food and nutrients	Goal 2, Hunger	
Increased resource efficiency, agricultural intensification and use of recycled materials	Goal 12, Responsible Consumption and Production	

An industry-led moratorium on soy associated with Amazon deforestation had success in reducing forest loss. Efforts now focus on soy-linked deforestation in the Cerrado biome. In March 2019, a coalition of investors representing \$6.3 trillion in assets under management signed a statement of expectations on deforestation in soybean supply chains, urging companies to consider deforestation in non-Amazon biomes, including the Cerrado and Gran Chaco. Work is underway to develop a mechanism to pay soy farmers to reforest or avoid deforestation on parts of their land. Considerable investor and consumer attention has also focused on the large-scale deforestation linked to palm oil plantations in Indonesia, contributing to momentum behind certification for palm oil under the Roundtable for Sustainable Palm Oil (RSPO).



EFFECTIVENESS

Does Domini have the experience, expertise and resources to achieve material, positive impact?

Domini has worked through multiple avenues to address forest-related issues over the past decade.

For more than two decades, Domini, alongside other investors and partners, has worked to mitigate deforestation through a variety of initiatives. These have given us the experience and expertise upon which to build in our current work.

APPLICATION OF FOREST-RELATED KEY PERFORMANCE INDICATORS

In our company analysis we include industry-specific, forest-related key performance indicators (KPIs). Our Forest Product, Pulp & Paper and our Packaging sub-industries, for example, include KPIs such as

- Percentage of forestland certified under such programs as the Forest Stewardship Council Stewardship Forestry Initiative (positive), Sustainable Forestry Initiative (neutral), and Programme for Endorsement for Forestry Certification (neutral).
- Numerous companies that perform poorly on various KPIs have been excluded from our approved universe of stocks for our US and International funds. A Japanese pulp and paper company, for example, was excluded for not banning use of High Conservation Value Forests leading to its sourcing of primary forest wood from Tasmania, Australia, for use in wood chips.

INFORMATION-SHARING THROUGH WHITE PAPERS, ISSUE BRIEFS, IMPACT REPORTING

We promote communications to other investors about tools that can help identify and support forest-related value creation. We have, for example:

- “In the Domini 2019 Impact Report, explained the Forest Project and rationale for our Focus on Forests. <https://domini.com/insights/domini-2019-impact-report-release/>
- Published an article, “Valuing Forests: why investors must wake up to deforestation” addressing investors and forest risk on CDP’s blog in February 2018.
- Spoken on panels at major industry events about forest risk and our work and tools to create value. In 2016, Domini gave the keynote address for the launch of CDP’s 2016 Global Forest Report at the London Stock Exchange and spoke about forestry crime at INTERPOL headquarters.

CORPORATE ENGAGEMENT THROUGH DIRECT DIALOGUE, PUBLIC SIGN-ONS, PROXY VOTING, AND SHAREHOLDER PROPOSALS.

We have collaborated with other investors in dialogues and filed shareholder resolutions with corporations on deforestation matters. For example, we have:

- Encouraged companies to source sustainable palm oil and filed shareholder proposals with companies that source palm oil and other forest-risk commodities, prompting them to update their supply chain policies, increase public reporting, and join certification bodies, including the Roundtable on Sustainable Palm Oil (RSPO). Several of these companies now have time-bound commitments to source 100% certified oil.
- Voted our proxies on forest-related issues in line with our proprietary proxy voting guidelines that support sustainable forestry practices.

VOLUNTARY INDUSTRY STANDARDS

We support other investors and non-profit environmental organization working to develop voluntary industry standards on sustainable forestry practices. We have, for example, worked with:

- RSPO to strengthen their standards, submitting comments on their 2018 Principles and Criteria review, which set its standards for the next five years.

- Rainforest Action Network and Green Century Capital Management to send a letter on behalf of 101 institutional investors managing more than \$3.2 trillion to RSPO's Complaints Panel, calling on RSPO to implement a more transparent and responsive complaints mechanism to properly uphold the credibility of its certification system. RSPO members voted overwhelming in favor to strengthen their standards.

AMPLIFICATION THROUGH COLLECTIVE ACTION.

