Lombard Odier Investment Managers statement with respect to the elimination of deforestation risks in portfolios in accordance with the Financial Sector Deforestation Action (FSDA) initiative

At COP26 in November 2021, Lombard Odier Investment Managers (LOIM) became a signatory of the Financial Sector Deforestation Action (FSDA) initiative[1], bringing together financial institutions working towards eliminating agricultural commodity-driven deforestation risks (from palm oil, soy, beef and leather, pulp and paper) in their investment and lending portfolios, primarily through active ownership, and other measures expected to lead to real-world impacts.

To outline the specific actions taken with respect to this initiative, this document first introduces forests and the deforestation challenge (Section 1), then outlines the LOIM approach towards addressing deforestation risks (Section 2) and concludes by highlighting the importance not only of negative screenings, but of positive investments into the protection and restoration of nature (Section 3). Appendix 1 includes additional details as to our specific screening capabilities, while Appendix 2 includes further details regarding our deforestation and biodiversity loss focused stewardship and engagement framework.

1. Introduction

Forests create the conditions essential for life on Earth. They sustain 80% of the world's known terrestrial biodiversity[2], with tropical forests particularly rich in both the abundance and variety of life. This biological diversity provides the foundation for countless ecosystem services from water filtration to pollination, all of which are value generating processes, not to mention essential for sustaining life on earth. Biodiverse forests are not only important for the economy today, but they preserve a pool of untapped genetic resources for future scientific discoveries. As well as this, forests are one of the largest carbon sinks on Earth, capturing and storing 7.6 billion net metric tons of CO_2 equivalent per year[3], equivalent to 1.5 times the US's total annual CO_2 emissions, providing essential, and economically viable, climate change mitigation[4].

Despite their evident value, the FAO Global Forest Resources Assessment (FRA) 2020[5] estimated that 420 million ha of forest was deforested (converted to other land uses)[6] between 1990 and 2020; although the rate declined over the period, deforestation was still estimated at 10 million ha per year in 2015–2020 (approximately 0.25 percent per year).

In this context, at COP26 in 2021, world leaders pledged to halt and reverse forest loss and land degradation by 2030[7], and to restore 350 million hectares of degraded landscapes and forestlands. This entails the transformation of the agro-industrial sector – the primary driver of deforestation, with 50% attributed to cropland expansion, and a further 38% to livestock grazing[8]. The remaining deforestation is associated with other drivers, such as urban and infrastructure development, and dam construction.

We recognise the importance of ending commodity-driven deforestation to tackle climate change, reduce biodiversity loss, and support food security, and seek to reflect this in the specific actions described in the next section.

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[1] Commitment established by Lombard Odier as a member of The Glasgow Financial Alliance for Net Zero, and signatory of the Financial Sector Commitment on Eliminating Agricultural Commodity-Driven Deforestation (FSDA). Deforestation Commitment Letter.

[2] IUCN, 2021. Forests and climate change - resource | IUCN.

[3] Harris, N.L., Gibbs, D.A., Baccini, A. et al. Global maps of twenty-first century forest carbon fluxes. Nat. Clim. Chang. 11, 234–240 (2021). https://doi.org/10.1038/s41558-020-00976-6.

[4] World Resources Institute, 2021. Forests absorb twice as much carbon as they emit each year. Quantifying Carbon Fluxes in the World's Forests | World Resources Institute (wri.org).

[5] Global Forest Resources Assessments | Food and Agriculture Organization of the United Nations (fao.org).

[6] FAO. 2018. Terms and definitions – FRA 2020. Forest Resources Assessment Working Paper 188. Rome. (also available at https://www.fao.org/3/I8661EN/i8661en.pdf).

[7] Glasgow Leader's Declaration on Forests and Land Use, 2021. UN Climate Change Conference (COP26) at the SEC – Glasgow 2021(nationalarchives.gov.uk).

[8] FRA 2020 Remote Sensing Survey, 2022. FRA 2020 Remote Sensing Survey (fao.org).

