

Finance and nature: additional complexity or urgent necessity?

1. The importance of biodiversity for the economy and the financial sector

The Chair emphasised that nature was something to care about because of the alerts from science. It is important for society to stick to a vision of life in which science and rationality matter. There are limited resources in the world. Ecosystems are fragile and limited. A study from June 2023 by the European Central Bank (ECB) stated that 72% of the loans distributed to companies within the euro area are given to those dependent or highly dependent on ecosystem services.

A Central Bank official remarked that De Nederlandsche Bank (DNB) has been trying to identify links between the loss of biodiversity and the financial sector. It recently published a technical paper aimed at linking the ramifications of biodiversity loss scenarios with the solvency of financial institutions and financial stability.

Four transition scenarios and one physical risk scenario were considered for the Dutch financial sector. Biodiversity is more localised than climate, so what is important for the Dutch financial sector might not be important, at least in the short term, for a Brazilian financial institution, for example. Tipping points and second round effects were excluded.

An industry representative stated that society depends on healthy ecosystems, and no businesses, resilient economies or long-term growth are possible without nature conservation. CDC Biodiversity aims to measure its biodiversity footprint and that of other companies, so it launched the global biodiversity score (GBS). The idea is to assess biodiversity impact in all areas of companies' activities across the whole value chain and express that as a single metric. Speaking a common measurement language is key.

2. The implementation of the Taskforce on Nature-related Financial Disclosures (TNFD) Recommendations

An official detailed that the TNFD is a taskforce founded by the UN, and funded by several governments, including several from Europe. The TNFD includes 40 Taskforce Members, all large corporations, and financial institutions from around the world, including one on the panel. It has developed a set of disclosure recommendations and guidance that encourage and enable business and finance to understand how nature interacts with their businesses, and the relationship between their business

models and nature. The TNFD aim is to support a shift in global financial flows away from nature-negative outcomes and toward nature-positive outcomes.

The methodology proposed is meant to help decipher how a business model depends on ecosystem services and which ones and understand what the company's impact on nature are through its operations and through its value chain. The TNFD guidance provides a framework for companies to approach this issue in the same way, and then report consistent, comparable, and decision-useful information. About a company's impact on nature, that might be through CO₂, but it is only the third-ranked problem. The first is land use change, the second is overuse of resources and the third is pollution, at equal level with CO₂ emissions. This is about the facts, the science, and the physical reality of nature.

The framework has 14 recommendations, which are built on those of the Task Force on Climate-related Financial Disclosures (TCFD), to help make them more familiar.

An industry representative reported that on 16 January the TNFD announced the number of companies that had volunteered to become early adopters. Of the roughly 320 companies, 80 were from Japan, making it the country with the largest number of volunteers. The UK was next with 46 companies and then France with 19.

Japan does not have the same kind of political divide that there is in the US. European companies are prioritising the European Sustainability Reporting Standards (ESRS) overuse of TNFD. Japanese companies were advised to utilise TNFD while it was not compulsory, as they could make mistakes and gain useful experience before it becomes compulsory. The goal is not saving nature. Nature will survive one way or the other. The question is whether human beings will be able to survive.

3. The legal and political background in the EU

A public representative remarked that there is currently a debate in European politics on what to do with nature. The Green Deal always assumed that it was not just about climate change; it was also about preserving and restoring nature. However, in the Parliament there have been more debates, mainly on the nature restoration law and pesticides. Some groups do not want to head in that direction. The upcoming elections could shift the balance on the issue.

There is a delegated act on the taxonomy, the environment and climate, which addresses biodiversity. For example, it takes the position that biodiversity offsetting can provide a substantial contribution, which is odd because biodiversity offsetting is a zero-sum game. There is

pressure on the legislator and the Commission to not go too far, and that pushback has existed for some time.

It is positive that the TNFD, DNB and the ECB are taking the time to further develop the understanding of the impact on the ecosystem, and ecosystems' impacts on businesses, in order to produce workable methodologies.