We have worked in collaboration with coalitions of investors and civil society groups to facilitate development of best practice on forest-related challenges and increase impact. We have, for example, worked with:

- Rainforest Action Network and Friends of the Earth to engage in dialogue with a major beverage and snack-food company related to its palm oil sourcing practices. Prompted by our questions, the company amended its published list of suppliers to note that it had suspended purchases from one accused of human rights violations during 2017.
- Coalitions organized through the Interfaith Center on Corporate Responsibility and the UN Principles for Responsible Investment (PRI) on soy- and beef-related deforestation in supply chains, including signing investor statement of support for the Cerrado Manifesto, related to deforestation in that biome, an investor expectations statement on deforestation in soybean supply chains as part of the PRI and Ceres Investor Initiative for Sustainable Forests. Participation in the Finance for Biodiversity Pledge and the Investor Policy Dialogue on Deforestation.

These initiatives have laid the groundwork for our current initiative that builds on the knowledge and expertise we have gained over the years. With intentionally targeted initiatives. We hope to more rapidly address systemic risks and create desirable outcomes.

1. The State of the World's Forests 2020: Forests, Biodiversity and People. Rome: Food and Agriculture Organization of the United Nations, 2020. Accessed October 13, 2020. <https://doi.org/10.4060/ca8642en>.

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Domini forest focus seeks to address the challenge of global deforestation and reforestation, as is appropriate in our role as a fiduciary. To delineate how the work is compatible with this duty, we have posed and answered the following four questions:

 **Consensus** - Has this challenge been subject to widespread analysis resulting in a reasonable global consensus as to its importance in the maintenance a stable, sustainable, and productive environment and society?

 **Effectiveness** - Do we have the experience, expertise and resources to achieve material, positive impact?

 **Relevance** - Is this challenge material to our investment decision-making and returns across all asset classes?

 **Uncertainty** - Do this challenge's fundamental uncertainties require the application of tools beyond those of traditional risk management—i.e., beyond portfolio diversification, hedging techniques, etc.?

See Report Section 4 for the answer to the Consensus and Effectiveness questions



RELEVANCE

Is this challenge material to our investment decision-making and returns across all asset classes?

Forests pose material risks and offer potential rewards across the two asset classes that Domini invests in: public equities and fixed income.

Domini has a duty to monitor risks and create value for its shareholders. Deforestation is occurring at a scale that is a macro-risk to our investments across asset classes and could threaten the global economy. We have analyzed our portfolio exposure to deforestation and use of forest services. Our findings demonstrate the relevance of forests to our operations.

INFORMATION-SHARING THROUGH WHITE PAPERS, ISSUE BRIEFS, IMPACT REPORTING

Today, a negative reinforcing dynamic in forest-related systems is generating progressively worse outcomes relating to fresh water, local and global climate, biospheric integrity, rural and Indigenous livelihoods, and nutrient cycling systems. Our activities in these areas are regularly documented through publication of our Impact Reports and Updates on our website.

Considering the broader systems dynamics of sustainability challenges helps us to identify forward-looking companies that are cognizant of risks and working to preempt them. We believe sustainability strategies provide a good indicator of strong management that can enhance firms' long-term financial performance. System analysis can also help us identify where in the system to invest in solutions to emerging challenges. Furthermore, investing with the aim of long-term value creation sows the seeds for own future investment returns. Internally, building that capacity to understand challenges from a systemic view enhances our ability to think strategically and plan for the long term.

FOREST LINKAGE ANALYSIS

Industries have different degrees and types of exposure to the systemic risks related to forests, largely based on how directly linked their business model is to forests products, other ecosystem services provided by forests, and deforestation.

In our analysis, we defined four categories of linkage based on proximity to the firms' impact and dependence on forests. Each of these four has different forest-risk profiles, and differing degrees of ability to have a positive impact on forests. The categorization illustrates the degree to which forests are linked to the core business of the industry. The linkage may be a need for forest products or services, i.e. forest value, or a negative, value-destroying effect on forests, or both.

