



Biodiversity loss can disrupt ecosystems, diminishing their ability to provide essential resources like food, clean air and water, while potentially accelerating the spread of zoonotic diseases.

Increasingly, the issue is also being viewed through an economic lens. The World Economic Forum estimates that over half of global GDP is "*moderately or highly dependent on nature and its services*". From water shortages putting stress on global supply chains, to deforestation reducing the availability of valuable commodities, in our view the loss of 'natural capital' may have implications for businesses across a range of sectors. For some companies, the risks are not only operational, but potentially systemic.

Regulation Is Coming

With the current rate of global biodiversity loss now higher than at any other time in human history, several regulators and policymakers are placing greater emphasis on biodiversity-related financial risks.

As the potential economic consequences of nature loss are better recognised, it is important that we understand as fully as possible the financially material biodiversity-related risks faced by the companies in which we invest. Reflecting this, we recently undertook a biodiversity-related risk-mapping exercise across our portfolios.

Mapping the Big Four Commodities Driving Deforestation

Our research is guided by the Taskforce on Nature-related Financial Disclosures (TNFD), which provides guidance for companies and investors on how best to consider nature and biodiversity-related risks and impacts.

TNFD divides nature into four "realms": land, ocean, freshwater and atmosphere. Biodiversity refers to the variability among living organisms that is essential to the productivity, resilience and adaptability of ecosystems within these realms.

Based on our review of this guidance and the sector weightings in our portfolios, our initial assessment focused on deforestation. The Intergovernmental Science-Policy Platform on Biodiversity and Ecosystem Services has identified four commodities as key drivers of deforestation: beef, palm oil, soya and timber. Despite limited data availability on biodiversity loss, there is readily available data specific to these four commodities, which we considered when assessing our portfolio holdings.

As anticipated, the mapping exercise revealed only a relatively small number of companies in our portfolio with exposure to one or more of the four commodities. The number with direct exposure is even smaller.

Palm Oil: A Complex Crop

Of the four commodities, palm oil carries a high potential deforestation risk. Appearing in almost half of all supermarket packaged products, palm oil can be found in food, cosmetics and cleaning supplies. It is also used in biofuels and as a cooking oil.

Valued for its stability and versatility, oil palm is an incredibly easy and efficient crop to grow, yielding around 40% of the world's vegetable oil demand on just under 6% of the land used to produce all vegetable oils. This makes it lucrative for growers, who have responded to huge global demand by increasing production, in Indonesia and Malaysia in particular, which collectively account for around 85% of global production.

Due to the potential for deforestation, there have been frequent calls to abstain from using palm oil. However, Procter & Gamble (P&G) shows there could be a more nuanced approach.

P&G uses palm oil in its fabric care, home care and beauty products and it is estimated to use around 0.6% of global palm oil product annually⁴.

P&G's answer to those who demand it phase out palm oil concerns the lack of viable and scalable alternatives. Palm oil is a natural, high-yielding substitute for many petroleum-based products. Replacing production with lower-yielding vegetable oil crops could potentially lead to increased deforestation and land degradation in other regions of the world.

Rather than explore sub-optimal alternatives, P&G believes it can best mitigate deforestation through responsible supply chain management and an adherence to appropriate regulatory and industry standards. In that respect, the company can point to considerable progress since 2020, when two-thirds of shareholders voted for a shareholder proposal encouraging the business to "*eliminate deforestation and the degradation of intact forests in its supply chains*." As a member of the Roundtable on Sustainable Palm Oil (RSPO), P&G's brands have used 100% RSPO certified palm oils since 2021.

When framing the debate around palm oil, we believe it is important to distinguish between mature production – those large-scale plantations already in existence – and further expansion into tropical forests with high conservation value. P&G's sourcing policy adheres to the 'No Deforestation, No Peat and No Exploitation' commitment, and a list of tier-one suppliers, all of whom are expected to be members of RSPO, is published bi-annually.

The use of environmental satellites enables P&G to monitor its supply landbank in real time to mitigate potential deforestation. Over 18.9 million hectares of suppliers landbanks in Indonesia, Papua New Guinea and Malaysia are currently monitored. In 2024, 99.95% of landscapes monitored were found to be "*free of deforestation or conversion issues*". Where issues were identified, the business has engaged with suppliers on remedial action.

Disclosure and Mitigation

We believe that by recognising the financially material risks to its business and by adopting robust mitigation measures, P&G exemplifies a proactive approach. Sufficient disclosure also enables external assessment of the materiality of the company's biodiversity risks and the appropriateness of its mitigation measures. This can then be augmented through ongoing engagement with management.

While we are conscious of the limits of a one-size-fits-all approach, we think companies should as standard adhere to relevant regulations, maintain good levels of disclosure and take appropriate mitigation steps. As biodiversity loss accelerates, potentially impacting asset values and long-term returns, it is important that exposed companies and investors understand and assess the associated risks.

Similar nuances and considerations apply to the other three commodities (beef, soya, timber) that were included in our risk-mapping review, which we think emphasises the importance of undertaking fundamental company-level analysis on such issues, in addition to portfolio-level thematic research.

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1.0_COM002584_14/10/2025

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