There is a growing consensus that transition planning is essential for sustainable finance to work. It is not self-evident that there is a long-term horizon among corporates and financial institutions, so transitional planning is important. This is a necessary vehicle, because the tipping points may be not five or 10 years away; they may be 10 or 20 years away. It must be ensured, in the current mandate, that the understanding of biodiversity and what corporates and financial institutions can do about it, are better understood, and for the resulting recommendations to have a place in investment decision processes.

An official agreed that many financial institutions and companies in Europe want to concentrate on the Corporate Sustainability Reporting Directive (CSRD) and think about TNFD later. However, adopting the TNFD Recommendations helps in answering the ask from the European Financial Reporting Advisory Group (EFRAG) on ESRS. A methodology called Locate, Evaluate, Assess, and Prepare (LEAP) has been provided by TNFD, which can be used by companies doing ESRS disclosures. They should work together because they are, purposefully, highly interoperable.

The Chair asked whether the backlash regarding there being too many norms and about excessive complexity could disappear after the election. A public representative suggested that for sustainable finance in general, and biodiversity in particular, the benefits for corporates and financial institutions are sometimes elusive. It is unclear what they will bring, so it is sometimes difficult to have this discussion within the corporates or financial institutions. Long-term planning should therefore be emphasised because that will at least make the importance clear.

On the other hand, the costs are clear and sometime high. CSRD is a major effort. That means there is a need to also think about the ecosystem of financial services and whether it is available to make sure that the framework is ready to be implemented relatively cheaply and at a large scale. A public/private partnership to take this into account might be needed.

In the EU, there is money devoted to biodiversity and there is a biodiversity strategy. The problem is with what is done at the national level. In the EU, there is a somewhat coherent approach. However, there is not a particularly consistent approach at the national level.

4. The risks and opportunities for the financial sector

An industry representative stated that, for holistic investment management, portfolio managers need to understand all the risks and opportunities available to a

company. Though the situation has improved on climate it is still lagging where it should be, but the situation lags even behind for nature in terms of pricing in the externalities. The conversation is about understanding where the exposures, impacts and dependencies are. The opportunity is that there are plenty of sustainable projects and investments to direct capital to.

However, that new investment alone will not solve the problem. It is about funding the transition and having discussions and engagement with the corporates. The stewardship activity will help push the needle in the right direction. There are many ways that the financial sector can play a role. The goal is to incentivise companies to start thinking about that.

However, the financial sector alone cannot solve the problem. It needs to work together with governments and the private sector generally. Everyone has a role to play. The incentives and creating that enabling environment are very important, and all parties must create space for the corporates to move in the right direction.

The Chair suggested that entities are focused on what they are obliged to do first. The current stage is early in the process, and there will not be a perfect methodology immediately.

A Central Bank official remarked that there are many avenues that central banks could take, depending on their mandates. Supervision also plays a role. From a prudential perspective, the focus will be more on the risk management side. A great deal of analytical work is being carried out. Entities should be prepared for what is going to happen and manage their risks from a financial stability point of view. Then the link can be made, which is needed for price stability. This is not about a harvest that might go bad in one year; there are structural problems. The numbers will then be worked on, as was done with climate. After several years, nobody doubts the importance of climate from a financial stability or prudential standpoint.

The hope is that, with what is being done in terms of risk management and regulation, nature-related risks will be on par with climate-related risks. With regards to disclosures and measurement, as far as possible a framework that institutions already know is being adopted. If CSRD is taken seriously, it will not be a very large step to also take nature-related risks into account.

An industry representative stated that CDC's role is to invest. It invested €3 billion in the last three years in the framework of the recovery plan for biodiversity-friendly projects. However, its main role in this area, as in other general interest areas, is to channel public financing. Public financing is becoming rarer, and there is a challenge to blend financing in order to have public European or national finance, and to optimise the leverage with the investments and private investments. It can be useful, when financing biodiversity projects, to have promotional financing from the EU and the European Investment Bank (EIB), together with CDC'S financing.