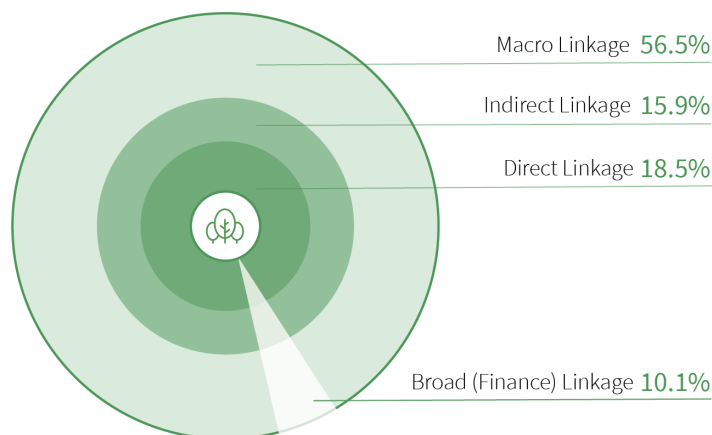
All four types of industries rely broadly speaking on the regulating and supporting services from forests, particularly mitigation of climate change. In the two categories of direct and indirect linkage the ties to forests are more immediate, and are subdivided into three groups: *impact*, those that mainly cause deforestation (i.e. mining), *depend*, those that need services or resources from forests but don't cause deforestation (i.e. the pharmaceutical industry), and *impact & depend*, those that both cause deforestation and need ecosystem services or products from forests (agricultural companies, timber producers). Based on this categorization, we determined which types of interventions would be most effective in addressing systemic risks to the industries in each category. We believe companies in the *impact & depend* category have a particular impetus to act on forests, as they stand to undermine their own operations.

DIRECT LINKAGE

Directly linked industries either directly source forest products, meaning they rely on the provisioning service of the ecosystem, or directly contribute to deforestation, or both. Provisioning services are the food, fresh water, raw materials, and genetic and medicinal resources that are sourced from nature. The direct connection between forest value and these industries is certain, and therefore risks to forests may be possible to translate into prices for companies in these industries. The pulp and paper industry, for example, is an *impact & depend* company as it both impacts forests through its management practices and depends on them to create its products. We believe these companies should help create industry-wide standards and initiatives, such as supplier violation suspension protocols and supply chain monitoring. Directly linked companies also includes *impact* companies that only cause deforestation, such as mining companies. The incentive to act on deforestation does not come from business model risk, as it does for companies that depend on forests. Instead it comes from reputational and legal risk from being involved in deforestation, with a potential tie to a company's climate strategy. These companies often have the most direct ties to deforestation and therefore the most ability to halt it. Finally, *depend* companies, such as pharmaceutical companies that source compounds from the forest, need healthy forests, but must develop novel means to protect them in conjunction with other actors, since their own operations don't have negative effects on forests.

INDIRECT LINKAGE

Indirectly linked industries rely on forests and forest products in some parts of their business but are at least one step removed from the sourcing of products or from deforestation. Food retailers are a sub-industry that fits this category. These companies' leverage for action on forest often involves sourcing standards and pressure on suppliers. The impact, depend, and impact & depend categories are relevant for these companies, and justify the case and leverage for action on deforestation.



The relationship between forests and linkage categories. Percentages are the proportion of Domini's portfolio companies that fall into each category. Directly linked companies have the closest relationship to forests, while macro category companies are linked to forests by their effects on the climate. The broad, finance linkage category spans all types of linkages.

MACRO LINKAGE

Industries with a macro linkage to forests will be impacted by disruptions to the climate and other biogeochemical processes from loss of regulating and supporting ecosystem services that forests provide. These include all industries without the other types of linkages.

These industries depend on a stable global climate with predictable rainfall and temperature patterns, and are adversely affected by extreme weather events, lack of clean water, or by geopolitical instability caused by these disruptions. Climate change can affect all geographies, industries, and asset classes. Climate can impact assets and supply chains, both currently because of more frequent and severe weather and in the long term in wider-ranging, fundamental changes. These physical risks may in turn increase firms' exposure to financial challenges such as loss of profits, default on debt, and legal liabilities. Additionally, transition risks—including disruptions in employment, public policy uncertainty, potential for legal damages, risk of stranded assets, and reputational risk—can also contribute to volatility across all asset classes, as well as lower economic growth.

BROAD LINKAGE (FINANCE LINKAGE)

Financial institutions are linked to forests in many ways, direct and indirect. Diversified financial services firms, primarily insurance companies, may own forests directly; others may lend or have ownership in companies that either rely on forest products or cause deforestation; all are affected by regulating and supporting services of forests, particularly those impacted by climate change, a primary concern for the property and casualty and re-insurance industries. We view financial institutions, with these multi-layered linkages as a separate category; effective ways to address these firms' impact on forests can be tailored to their individual pattern of linkage.

