

## Domini's Forest Project

### Yesterday Today and Tomorrow: Evolution of the Forest Project

December 2023

Domini launched its Forest Project in 2018, but its underlying concerns can be traced back to the 2008 financial crisis, which planted the seeds for our consideration of the need for a system-level approach to investment. Over the next several years, we conceived of an approach that could address such systemic risks and then applied it to the Forest Project.

We describe here briefly three stages of that evolution.

- *Prelude 2008-2012.* The 2008 financial crisis and the ever-growing seriousness of the risks of climate change make us increasingly aware of the impacts of systemic risks on our investments and, conversely, our investments' impacts on these risks.
- *Investments and Systemic Risks 2013-2019.* We considered what it might mean for investors to intentionally seek to manage systemic social and environmental risks and opportunities and contemplated whether or not to venture down that path. In 2016, we decided to explore a system-level approach, but got off to a false start when we experimented with the simultaneous tackling of eight areas of systemic risks. The need to focus on a single risk area became clear.

In 2018, after considerable discussion, we decided to focus on forests. Our first steps were to deepen our understanding the dynamics of current forest-related systems and their risks and opportunities and to identify key themes or leverage points.

- *Development of the Forest Project 2020-2023.* We explored three approaches to forest-related systemic risk management as it relates to our investments and system-level change. 1) We defined and set goals for six major types of forest and agricultural lands, along with their primary challenges, including biodiversity loss. 2) We adopted "advanced techniques" designed to influence forest-related systems dynamics. For example, we supported forest-positive in public policy initiatives and joined with peers in forest-specific collaborative initiatives. 3) We began to engage with specific companies on how their business models could be modified to include forest-related long-term value creation while still achieving competitive returns.

Among the future challenges that we seek to address are those of how to promote within forest- and agriculture-related industries those changes in fundamental business models that will be necessary to generate resilient systems and positive outcomes from the outset. In the long term, we hope this approach can be a model for other industries as they seek to manage these systemic risks and make transitions to new business models that can help address the great social and environmental challenges of the 21<sup>st</sup> century.

## Yesterday

### ***Prelude 2008-2012***

The financial crisis of 2008 was a wakeup call for the investment community. The dangers of systemic risks were made abundantly clear when the global financial system cratered in the fall of 2007 and on into the spring of 2008. The U.S. government stepped in to nationalize Fannie Mae and Freddie Mac, bail out the largest U.S. insurance company, and prop up automobile and banking firms. The housing market crashed and burned, the stock markets tumbled, jobs were lost, and the economy threatened to grind to a halt.

If that weren't enough, in 2012, just as we recovered from the shocks of 2008, Superstorm Sandy brought the lesson of climate change literally to the doorstep of Wall Street. This was a dramatic reminder that climate change was creating incalculable risks that, like the 2008 financial crisis, threatened the resilience of the economic, social, and environmental systems upon which investments depend.

The challenges that we as investors were facing in the 21<sup>st</sup> century started to look fundamentally different from those in the recent past. And we came to believe that we as investors should consider a fundamentally different approach.

### ***Investments and Systemic Risks 2013-2019***

Our situation was becoming increasingly clear. Our portfolios may have positive social and environmental stories, but little progress was being made on the most serious and systemic challenges of our time, such as climate change, biodiversity loss, income and racial inequality, and poverty alleviation.

In 2016, we decided to explore what it would mean to integrate a system-related perspective into our investment practices. Our first step was to develop an investment beliefs statement that stressed our conviction that addressing systemic risks and rewards could play a role in sound investment policies and practices.

In 2017, we then proceeded to sketch out an ambitious agenda, identifying eight key system-level challenges that we believed had implications for our investments and that we could help address. We created small teams to tackle each issue and set them to work. As it turned out, eight systemic challenges at one time were far too many. By year's end it was clear that we should focus on a single issue and go deep.