2. LOIM approach to address deforestation related risks

LOIM's approach is based on five interconnected steps with the aim to understand, identify and address deforestation risks within its portfolios, primarily through strategically-targeted active ownership.[9]

2.1. Understanding deforestation risks

At LOIM, we adhere to a research-based approach to recognising and understanding deforestation risks. Our research team comprises over 50 FTEs[10], among which some specifically focus on key nature-relevant topics, including food systems, the bioeconomy, geospatial analysis, deforestation and biodiversity metrics, and the circular economy. In June 2023, we also created a Chief Nature Officer role, responsible for the further development of our nature strategy.

Supporting its research capabilities, LOIM maintains an academic partnership with Oxford University, focused on the environmental transition (3+1 system changes)[11] at large, as well as with E4S (a consortium of three Swiss universities) focused on the circular economy. LOIM is a founding member of the Circular Bioeconomy Alliance (CBA) and a member of both the Natural Capital Investment Alliance (NCIA) and the Glasgow Financial Alliance for Net Zero (GFANZ). To further strengthen our engagement in these areas, LOIM also participates in nature-related stewardship, policy advocacy and data initiatives, including Terra Carta initiative[12], FAIRR[13], Forest Investor Club[14], ShareAction[15], among others.

2.2. Assessment of deforestation risks

Assessment and disclosure of deforestation risks: we are following a staged approach to the integration of screening of commodity-deforestation risks (from palm oil, soy, beef and leather, pulp and paper) and biodiversity loss risks associated to operations in areas of concern. We have developed specific screening capabilities, which are described in detail in Appendix 1 and summarised below:

ESG materiality and controversy screening: Since 1997, we routinely screen investment portfolios for companies with exposure to severe controversies (level 5/5) according to the Sustainalytics rating scale, which includes environmental controversies related to deforestation. We also routinely assess ESG materiality scores across our portfolios, which integrate up to 150 different data points per company in relation to its business practices, including specific data points related to environmental management, including deforestation risks.

Deforestation risk management: In 2022, we developed a specific deforestation management tool, also described in Appendix 1. This tool identifies exposure to deforestation risks associated with the production and consumption of palm oil, soy, beef and leather, pulp and paper, and other agricultural commodities. This encompasses companies throughout the food and timber supply chain, including producers, processors, traders, manufacturers, and retailers. We have now integrated data points from this capability into our overarching "alignment" framework described below.

SFDR alignment framework: We have also developed a proprietary and overarching framework to assess alignment to the transition, compatible with our SFDR obligations, which classifies companies into red (potentially harmful), grey, and green (sustainable) investments. This is intended to be a holistic framework, considering companies' contribution to the transition, do no significant harm factors, and governance considerations. The do no significant harm (DNSH) component of this framework specifically integrates variations of the data points above. The framework is described in more detail in Appendix 1.

2.3. Disclosure of deforestation risks

We routinely integrate disclosure on the above ESG scores in our quarterly disclosures. From the end of 2023, we will also begin to disclosure using our more holistic alignment framework, classifying investments into red, grey and green investments, which integrates data points from our more specific deforestation risk management tool.

For selected thematic strategies with specific significance to deforestation risks, we separately report on deforestation risks assessments through an annual report. This primarily comprises our New Food Systems and Circular Economy strategies.

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[9] Commitments in this section applies to all LOIM entities. Only some of LOIM's products are out of scope, including: i) funds following a fund or funds strategy or which feeds into funds which are not managed by LOIM entities, ii) funds which invest a substantial portion of their assets in indices, baskets of indices or other non-direct investments, iii) Funds managed by portfolio management firms outside of the LOIM group, iv) dedicated funds and segregated mandates (including those mandates which are in the form of investment funds), unless a client has specifically approved the application of this statement to the fund or the segregated mandate, v) selected private market funds depending on data availability and the nature of the investment (direct investment, co-investment, sub-funds), vi) alternative strategies due to its high turnover, which makes a meaningful engagement strategy difficult to implement.