To determine what type of system-related interventions are appropriate, we began by applying the linkage categories to our proprietary sub-industries. We then calculated the percentage of our holdings and approved universe that fell into each of the four types of linkage: direct, indirect, macro and broad. Our interventions will vary from one linkage category to another.



UNCERTAINTY

Do this challenge's fundamental uncertainties require the application of tools beyond those of traditional risk management—i.e., beyond portfolio diversification, hedging techniques, and the like?

The long-term environmental and economic implications of deforestation at current rates are highly uncertain. It therefore constitutes a systemic risk not susceptible to conventional portfolio risk management techniques.

Due to their unpredictable nature, the system-level implications of continued deforestation are fraught with uncertainty. The use of scenario analysis is one means to understand and plan within this context of uncertainty.

INVESTMENT IN AN UNCERTAIN FUTURE

Passing planetary-boundary thresholds for maintenance of a stable and resilient environment can result in dire, rapid, and unpredictable changes. Loss of forests is a contributor to land-use changes that have pushed global systems into a “zone of uncertainty” and biodiversity loss into a “high risk” level, according to the Stockholm Resilience Centre. Moreover, increasing risks in one biosystem can impact other systems in complex and unpredictable ways. Deforestation, for example, can influence not only biodiversity,

but global warming, shifts in rainfall and temperature patterns, and human health e.g. COVID. Regime changes—shifts from one type of ecosystem to another, from a kelp forest to a sea urchin barren, for example—could occur as a non-linear result of drivers like deforestation and pollution.¹ These thresholds for regime change are hard to predict, and once they occur may be irreversible.

Over the past several decades, we have denuded the Earth of almost half of its forests and this trend is continuing. Simultaneously, atmospheric concentrations of greenhouse gases have risen at an unprecedented rate. The globalized economy and the internet have generated an unparalleled degree of globally connectivity and complexity. This mixture has given rise to many complex and interconnected challenges and unpredictable environmental and social macro-risks.

FINANCE AND UNCERTAINTY

Traditional financial valuation is unable to account for the degree of uncertainty involved with rapid forest loss and its concurrence with other unprecedented biogeochemical and ecological changes. Deforestation is recognized as a global risk, but there are differences of opinion surrounding its importance, linkage to other risks, who is responsible for mitigation, and the best means of addressing unsustainable systems dynamics and outcomes, including biodiversity loss and climate change. Furthermore, although forests are understood as stores of value, their actual worth and the means of accounting for ecosystem services, especially in valuation exercises and decision making, are widely debated. As delineated in Constanza et al. (2014)² a variety of acceptable valuation methods for such environmental services exist and can be selected based on their intended use. These potential financial valuations, however, range in magnitude and the mechanisms for their realization to such a degree as to be of little practical use for investors in their daily decision-making.

COPING WITH UNCERTAINTY

Crossing planetary boundaries has the potential to create changes of unprecedented speed and scale with systemic risks that are difficult, if not impossible, to quantify. Scenario planning is one helpful means for conceptualizing such systemic risks and evolving strategies of potential use for coping with potential challenges as circumstances evolve.³ The Taskforce on Climate-related Financial Disclosure has endorsed scenario analysis in contending with the uncertainty of global warming. This approach is similarly appropriate for contemplating the impacts on the economy and investments across asset classes under differing futures for the forests of this world.

Endnotes

1 Hughes T.P. et al., (2013) Multiscale regime shifts and planetary boundaries, Trends in Ecology and Evolution, vol. 28, no.7.

2 Costanza, Robert, Rudolf de Groot, Paul Sutton, Sander van der Ploeg, Sharolyn J. Anderson, Ida Kubiszewski, Stephen Farber, and R. Kerry Turner. "Changes in the global value of ecosystem services." Global Environmental Change 26 (2014): 152-58. Accessed October 2, 2020. <https://doi.org/10.1016/j.gloenvcha.2014.04.002>.