But which issue? We surveyed our staff but found no clear consensus. From previous surveys of our investors, we knew environmental issues were of particular concern. But should we focus on climate? Oceans? Fresh water? Biodiversity? A focus on forests is where we finally landed. Forests were an identifiable physical system with relatively clear dynamics, a strong relationship to climate change, and an important role to play in biodiversity preservation. Moreover, we had previous experience in the area from engagement with companies on deforestation from palm oil plantations and harvesting from old growth forestlands. At that time, relatively few investors were focusing on the issue, giving us an opportunity to catalyze interest.

## **Yesterday Today and Tomorrow: Evolution of Forest Project**

Having made this commitment, our first step was to survey the landscape to determine the major obstacles to change posed by current dynamics. We interviewed 18 experts to help identify those leverage points at which influence could potentially create the most positive change. From this process emerged our seven major themes.

At the same time, we began to deepen our knowledge of forest, the ecosystem services they provide, their role in biodiversity, the threats of deforestation, the policies and practices of commercial forest management, and the role of Indigenous Peoples and their traditional rights of usage of forest lands and knowledge of their management.

We also recognized that the traditional tools of individual security and portfolio risk management were not designed to bring about system-level impact or change. Additional techniques would be needed for us to exercise effective influence at the system level. Consequently, we supported the pioneering work of The Investment Integration Project (TIIP) in this area. Its concept of the intentional use of certain “advanced techniques” designed for system-level influence proved useful.<sup>1</sup>

## Today

### ***Development of the Forest Project 2020-2023***

As the varied threads of our approach developed, we consolidated them into an increasingly unified approach.

Our definitions for the six specific types of forests prompted us to set goals for each type and then identify best practices for initiatives investors might use to manage toward those goals at a security and portfolio level, as well as at a system level.

We can now look across our seven themes to see what initiatives and techniques we have employed at various leverage points to achieve desired outcomes and then evaluate progress that may have been made.

We now understand how consideration of the long-term value creation that companies can incorporate into their short-term value-extraction business models can lead a balanced or hybrid approach for forest- and agricultural-products companies. We can see how a transition to this model will help if, while remaining competitive, these firms are to contend with specific industry challenges relating to investments in land-enriching preservation and resilience, relations with Indigenous peoples, sustainability in supply-chain management, and alternatives to carbon-based fuels for their energy needs.

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<sup>1</sup> Steve Lydenberg is Founder and Chairman of The Investment Integration Project, a for-profit applied research and consulting firm. At Domini Impact Investments, where he is employed part time, he serves as Partner, Strategic Vision. Domini consults with TIIP on general matters relating to system dynamics in the investment process.

## Yesterday Today and Tomorrow: Evolution of Forest Project

The basic elements in these unifying approaches are described in three of our background documents:

- “Themes, Leverage Points, Initiatives, and Progress” An analysis of our initiatives grouped by our seven key themes and their corresponding leverage points. We explain why we view each theme as representing a challenge that offers leverage for the management of investment and systemic-risks, and assessments as to whether we have seen progress toward that change.
- “Forest-related Definitions and Goals” Definitions and descriptions of the six types of forest-related lands that we have identified, accompanied by goals for each type of land and what investors’ best practices might be to aid in achieving those goals.
- “Value Creators: Forest-related Business Model Change in the 21<sup>st</sup> Century” A backgrounder on a hybrid business model that balances the sort of value creation and value extraction that we view necessary for forest-related lands to contend with the complex investment- and system-level challenges of the 21<sup>st</sup> century. This piece includes specifics on how investors might best influence a transition to this hybrid business model.

## Tomorrow

System-level change is not an easy task. We recognize, for example, that a transition to a hybrid business model for forests and agricultural lands will take time, but we believe that the existential challenges of climate change, biodiversity loss, extreme weather events, and the like will eventually force such a transition, as difficult as that transition may be. Ultimately, that transition will include a shift in the mindset of investors and corporations to one that values and communicates the necessity to balance value extraction with value creation.

We plan to continue to elaborate our work on the Forest Project in ways that we believe provide a viable model for a financially responsible transition for the forest- and agricultural-products industries. We hope it will serve as a model for similar transitions in other industries as they contend with the complex challenges of the 21<sup>st</sup> century, a model that will help create a stable and resilient foundation of fundamental systems upon which investors can depend.

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## **Yesterday Today and Tomorrow: Evolution of Forest Project**

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