[10] Full- time equivalent approved positions. Actual headcount at any given time may vary depending on staff movement.

[11] LOIM conviction is that the environmental transition is needed at scale along three system changes (3+1), which are energy system, material system, land and oceans system, and pricing of externalities through carbon markets. See more information in CLIC® economy I Lombard Odier

[12] Terra Carta | Sustainable Markets Initiative (sustainable-markets.org)

[13] FAIRR Initiative | A Global Network of Investors Addressing ESG Issues in Protein Supply Chains

[14] Forest Investor Club - World Business Council for Sustainable Development (WBCSD)

[15] ShareAction | Registered charity that promotes Responsible Investment

By the end of 2023, as per our FSDA commitment, we will also provide a summary disclosure outlining the present screening of our portfolios, identifying where we have potential exposure to deforestation concerns (noting that this will comprise many companies in the food, mining, material, forestry, and other selected sectors), the present assessed levels of their deforestation management quality, and an overview of our engagement activities in this regard. We note that availability of data is still limited.

2.4. Addressing deforestation risks through active ownership

In our approach to addressing environmental risks, as per the spirit of the FSDA commitment, we seek to prioritise "active ownership, ongoing stewardship, and other measures that are expected to lead to real-world impacts".

To this end, we have developed a specific engagement strategy aimed at addressing deforestation and biodiversity loss-related risks identified among target companies. We have developed a four-step engagement process, aimed at initiating dialogue, encouraging investee companies to set credible commitments, disclosure on key performance indicators, and regular follow-ups for continuous improvement.

Our stewardship and engagement strategy related to deforestation and biodiversity loss risks is described in detail in Appendix 2.

2.5. Investment restrictions

LOIM's investment philosophy favours active ownership and other approaches that pursue real world impact and seek to accelerate transitions by embedding relevant insights into our research processes, over an approach to investment based on binary exclusions that avoid rather than addresses exposure to sustainability concerns.

Our exclusion policy is therefore restricted to specific core values and to sectors and economic activities that are incompatible with key system changes:

- We have a group-wide exclusion on trades in the derivatives of essential food commodities (e.g., wheat, rice, corn, soybeans) to avoid contributing to price volatility in these essential food products.
- We apply a restriction with respect to companies with severe controversies (level 5/5), on the Sustainalytics rating scale, indicating a very severe breach of international norms & standards as defined by the ten principles of the UN Global Compact, the OECD Guidelines for Multinational Enterprises, the UN Guiding Principles on Business and Human Rights (UNGPs) and their underlying conventions. Deforestation-related controversies include issues related with land use, land conflicts, labour, human, and social rights.

3. Increasing investment in nature-based solutions

We believe that while addressing deforestation risks is vital, a key challenge for coming decades is to significantly ramp up investment in nature-based solutions in order not only to preserve nature, but to restore it.

In June 2023, Lombard Odier and its longstanding research partner, SystemIQ, announced the formation of holistiQ Investment Partners, which represents the part of the business of LOIM specifically geared to the environmental transition. holistiQ has, among others, a specific ambition to raise capital at scale for direct employment into nature-related investable opportunities.

Ultimately, as part of the transition to a net zero and nature positive economy, at least 30% degraded areas may need to be restored[16] – including through reforestation and afforestation, and the transformation of land to more regenerative practices. Investments in such nature projects, however, represent investments in productive assets, that may produce regenerative, forest-based commodities and ingredients, carbon and biodiversity credits, and additional ecosystem services.

The development of regenerative value chains will ultimately require trillions of dollars of investment redirecting capital to forest landscapes and communities, protecting and restoring the forest frontier at scale, while delivering net-zero and a host of benefits to global food and cosmetics brands (e.g., increased supply chain resilience to physical risks[17], alignment with nature targets, and social co-benefits).