3 See Schwartz, P. (1996), The Art of the Long View, Crown Business.

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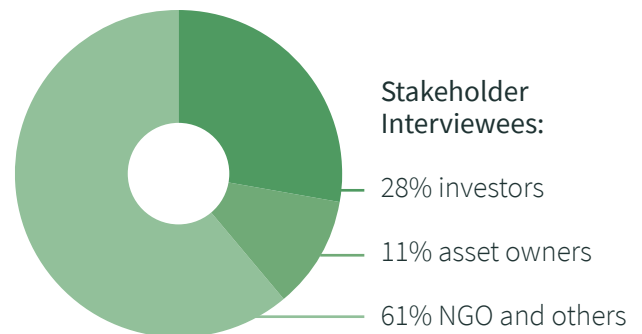
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SYSTEM VISIONING

In order to “see the whole system” well enough to seek change, we had to expand our perspective. To understand the dynamics causing unsustainable outcomes within the forest system and possible solutions, we initially conducted 18 interviews with a wide range of stakeholders. Interviewees included investors, asset owners, and representatives and researchers from NGOs and think tanks. Overall, stakeholders’ responses solidified our hypotheses about the leverage points for positive change in the global forest system and crystallized our understanding of forest-related themes.



FOREST SYSTEM THEMES

To figure out where to focus our efforts, we identified leverage points or solution areas that must be addressed within global forest systems. These themes are areas where either paradigms, metrics, behavior, or other elements must be transformed for the system dynamics impacting forests need to change. We distilled our major themes from this interview process and desk research. We then used these findings to guide our next step: the development and analysis of possible tactics and targets.



THEME 1 RESPONSIBILITY FOR LONG-TERM SYSTEM HEALTH:

A sophisticated and targeted business case will help illustrate why it is in investors’ and corporations’ long-term interest to preserve and enhance forest value.

Theme 1A, Metrics Measuring Forests’ Price-based and Inherent Values:

Ecosystem services and other value from forests are not well developed, either as translated into price or through an understanding of their inherent worth in climate mitigation and other difficult-to-value services such as biodiversity. Values of these sorts are therefore not sufficiently accounted for investment decision-making. Metrics and evaluation techniques able to capture these values could impact crucial investment decisions that affect forests.



THEME 2 DEMAND – EMERGING MARKET AND SUSTAINABLE SUPPLY CHAINS:

Most corporate challenges relating to forest-risks and rewards arise in the context of consumer-facing companies and these challenges impact companies primarily through reputational risks. Consumer demand for forest-friendly products can help address both these companies’ reputational risk and aid in the minimization of longer-term operational risks. The future of consumer demand in emerging markets will play a crucial role in this regard. Additionally, to reach smaller private companies down the supply chain, corporations must increase their demand, and set high sustainability and reporting standards, for forest-positive practices on the part of their suppliers.

Theme 2A, Transparency and Disclosure:

A major avenue for improving and scaling forest positive practices is increased reporting of higher-quality, decision-useful data.



THEME 3 DUE DILIGENCE ON FINANCING AND LENDING:

Those financial institutions engaged in project lending can exercise strong leverage to demand site-specific information on deforestation and forest-related practices (FPIC). Encouraging sound sustainability practices at the project level is key to seeking deforestation-free supply chains leveraging the power of finance.



THEME 4 GOVERNANCE – ILLEGALITY, LAND RIGHTS, AND ENFORCEMENT:

Investors can support and help create an enabling environment for rules and regulations that support no-deforestation policies and practices. Governments have a major role to play in securing land tenure for Indigenous people and small holders, helping prevent deforestation. A major portion of deforestation is illegal. Investors and companies can support enforcement of efforts to end illegal deforestation but cannot tackle it directly on their own.



THEME 5 POSITIVE IMPACT AND SOLUTIONS:

Most corporate and investor work on forests has focused narrowly on improved practices relating to a single forest-risk commodity, such as beef, soy, palm oil, and timber, and on mitigating harm rather than creating positive impact. Sustainable forest management solutions that go beyond halting deforestation and degradation to reforestation and positive impacts on biodiversity and climate are also essential. Examples of sustainable forests and solutions such as a jurisdictional/landscape-level stewardship approach and effective deployment of natural climate solutions (NCS) are needed.

ASSESSING THE FULL SCOPE OF TACTICS AND TARGETS

To rigorously assess our means to effect change, we created a matrix of possible strategies. We analyzed how general tactic types could be applied to influence key stakeholders. This analysis allowed us to explore a variety of opportunities and consider creative possibilities. We rated strategies by various criteria, including difficulty of implementation and previous experience. The wide range and number of options, while clearly not all possible or appropriate to carry out ourselves, provided starting point for developing an effective strategy that could also be used by other actors to influence deforestation dynamics.

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