

# ESG VIEWPOINT

## Deforestation in Brazil



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### At a glance

- Brazil's natural habitats are valuable on a global scale – the country contains 15-20% of the world's biological diversity and 60% of the Amazon rainforest.
- Deforestation increased under President Bolsonaro with cattle farming, soy production and gold mining the key drivers.
- President Lula has pledged to halt deforestation.
- We believe deforestation in Brazil poses material risks to investors, explore why it matters and discuss changes in the regulatory backdrop.
- In Brazil we engaged with policy makers and a range of companies operating in a range of industries linked to deforestation together with businesses with related value chains.



## Introduction

Brazilian ecosystems have immense environmental, social, and economic value, but the rate of degradation has accelerated during five years of weak environmental protection under President Bolsonaro

The return of President Lula is a boost to efforts to halt deforestation, but he faces significant impediments in his efforts to move the needle. We are assessing how this alters the landscape of deforestation-related risks and opportunities for investors, and what new opportunities this presents for investors to engage with governments and corporates. We travelled to Brazil to deepen our understanding of the issues and encourage reform, where we met with policymakers, soy traders and meatpackers as part of our wider engagement programme on this topic.

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Are we at a turning point?



Investment risks posed by deforestation



Dialogue on the ground in Brazil



Final thoughts – engaging for positive change



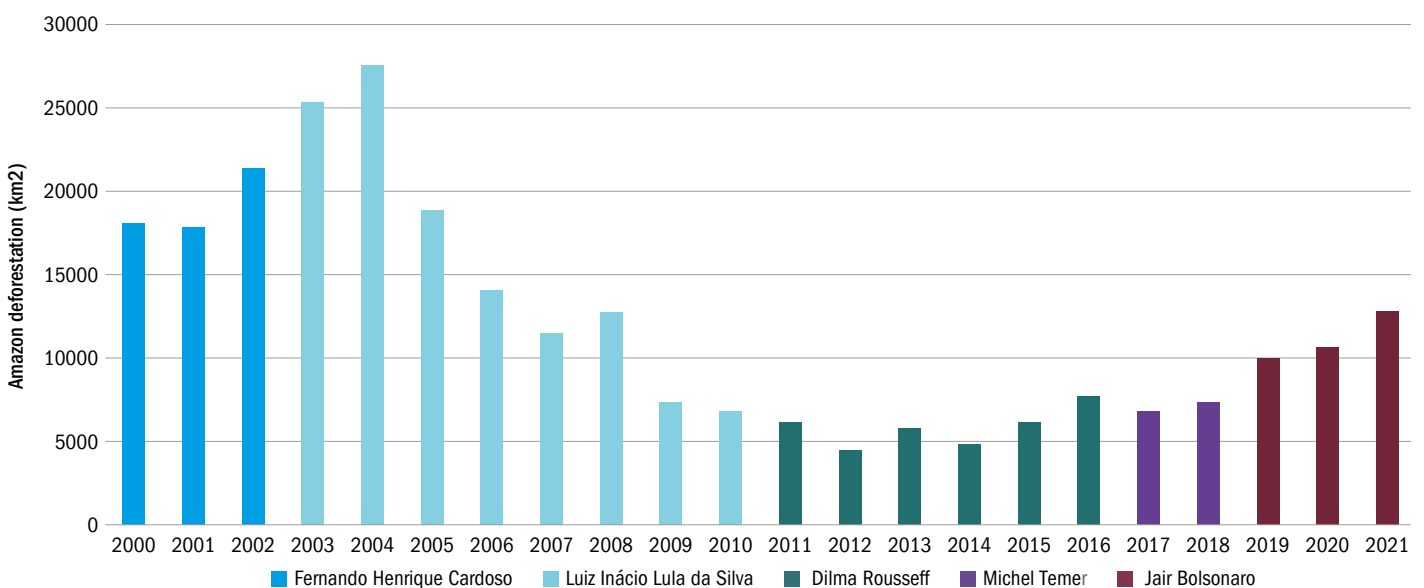
## Rainforest degradation – are we at a turning point?