It is among the stated objectives of the new HolistiQ partnership to further develop a product offering with strategies dedicated specifically to investment in nature-based solutions described above, with further announcements on this topic forthcoming.

[16] COP 15: Nations Adopt four goals, 23 targets for 2039 in Landmark UN Biodiversity Agreement, 2022. COP15: Nations Adopt Four Goals, 23 Targets for 2030 In Landmark UN Biodiversity Agreement | Convention on Biological Diversity (cbd.int)

[17] Includes acute (e.g., drought, floods and extreme weather) and chronic risks (e.g., yield losses from temperature increases).

Appendix 1: Screening and assessment capabilities

A. Our SFDR-compatible red / grey / green "alignment" framework

The below is intended to be illustrative and represents a summary of our framework under the SFDR. The summary below may be subject to change, contingent on amendments to the more detailed definition of our framework described elsewhere.

Since 2021, we have developed a proprietary framework to provide a cohesive, granular and in-house definition of a sustainable investment (in line with expectations under SFDR)[18].

Our framework considers three distinct tests, these being:

1. Whether a company makes a substantial contribution to an environmental or social objective, within which – as of today – we focus on the environmental dimension[19].
2. Whether a company, despite potentially making a substantial contribution, does no significant harm (DNSH) to other environmental or social objectives – for which we use Principal Adverse Indicators (PAIs).
3. Whether a company meets good governance standards.

On the basis of these tests, our framework aims to classify companies into one of three categories:

- Green companies that make a substantial contribution to an environmental objective, and pass the do no significant harm and governance tests.
- Grey companies that fail to make a substantial contribution, that do no significant harm, or those that make some positive contribution but with remaining legacy concerns yet to be further resolved. This also includes companies standing in between, with some contribution but remaining legacy issues to be further resolved. We consider this a company that neither accelerates nor delays the 3+1 transition.
- Red companies that are considered potentially harmful, either by virtue of the nature of their activities, or with serious concerns identified in the other criteria outlined below.

The framework has been designed to be an overarching one, encompassing various sub-dimensions, considerations and more detailed data points. As regards to commodity-deforestation risks and biodiversity loss risks associated to operations in areas of concern, the second DNSH test outlined above comprises, for selected sectors, the following three sub-indicators,

I. Exposure of companies' activities to potential deforestation and biodiversity loss risks.

II. Management practices implemented to mitigate deforestation and biodiversity loss risks.

III. Location of companies' operations in relation to areas of high biodiversity[20].

For a company to be classified as *"green"* or sustainable it should be: involved in activities with low impact on nature and have no known locations in areas of high biodiversity; or involved in activities with a medium impact on nature, but with management practices of at least B or above on our internal deforestation management quality score (ranging from A+ to F), as described below.

A *"grey"* company otherwise scores between C and B using the deforestation management quality score described below, while a *"harmful"* company is involved either on activities with an inherently high, adverse impact on biodiversity or has management practices scoring below C using the below deforestation management quality score.

B. Our purpose-built deforestation and biodiversity management tool

In 2022, we developed a purpose-built management tool to assess risks related to deforestation and biodiversity loss. The data points from this tool are integrated into our overarching alignment framework, related to sub-indicators I and II in the section above.

As described in our FSDA commitment earlier in this document, we disclose on the specific data points that are assessed by our deforestation management tool in selected product-specific disclosures and will begin to assess and disclose this across our wider product range by the end of 2023.

[18] 'Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector' (2019) *Official Journal* L198. Available at: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:02019R2088-20200712