An industry representative emphasised that such blending of public and private finance is beneficial. The public sector's role is predominantly one of stewardship, engaging

the companies adopting the TNFD framework and starting to disclose. On the private side as well as on the blended finance side, project finance can be considered.

The 80 Japanese companies that decided to proceed with TNFD are a mixture of financial and non-financial. There are many financial institutions partly because of their rivalry, and partly because of their role to play. The institutions were told that other institutions would be using TNFD. There are also many corporates, predominantly in the manufacturing, food, and telecommunications. Heavy emitting industries like steel or coal are not present yet. Financial institutions should be involved because this is a global issue that everyone must deal with, and many of the entities have global activities. Financial institutions are a channel that governments can work through.

This is an externality, and the question is how to internalise it. In terms of economics, the simple answer is to tax it. But the question is how to come up with a tax rate and how to measure it. If there is this externality, it will not be solved by the private sector alone. Either the activities are made pricier, or the risks are removed so that there can be investment. Blended finance is the typical example of the latter approach.

5. The situation in Asia

The Chair referred to countries like Malaysia and Indonesia and highlighted that some of the key issues worldwide include whether the great rainforests are protected for the biodiversity they contain and for their role as a carbon sink. There are sometimes trade-offs between climate mitigation and protecting ecosystems, such as with the production of lithium for mining for rare earth materials.

An industry representative detailed that TNFD will help improve the level of awareness of these issues. The Japanese economy is dependent on imports for raw materials, including from Southeast Asia. Japan therefore has many transactions with the Southeast Asian countries. There are issues with, for example, palm oil, human rights, and scope three matters.

Companies need to be aware of how their supply chains or value chains are created, and they need to work hard at ensuring the value chains' relationships with ESG issues are dealt with properly. When companies are working through their value chains, they should not work on these items one by one, for example by sending out questionnaires on scope three, then on human rights and then on nature. They should instead deal with all these issues at the same time, which will probably lead to a better set up of the value chains. This could lead to economic security improvements. There are many benefits to trying to understand and improve the resilience of the supply chains and value chains.

This is also an opportunity for all the companies, and through this kind of activity the awareness of the people on the receiving end of these requests should improve. They will have a better understanding of what they need to do and why they are receiving the requests.

An industry representative remarked that many companies in Asia have proactively reached out regarding climate and nature. They see it as an opportunity to attract European investment. They should be thinking about it from a risk management and opportunity perspective, but it is also a way of attracting investment from this side of the world as well.

An official suggested that most of the financial flows being considered are financial flows to corporations, and they are much larger than flows to just a few projects. It is in those flows that there is a need to channel to the right companies that are taking the right transition paths and are planning their transition towards something that makes sense with regard to nature. Part of TNFD's work is to help companies understand what makes sense. There are attempts to develop transition pathways for each sector in turn, so that people see more clearly where they are investing and whether they are investing in the right entities.

The Chair summarised that the risks are real and irreversible. Tipping points can be close, both for humanity and businesses. For example, in the agri-food sector, it is very serious and very quickly there might not be coffee or chocolate. The question is about externalities. Economists usually know how to deal with externalities, but the truth is that there is political force against that, in terms of putting in prices, and there are also very difficult moral and scientific questions around putting a price on nature. However, it is not actually about putting a price on nature; it is about looking at the costs of destroying nature.

Everything is local for nature and biodiversity. It is about channelling money to the right projects worldwide. Given the issues are local, the recommendations will not be one size fits all; a set of different solutions are needed for different ecosystems.

Data and good measurements are needed. Methodologies are already being worked on. For example, there is the LEAP approach, which helps organisations identify and assess nature-related issues, and the global biodiversity score. These tools are a good start. The work is at an early stage, and this should also include issues about transition.

In education, people learn that a company needs capital and a workforce, but what is also needed is access to resources, such as water, materials, and energy. To that extent, everything is global.

It is positive that TNFD has worked well. The International Advisory Panel on Biodiversity Credits will do its best. The hope is that the legislators of the future, the central banks and the private sector will help deliver what is needed to ensure people can continue living on this planet.