Brazil’s natural habitats are incredibly valuable on every metric. The country contains **15-20%** of the world’s biological diversity, including two biodiversity hotspots (the Cerrado and Atlantic Forest) and 60% of the Amazon rainforest

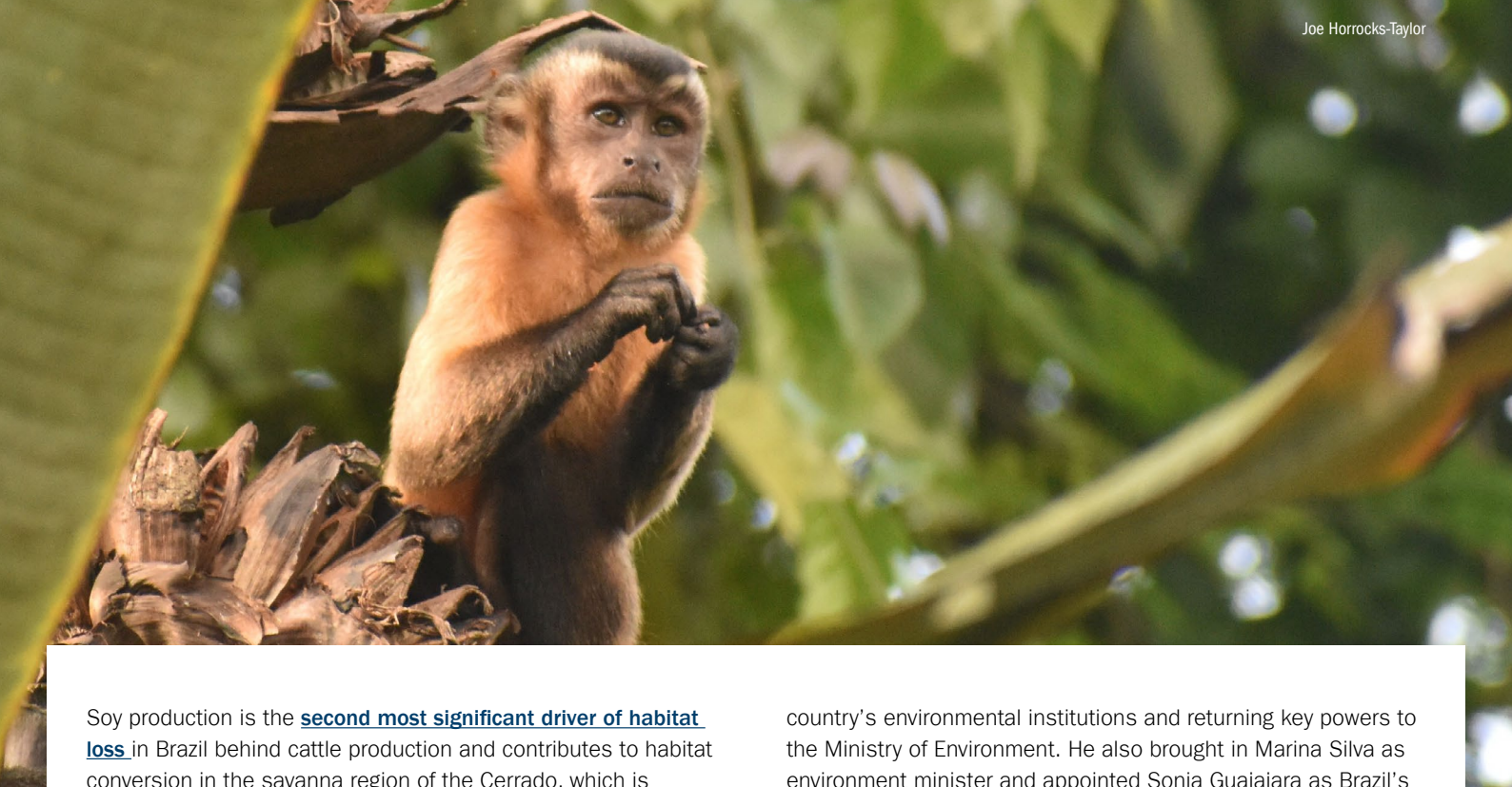
These habitats are also important socio-economic contributors – the Amazon contributes **\$8.2 billion** to the Brazilian economy and there are almost **900,000 Indigenous peoples across 305 ethnic groups in Brazil**.