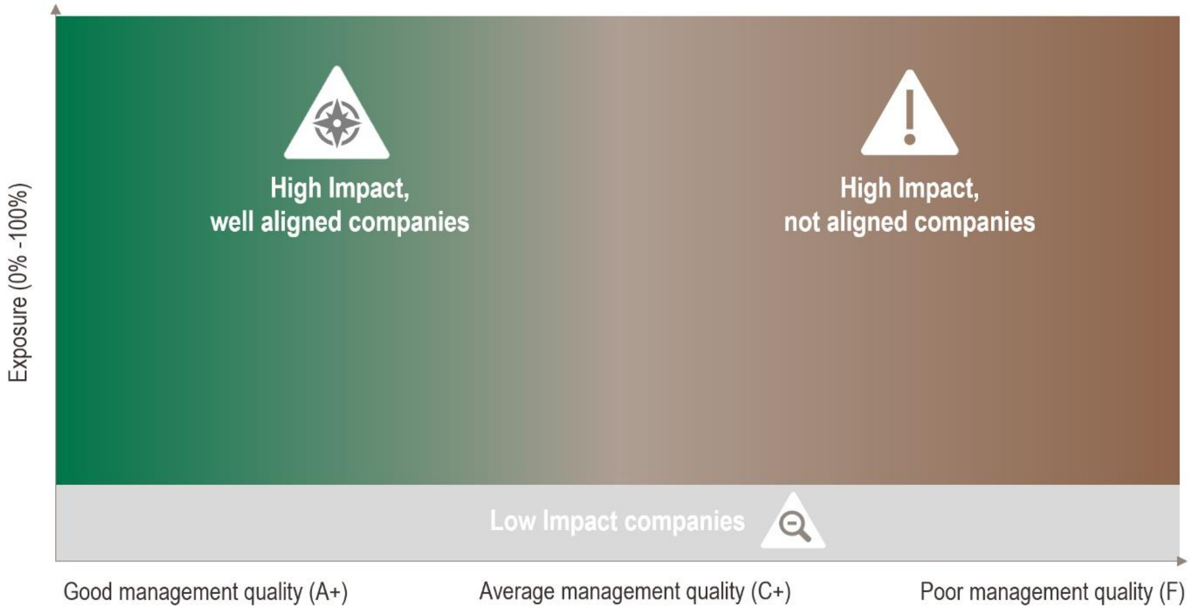
[19] Six Environmental Objectives as defined by the EU Taxonomy: Climate change mitigation, climate change adaptation, sustainable use and protection of water and marine resources, transition to a circular economy, pollution prevention and control, protection of healthy ecosystems.

[20] PAI as mandated in the EU Taxonomy.

Our LOIM Deforestation Management Tool specifically evaluates two distinct dimensions for companies, as regards their exposure to potential deforestation management concerns:

- The **exposure** of a company to potential deforestation risk impacts. If a company has revenues in activities that may impact forests or other natural-ecosystems (e.g., mining activities in forest areas, or production of food using forest-related commodities, such as palm oil, soy, beef and leather, pulp and paper, and other agricultural commodities), these are captured in the exposure indicator. The exposure is calculated by summing the percentage of companies' revenues exposed to deforestation management considerations and varies from 0 to 100%.

- The **management** practices implemented to mitigate deforestation risk impacts. This is based on historical performance (e.g., management of land-use controversies) and target credibility. The final scores vary from **A+ to F**, and it is compounded by the historical performance (66% weight) and target credibility indicators (33% weight).



The LOIM Deforestation Management Tool informs and guides our engagement strategy (Appendix 2) with specific data points and sub-indicators. Some of these include:

- Existing controversies in the operations and supply chain related with deforestation and biodiversity loss, land conflicts and labour and social standards controversies[21].

- Specific revenue streams, which are not compatible with the nature system transformation (e.g., direct production of agri-commodities with high-risk of deforestation).

- Description of the scope and content of deforestation and biodiversity policies.

- Location of companies' operations in relation to forest areas of high biodiversity, such as terrestrial protected areas and intact forests landscapes[22]. This indicator is different from the sub-indicator III in the section above – which includes all protected areas (e.g., marine and terrestrial), irrespective if they are or not within forest ecosystems.

C. Our proprietary ESG materiality rating system

Our ESG materiality framework has been developed over many years and allows investment managers to focus on the Environmental Social and Governance (ESG) dimensions that matter most to a company across its value chain.

