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**Proxy Voting Guidelines for External Managers**

**Topic:** Environmental Issues  
**Subtopic:** Deforestation Risk in Operations and Supply Chains  
**Approved:** March 1, 2021

**Description:**

Resolutions on this topic ask companies to address deforestation directly in their operations or indirectly through their supply chain. Such resolutions may request that a company implement a policy to prevent or mitigate deforestation, provide quantitative metrics on supply chain impacts, set quantitative goals, or report on progress on existing commitments.

**Topic background:**

Protecting the world's forests and supporting careful reforestation are essential to combating climate change. The clearing of forests for commodities creates large amounts of greenhouse gas (GHG) emissions. Once a forest has been cleared the potential for future carbon sequestration from the forest has been lost, and, if the area is then converted to agricultural use for crops or livestock, a new source of human-activity-driven GHG emissions replaces the carbon-absorbing forest. Agriculture, forestry, and other land use constitute the second-largest source of GHG emissions after the energy sector,<sup>1</sup> emitting 23% of total net emissions from human activity.<sup>2</sup> Forests shape local climate, and their removal can significantly alter temperature and precipitation for a region. Preventing deforestation is seen as a key element in limiting the average global temperature rise to less than 2 degrees Celsius, a goal of the 2015 Paris Agreement.<sup>3</sup> For these reasons, deforestation is an important factor in the efforts of companies and investors to help achieve the goals of the Paris Agreement and limit portfolio climate risk.

Involvement in deforestation, whether through direct operations or a supply chain, can pose material financial risks for companies. Most directly, for companies involved in agricultural production, alterations to climate and environment that result from deforestation can compromise the capacity of land holdings to sustain agricultural activity, and can create reputational risks. More indirectly, deforestation can pose a material risk to the food supply chain underlying many sectors, including

- Food and beverage companies that purchase agricultural commodities such as soybeans, corn, or beef in which production may involve the clearing of forests.
- Consumer goods companies that use leather, paper and pulp, or rubber, for which forests may be cleared and replaced with pasture or plantations of specific trees.
- Household and personal care product manufacturers of soaps, cleaning products, and beauty products that rely on palm oil – the production of which is a major driver of tropical deforestation – as an essential ingredient.

Policies that support traceability and monitoring in a company's supply chain are essential to understand its exposure to deforestation. In addition, companies whose activities are seen as abetting deforestation can incur reputational and legal risks. As examples, both JBS (a beef company and exporter) and IOI Corporation Behand (a palm oil producer), have faced financial consequences from being implicated in deforestation. For JBS this has led to investor engagement, loss of contracts, and action from environmental regulators including fines. IOI was once suspended from the Roundtable on Sustainable Palm Oil. This suspension limited market access for the company and affected crude palm oil buyers' supply chains.<sup>4</sup>

Investors consider a number of elements in evaluating a company's financial risk exposure with regard to deforestation, such as supply chain management and the impact of land use change on carbon emissions. In addition, for companies and investors who are trying to understand their carbon footprint, deforestation is a key component in calculating Scope 1 GHG emissions for direct operations and Scope 3 emissions for exposure through supply chains.

### **Considerations for voting:**

- Deforestation is a problem with, on the one hand, significant global climate consequences and, on the other, differing relevance for individual companies. In general, we support well-constructed proposals on the reporting of policies and programs to prevent and mitigate deforestation at companies for which direct financial and reputational risks can be clearly identified. In addition, we favor supporting such proposals at companies for whom the indirect risks of deforestation – in the supply chain, for example – are clear.
- Given the importance of quantitative metrics for assessing deforestation impacts and of quantitative goals for eliminating deforestation, we generally favor well-constructed proposals that incorporate expectations about quantitative metrics and goals for progress against deforestation.
- We note that shareholder proposals may address either “net-zero deforestation,” in which mitigation and replacement are intended to offset deforestation activities, or “no-deforestation,” which seek to prevent the loss of existing forests. Care should be taken to understand the extent to which the former proposals consider all material financial risks.
- Harvard Management Company explicitly includes assessment of material ESG risk, including deforestation risk, in its portfolio risk assessment, and its board includes consideration of ESG risk in its oversight of material risk. For this reason, we are generally supportive of proposals that constructively direct a company's attention to the material ESG risk of deforestation. Such proposals, to be supported, should be directed at companies that clearly face such material risks and do not appear to adequately assess them currently.
- Harvard University's support for well-constructed proposals to mitigate deforestation reflects its institutional commitment to sustainability<sup>5</sup>.

### **Illustrative examples of votes:**

1. Vote in support of resolutions that request a company to issue a report on its global supply chain or other impacts on deforestation, including quantitative data on such impacts and

assessing how the company might increase the scale, pace, and rigor of its efforts to eliminate deforestation from its supply chain.

2. Vote in support of resolutions that request a company to set quantitative goals for reducing its supply chain impacts on deforestation, and report annually against key performance indicators and metrics that demonstrate progress against these goals.
3. Vote against resolutions that prescribe particular pathways to mitigate specific risks or that are not related to the company's long-term financial sustainability.

*Harvard offers broader general guidance on its recommended approach to considering shareholder resolutions in "Overview of Harvard University's Proxy Voting Guidelines for External Managers" (follow [link](#) to download full text). When determining votes on resolutions, we consider each resolution in light of this general guidance as well as in light of a resolution's specific request and contextual information about the relevant company and its approach to the issue.*

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<sup>1</sup> The World Resource Institute, *4 Charts Explain Greenhouse Gas Emissions by Countries and Sectors*, <https://www.wri.org/blog/2020/02/greenhouse-gas-emissions-by-country-sector>

<sup>2</sup> For the timeframe 2007-2016 AFOLUs accounted for **13% of CO<sub>2</sub>, 44% of methane, and 81% of nitrous oxide.** **For this and more information see the IPCC, *Special Report on Climate Change and Land*** <https://www.ipcc.ch/srccl/chapter/summary-for-policymakers/>

<sup>3</sup> Ceres, *Investors Guide to Deforestation and Climate Change* <https://www.ceres.org/resources/reports/investor-guide-deforestation-and-climate-change>

<sup>4</sup> For more detail on these examples and other case studies see Ceres's *Business Risks from Deforestation*, <https://engagethechain.org/case-studies-business-risks>. There are also calls from NGOs and other stakeholders for specific companies to halt deforestation, <https://amazonwatch.org/news/2019/0830-dirty-dozen-companies-driving-deforestation-must-act-now-to-stop-the-burning>

<sup>5</sup> For information on Harvard's sustainability plan, see <https://green.harvard.edu/campaign/our-plan>. For information on current Harvard sustainability efforts, see <https://green.harvard.edu/>.