However, Brazil’s natural habitats are being systematically degraded. There are three primary industries that drive habitat loss and degradation in Brazil: cattle, soy and illegal gold mining. Cattle production is the proximate cause of more than **70% of Brazilian Amazon deforestation**, of which **most is illegal**.

Figure 1: Brazilian Amazon deforestation dropped dramatically under Lula and nearly doubled under Bolsonaro



Source: [Program to Calculate Deforestation in the Amazon](#) (PRODES), [INPE](#), graph from Carbon Brief



Soy production is the [second most significant driver of habitat loss](#) in Brazil behind cattle production and contributes to habitat conversion in the savanna region of the Cerrado, which is [mostly legal](#). Illegal gold mining has an even more insidious impact, with illegal miners [encroaching on Indigenous reserves and protected areas](#) in the Amazon, propagating violence, disease and pollution. Products from these three industries flow into global supply chains where they can implicate corporates outside of Brazil.

The situation was exacerbated under the presidency of Jair Bolsonaro from 2019 to 2022, who oversaw a systematic weakening of the regulatory framework preventing habitat conversion. Under his administration, the government bodies responsible for monitoring the environment and enforcing laws had their [budgets reduced by over 30%](#); environmental experts were [purged from government positions](#) and hiring freezes were enacted; and key responsibilities were shifted to the more [business-friendly Ministry of Agriculture](#). The rights of Indigenous peoples were heavily eroded, with the [Indigenous affairs agency FUNAI effectively abolished](#) and illegal invaders of Indigenous lands given [government validation](#). The Bolsonaro administration saw Amazonian and Cerrado habitat loss hit [15](#) and [7-year](#) highs, respectively. In 2022, Brazil lost an area of habitat equivalent to the size of Israel from these two biomes.

The election victory of Lula da Silva over Bolsonaro in October 2022 heralded a fragile new dawn for efforts to protect Brazil's forests. Deforestation rates in Brazil [dropped by over 70%](#) during Lula's first stint as president in the early 2000s, and a key tenant of this campaign was the promise to deliver zero deforestation in the Amazon by 2030. On his first day in office of his current term, Lula signed a package of seven executive orders aimed at controlling deforestation, re-building the

country's environmental institutions and returning key powers to the Ministry of Environment. He also brought in Marina Silva as environment minister and appointed Sonia Guajajara as Brazil's first minister of Indigenous peoples.

However, Lula must navigate a host of impediments to drive down deforestation. The Brazilian Congress continues to be conservative-dominated and the [agribusiness caucus](#) is its largest organised coalition; it is likely to hinder attempts to curb deforestation. Lula has avoided Congress thus far by passing executive orders but will need its assent to pass wider environmental legislation and to affirm his executive orders. Congress is also attempting to [actively reverse Lula's efforts](#) and dilute the powers of the environment and Indigenous peoples' ministries

In addition, it will be a long process for Lula to heal the damage done to environmental institutions. Budgets can be restored, but it takes time to [recruit and train skilled staff](#) in institutions such as IBAMA, the environmental enforcement agency. Finally, infrastructure megaprojects around the Amazon threaten to tear open [fault lines](#) in Lula's coalition.

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## Investment risks posed by deforestation

Deforestation in Brazil poses material financial risks for investors across several different dimensions. The World Bank estimates the value of Brazil's standing Amazon rainforest **exceeds US\$317 billion per year** – around seven times more than the value linked to extensive agriculture, timber, and mining. We believe this makes it our imperative to engage with both the Brazilian government and companies linked to deforestation.

