

January 13, 2020

Assembly Member Ash Kalra
State Capitol P.O. Box 942849
Sacramento, CA 94249-0027

Re: Reintroduction of the California Deforestation-Free Procurement Act

Dear Assembly Member Kalra,

We, investors representing \$XX in assets under management, are writing to express our support for your introduction of the California Deforestation-Free Procurement Act (the “Act”). The Act’s mandate for No Deforestation, No Peat, and No Exploitation (“NDPE”) policies, certification and public disclosure from specific state contractors and subcontractors helps to provide investors with necessary information on material financial and climate-related risks on companies potentially linked to deforestation. Passage of the Act would help mitigate the material climate risk faced by our portfolios and the companies in which we invest, assist investors to identify companies that are fulfilling their commitments to zero-deforestation and NDPE policies, as well as offer investors an opportunity to invest in tropical-deforestation-free government bonds.

Deforestation presents material risks to companies that rely on forest services, which is relevant to two of California’s major sectors: agriculture and the pharmaceutical industry. Agricultural companies and those relying on stable agricultural yields are exposed to a number of potential risks throughout their supply chain due to unmanaged exposure to deforestation. Agricultural outputs are directly affected by the loss of forests’ cooling and water cycling services, sometimes at a great distance from the forests being lost. Deforestation in the Amazon, for example, is predicted to decrease rainfall in the US Midwest, Northwest, and parts of the South during the agricultural season.¹ Forests also harbor vital pollinators improving harvest quality and size. Pharmaceutical companies also face material risk from deforestation: one quarter of all pharmaceuticals are derived from the genetic compounds of wild plants, and nearly half of approved cancer treatments come from natural products.²

Deforestation is also one of the largest drivers of climate change, making it a material risk across our portfolios. Currently an estimated 15% of all greenhouse gas emissions result from deforestation. In the tropics, logging and burning now account for up to 40% of total above-ground carbon emissions.³ Climate risk, exacerbated by deforestation, can manifest as physical risk to assets from changing global temperatures and rainfall patterns and extreme weather, including heat waves, wildfires, flooding, and drought. Curbing deforestation is one of the most cost-effective ways to address climate change. As more state and national governments pass legislation to align with the Paris Accord, companies associated with deforestation are more likely to face regulatory risks and other financial risks, like stranded assets.

Compliance with the Act would also provide useful information to investors seeking to mitigate exposure to deforestation in their portfolios and choosing to invest in deforestation-free companies. Many

¹ D. Lawrence and K. Vandecar, “Effects of tropical deforestation on climate and agriculture” *Nature Climate Change*, vol. 5 (2014): 27–36.

² Frances Seymour and Jonah Busch, “Why Forests? Why Now? The Science, Economics and Politics of Tropical Forests and Climate Change” *Center for Global Development* (2016): 73-74.

³ RS Houghton, RS., “Carbon emissions and the drivers of deforestation and forest degradation in the tropics” *Current Opinion in Environmental Sustainability* 2012, 4:597-603 (2012).

investors were encouraged by the numerous corporate pledges made over the past decade to rid supply chains of deforestation by 2020. The Act would help ensure that companies fulfill these commitments and incentivize compliance where NDPE policies already exist. It would further aid companies and their investors by mandating public disclosure of their policies and corresponding data. Ultimately the Act would assist investors in conducting due diligence of their holdings in an effort to limit exposure to deforestation and climate-related risks and help to prepare for climate readiness in our portfolios.

Finally, passage of the Act would mean that, after its effective date, California state and municipal government bond issuances would offer investors a new way to manage deforestation in their debt portfolios. The market has demonstrated strong growth in demand for sustainable debt products like green bonds.⁴ More broadly, “environmental, social and governance investing” has become increasingly mainstream for investors in the fixed-income markets.⁵ California could be a leader in issuing sustainable government debt in the United States.

We appreciate your attention to this timely issue and for the reasons stated above, we respectfully encourage you to introduce the California Deforestation-Free Procurement Act this legislative session.

Signed,

⁴ Navindu Katugampola, “Ten Years In, The Green Bond Market is Poised for Growth” *Morgan Stanley Global Capital Markets* (2018).

⁵ *Id.*