Our new SFDR-compatible alignment framework (described above) incorporates many of the same data points and is intended as a more overarching, holistic framework that combines an assessment both of business practices (the domain of the ESG materiality scores described in this section), as well as the inherent nature of business activities.

[21] Related with human rights and the use of mechanisms such as Free, Prior and Informed Consent of indigenous peoples and local communities.

[22] Seamless mosaic of forest and naturally treeless ecosystems within the zone of current forest extent, which exhibit no remotely detected signs of human activity or habitat fragmentation and is large enough to maintain all native biological diversity, including viable populations of wide-ranging species. Intact Forest Landscapes (intactforests.org)

Our LO ESG rating methodology uses over 150 sustainability focused data points per company, which together score companies' business practices, including those relating to impact on local communities, supply chain management and environmental impacts. The latter encompasses all drivers of nature loss, including land & sea use change, direct exploitation, climate change, pollution, and others.

For each company, the Investment Manager calculates a score from 0 to 100 integrating materiality by overweighting the information that has greater significance based on its specific sub-industry (e.g., 158 sectors as indicated in the Global Industry Classification Standard) and underweighting general information that is less relevant. The methodology embeds the Investment Manager's proprietary 'Consciousness', 'Actions' and 'Results' ('CAR') methodology which overweighs the 'R' component – ESG indicators linked to definitive results and outcomes. These scores allow the Investment Manager to attribute to each company an ESG rating from A+ to D based on its percentile positioning in their respective sector.

In practice, the LO Rating Methodology enhances the Investment Manager's ability to monitor a company's progress on the most relevant sector-specific issues for long-term sustainability, including nature-related risks and opportunities, and engage with them on these material issues. The methodology is also used across all asset classes to filter prospective investments based on their ESG rating. In some cases, the Investment Manager adopts a selectivity approach investing a percentage of the fund in companies above a specific ESG Materiality threshold.

D. Our controversy screening system

Our screening for controversies considers breaches of international norms & standards as defined by the ten principles of the UN Global Compact, the OECD Guidelines for Multinational Enterprises, the UN Guiding Principles on Business and Human Rights (UNGPs) and their underlying conventions. Specific deforestation-related controversies include issues related with deforestation and biodiversity loss, land conflicts, labour, human, and social rights, and those related with broader drivers of nature loss (e.g., emissions, effluents, and waste).

Controversies are scored using a 1-5 rating scale, as defined by Sustainalytics, with higher levels indicating more severe controversies[23]. As outlined in section 2, we apply specific restrictions to investments exposed to controversies, as well as applying an additional layer of analysis to identify data errors and/or mitigating circumstances related to such controversies.

[23] Sustainalytics, 2023. Identify controversies affecting portfolio companies.

Appendix 2: Stewardship and engagement strategy

Active ownership and engagement form primary means through which LOIM seeks to address identified nature concerns (including deforestation risks) in its portfolios. We believe this to be essential as such concerns are widespread, particularly across key economic systems such as the food system, the material system, and otherwise. Rather than avoiding these sectors, we seek to accelerate the transition within sectors, through targeted engagements.

We favour concentrating our efforts on a limited number of focused engagements, rather than seeking to engage with every company with unresolved concerns, given our aforementioned view that regards most of the economy as still being based on unsustainable models. For this reason, the Stewardship team considers some of the following factors in prioritising its efforts:

I. Companies within LOIM funds classified as Article 8 or 9 under the Sustainable Finance Disclosure Regulation (SFDR), and specifically those with specific objectives related to nature-related themes.

II. Companies classified as “grey” or “potentially harmful” using our proprietary SFDR-compatible alignment framework that is described in the Appendix 1, particularly where this is related to nature-specific concerns, such as deforestation, in the “do no significant harm” (DNSH) component of the framework.[24]

III. Companies held in high-conviction, concentrated portfolios, where we generally have deep understanding of these companies’ business models, market position, challenges, competitive environment and can add value more meaningfully during engagement

We have developed a specific framework to guide our engagement on deforestation and biodiversity concerns. We seek to engage with companies and provide guidance on these topics through four key steps.