Rainforests play a crucial role in regulating regional climates:

- Rainfall generated by the forest itself, through a process termed precipitation recycling, accounts for up to **41% of the rainfall** in the Amazon.
- Deforestation increases the likelihood of droughts in the Southern Brazilian Amazon (SBA), with producers in Rio Grande do Sul state currently in their third year of drought, with losses predicted to be over **\$2.3 billion**.
- **Scientists** project that every **1% of forest loss reduces monthly rainfall by 0.25%** (or 0.1 mm). However, this linear relationship is not infinite. Models project that the Amazon is reaching a **tipping point of degradation**, which will cause the rainforest to undergo an irreparable mass dieback and switch to a savannah system. This creates substantial uncertainty in modelling climatic responses to Amazon deforestation.

With forest loss already exceeding 30% in the SBA and projected to climb to 56% by 2050, based on current trends, the impacts on agricultural productivity could be catastrophic. Brazil also relies on hydropower for over **75% of its electricity** – therefore, changes in precipitation driven by deforestation and climate change **threaten hydropower energy security**. Deforestation and its associated climate impacts poses real risks to investments in Brazilian corporates and **Brazilian sovereign debt**.

A combination of physical risks with changing market conditions and regulations means that agricultural assets in deforested areas could become stranded and experience write-downs, devaluations or conversion to liability. These risks are especially acute due to the rapidly evolving international policy landscape.

The **EU** and **UK** have recently brought in strict deforestation criteria for imported products, with similar draft legislation on

the floor of the **US Senate**. China, a very significant market for Brazilian agricultural exports, is also **signalling that it may tighten control of deforestation-linked imports**, and Chinese companies such as **China Mengniu Dairy** are starting to establish robust deforestation policies. These regulations are significant market signals; under the EU Deforestation Regulation, non-compliant operators can be fined up to **4% of their total annual EU turnover**.

The tightening policy landscape is increasing the risk of deforestation-related litigation, as evidenced by the recent **lawsuit filed by NGOs against BNP Paribas** for providing financial services to companies that contribute to Amazon deforestation. With financial organisations increasingly in the firing line on deforestation, deforestation-risk corporates could also experience **increases in their cost of capital**, with ensuing impacts on their creditworthiness. These transition risks are also being driven by changes in the domestic Brazilian policy landscape, with the inauguration of President Lula in January acting as a clear watermark for Brazilian ambition on deforestation.

Halting deforestation is essential for investors to be able to deliver on their net zero ambitions. Deforestation is responsible for **11% of global emissions**; if it is not halted by 2030, it will be **impossible to limit global warming to 1.5°C**. On the positive side, nature-based solutions are some of the most cost-effective and immediate climate solutions, and can provide up to **37% of the emissions sequestration** needed to limit warming to 1.5°C. Efforts to halt deforestation return a triple climate dividend by reducing emissions, enhancing carbon sequestration and strengthening climate adaptation.



## Engaging on the ground in Brazil

We are active participants in the Investor Policy Dialogue on Deforestation (IPDD) in both the Brazil and consumer countries working groups. As part of our work within the Brazilian regulatory landscape, we travelled to Brazil in April 2023 as part of an IPDD delegation

This trip reinforced our perspective that a broader, multistakeholder approach focused on collaboration is required to effectively address deforestation and the associated risks. As a result, at Columbia Threadneedle, we structure our engagement on deforestation into three pillars:

### 1) Collaborating with policymakers

The last five years is a clear lesson that government deforestation policy and corporate action need to work in tandem to deliver a reduction in rates of deforestation.

Our trip gave us the opportunity to engage with the Brazilian government on investor priorities for managing deforestation. In Brasília, we met with a variety of government ministries and bodies, including the Ministry of Environment, Ministry of Planning, Ministry of Indigenous Peoples, Central Bank, IBAMA and ICMBio. The purpose of these meetings was to understand the priorities and plans of the new Lula administration regarding deforestation management and to highlight the needs of investors.