Table 1 shows the four steps required for companies to demonstrate leadership in the management of deforestation and biodiversity loss risks. We engage with the companies to provide guidance on each of these steps, which are inspired by local, national, and international laws and regulations.

- The first two steps consist of the basic environmental and social practices (e.g., including key labour standards), and the required deforestation or biodiversity commitments. We require the investee companies to set targets following the recommendations of the applicable local, national, and international laws and regulations.
- Once a company has such commitments in place, we encourage public disclosures to enable the verification of the fulfilment of commitments and specific Key Performance Indicators (KPIs). We encourage the disclosure of the core metrics, such as volumes of used agri-commodities, supply regions at a country or sub-municipal level, use of certified commodities, percentage of traced commodities, as well as the disclosure of geospatial information.

[24] Companies classified as green (sustainable investments) may not be without fault, but have passed conservative assessment criteria, are deemed to contribute positively to the transition, and are not the primary engagement priority for that reason.

Table 1: LOIM Framework for Company Action on Deforestation and Biodiversity

	1: Basic requirements	2. Commitment (2023-2025)	3. Disclosure of KPIs (2025)	4. Continuous improvement
Deforestation risks (priority focus for companies with exposure through food system supply chains)	• Promote minimum supply chain knowledge (e.g. size of (in)direct suppliers, origin) • Promote key labour standards	• Promote commitment in line with strongest product regulations (e.g. zero gross deforestation, as mandated in EU regulation[25])	• Promote publicly available disclosure, in line with established frameworks (CDP[26] Forests, TNFD[27]) • Encourage inclusion of traceability and specific KPIs	• Follow up for further risk reduction (e.g. decreased use of commodities, excluded suppliers, best-in-class supply chain management, etc.)
Broader biodiversity loss risks (priority focus for companies with operational assets in areas of concern)	• Affirm commitment to Environmental Impact Assessments • Affirm commitment to free, prior and informed consent of indigenous people and local communities • Establish dialogue on any operations in areas with land conflicts • Promote key labour standards	• Promote commitment in line with no net loss biodiversity objectives • Promote commitment to ensure any new operations established outside of protected areas	• Promote publicly available disclosure, in line with established frameworks (CDP Forests, TNFD) • Encourage inclusion of traceability and specific KPIs	• Follow up for further risk reduction (e.g. improved efficiency in processes, etc.)

Where companies are exposed to deforestation risks primarily through their supply chains (as in the case of deforestation) and given the limited transparency of these supply chains, we focus on addressing deforestation risks as a well-defined priority area as a step to ensuring improved supply chain transparency and responsible sourcing. Where companies have more direct exposure, through directly controlled and high-impact operational assets in bio-sensitive areas, we apply a broader biodiversity lens to our engagement efforts.

As indicated in the table above, our engagement efforts target material improvements by 2025. For companies achieving expected benchmarks, our engagement would then shift to encouraging continuous improvement. Where companies fail to meet expectations, we will evaluate opportunities to further prioritise and/or escalate engagements, including through investor coalitions.

Proxy voting: We also undertake our stewardship responsibilities through proxy voting. We expect companies' boards to align with the requirements associated to the 3+1 transition, as well to manage potential sustainability risks related to deforestation and biodiversity loss. As such, we may vote against the chair of the board, or any other non-executive or executive director, if the company has not yet taken strong measures to end deforestation or tackle biodiversity loss. We also use the guidance on Table 1 to vote on additional requirements to these measures, such as target setting, disclosure of metrics, and existing programmes to improve on further risk reduction.

[25] European Regulation on deforestation-free products. EUR-Lex - 32023R1115 - EN - EUR-Lex (europa.eu)

[26] Climate Disclosure Project. Home - CDP

[27] Taskforce on Nature-related Financial Disclosures https://tnfd.global/