Through the IPDD, we emphasised four key asks of the Brazilian government:

- **Firstly**, the need for the government's animal transit and rural environmental registry to be validated, linked and made more accessible to private sector users in order for

investors to be able to identify corporate actors that enable illegal deforestation. We believe this necessitates the rural environmental registry remaining under the purview of an independent ministry.

- **Secondly**, the imperative to improve the land registry systems and regulatory landscape to support the development of incentive schemes, encouraging landowners to conserve standing forests and restore degraded land.
- **Thirdly**, the requirement for the budgets and staffing of enforcement agencies such as IBAMA to be restored to ensure that actors operating outside the legal framework to deforest do not financially benefit.
- **Finally**, we emphasised the risks that deforestation poses to our sovereign investments, and advocated for Brazil to pursue sustainability-linked issuances similar to those of Uruguay.

As the new administration continues to settle in, through the IPDD, we will continue to work with government ministries to explore opportunities to progress on these priorities.



## 2) Engagement with soy traders and meatpackers

We have active engagement programmes with many of the soy traders and meatpackers that are linked to Brazilian habitat loss through their direct operations or suppliers. We expect these companies to commit to deforestation-free and conversion-free production, sourcing and financing by 2025. This commitment should include the ability to fully trace all commodities sourced by corporates, and we expect them to articulate clear strategies to achieve these obligations.

We have engaged several times with Brazilian meatpackers **JBS** and **Marfrig** over the last two years. Our key concern is their ability to trace cattle beyond their direct suppliers. This is essential as JBS estimates at least 60% of the deforestation risk in its supply chain is located in its suppliers' suppliers. The company has started to conduct regional procurement assessments and target procurement from areas at lower risk of deforestation, but its ability to trace production to these levels remains quite limited. We encouraged the meatpackers to play a strong role in collaborating with the Ministries of Agriculture and Environment to align the animal health traceability and property deforestation checking systems.

We also met with **Archer-Daniels-Midland's** (ADM) director of sustainability for Latin America in Sao Paulo. We encouraged ADM to strengthen the sustainability requirements it sets for soy aggregators and to enhance the resource it commits to training aggregators and providing deforestation screening tools. We also advocated for ADM to set a zero-conversion target to keep pace with other soy trading peers.

## 3) Engaging with firms in the value chain

We have identified two industries within the value chain that have the potential to enhance the pressure on Brazilian agribusiness to act.

The first is leather, which is [key to meatpacker margins](#) and, unlike beef, is [largely exported](#). Half of exported Brazilian leather ends up in automobiles, many of which are produced in Europe where leather is subject to the new EU Deforestation Regulation. We have run a [focused engagement programme](#) with five car-seat suppliers and eight automakers to support their efforts to assess and manage their deforestation impact. We were a founding member of the [Investor Working Group for a Deforestation-Free Automotive Industry](#) in close collaboration with Rainforest Foundation Norway.

The second is European financial institutions. These are not currently covered by the new EU Deforestation Regulation, but it seems likely that they could be in the future. In addition, these institutions are under increased scrutiny by civil society, with [BNP Paribas currently being sued](#) by NGOs for providing financial services to companies linked to Brazilian deforestation. We will continue engaging with Brazilian financial institutions, but believe that the European policy environment increasingly offers a tailwind for engagement with these institutions on deforestation.

## Conclusion – engaging for positive change

To capitalise on the fragile window of opportunity offered by the re-election of President Lula, we believe responsible investors need to embark on a concerted engagement programme that encompasses agribusiness, policymakers, financiers and customers. At Columbia Threadneedle, we aim to drive change

by collaborating with policymakers, engaging with soy traders and meatpackers and engaging with firms in the value chain. We will continue to collaborate with other like-minded investors to speak with a common voice on this topic.


## Get to know the author



### Joe Horrocks-Taylor, Senior Associate Responsible Investment

Joe joined the Responsible Investment team in 2021 and is focusing on climate change and biodiversity. Before joining us, Joe worked as a sustainability consultant with a range of private and public sector clients. Outside work he enjoys playing sport, hiking and birdwatching.

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410400 (07/23)