Not Sure Where Climate Risk Ends and Biodiversity Begins? Exactly.

Featuring:

Matthieu Maurin, *CEO and Co-founder, Iceberg Data Lab*

Emily McKenzie, *Technical Director at the Taskforce on Nature-Related Financial Disclosure(TNFD)*

Philippe Zaouati, *CEO, Mirova*

Adam Bass (00:03):

This is MSCI Perspectives. Your source for insights for global investors, and access to research and expertise from across the investment industry. I'm your host, Adam Bass, and today is May 19th, 2022. Earlier this week, MSCI hosted the Capital for Climate Action Conference, which included a number of fascinating interviews, panels, and keynote speeches from some of today's leaders on the subject of climate change and its impact on investors. We'll link the full playback for you on the MSCI Perspectives landing page. But on today's episode, we explore some insights from a panel that Joe and I found particularly interesting, partly because it was on a topic that frankly does not get as much attention as it should, biodiversity.

For context, as we've mentioned on this program before, the gathering that's going to take place in Egypt later this year to discuss all things climate will be known as Cop number 27. The Biodiversity Conference happening in Kunming, China is COP 15. As we'll hear as we eavesdrop on our panel, the world's economic output and our ability to reach net zero emissions both turn on the preservation of nature. But how is this playing out in the scientific and investment community, and how are investors specifically confronting and accounting for nature-related risks in their portfolios? To help us answer these questions, we'll hear from Emily McKenzie. She's the technical director at the task force on nature-related financial disclosures, or TNFD. Matthieu Maurin, CEO and co-founder of Iceberg Data Lab. And Philippe Zaouati, CEO of Mirova, which is an asset management firm focused on responsible investing. One of the first issues that came up on the panel was the fact that the TNFD recently launched what Emily referred to as a beta version of its framework. She also spoke about what their hopes were for what the final framework will achieve.

Emily McKenzie (02:22):

TNFD's mission is to develop and deliver a risk management and disclosure framework so that organizations can report and act on evolving nature-related risks. Its ultimate aim in developing this framework is to support a significant shift in global financial flows away from activities that are harming nature, and towards nature-positive outcomes. The overall approach recognizes that nature is an asset, that they provide services that benefit people, and that the interactions that businesses and others have on nature presents both risks and opportunities. So very similar to TCFD. And in addition to shorter term financial risks that would be deemed immaterial today, there are long-term risks that are evolving through dependencies and impacts. But also, there are opportunities. Recognizing that understanding nature and how you depend and impact on it can also inform growth strategy and the pursuit of commercial opportunities.

So the three core components of the framework are first, an outline of fundamental concepts and definitions for understanding nature, and this is what the task force recommends market participants use when they're assessing and disclosing nature-related risks and opportunities. The second core component is a set of draft disclosure recommendations for nature-related risks and opportunities. And the third component is something more for internal risk and opportunity assessment. It's a set of guidance for looking at nature-related risks and opportunities, which we've called the LEAP approach, for incorporating that into enterprise strategy and risk management processes.

Adam Bass (04:02):

We'll get back to this LEAP approach in a bit. But in terms of talking through the three parts of the framework, it did seem wise to look before leaping, so to speak.

Emily McKenzie (04:13):

So when we get into the first part of the framework, we've outlined these concepts and definitions. We introduce nature through four realms that are very easy to understand. Land, ocean, fresh water, and atmosphere. And then as you move through, you see a set of biomes. Things like lakes and fresh water, tropical forests on land, open waters in the ocean. And then recognizing that nature is a stock of assets that provide a flow of services to people, that both corporates and financial institutions depend on for their enterprise value.

The second component I mentioned is a set of 12 draft disclosure recommendations on nature-related risks and opportunities. And in response to very clear calls from the market for a consistent and integrated approach to sustainability reporting, TNFD has explicitly built on the disclosure recommendations of the climate counterpart, the TCFD. So we follow the same four pillars of disclosures, so governance, strategy, risk management, and then metrics and targets. Priority areas of work for the taskforce ahead of us include small work on scenarios, on adapting the concept of scopes to look across value chains, as well as work on metrics and targets. And importantly, notably, the task force have added a new disclosure recommendation that is about location. And this is recognizing that nature-related risks and opportunities are place based. They occur in particular location. So you have to understand where you are operating, where you're investing.

Adam Bass (05:48):

Regular listeners may recall this concept from conversations we had with MSCI's Head of ESG Research, Linda-Eling Lee, while was attending COP 26 last year.

Linda-Eling Lee (06:00):

One of the mantra here is that a tree is not just a tree, and everyone kept talking about the right tree in the right place is actually what we should be shooting for. Because the value of a tree, whether it's to climate mitigation or to climate adaptation, as well as to other co-benefits such as increased biodiversity and soil quality, et cetera. Those are simply not comparable.

Adam Bass (06:25):

But back to Emily.

Emily McKenzie (06:27):

The final component in the framework is this set of guidance for both corporates and financial institutions to undertake nature-related risk and opportunity assessment internally, that we've called the LEAP approach. And this was developed because there was feedback and a thinking in the task force that this would help for market participants to get started, and also improve decision making. It has four core phases. Locating your interface with nature, that's the L of LEAP, evaluating your dependencies and impacts, assessing your risks and opportunities, and then preparing to respond to nature-related risks and opportunities and report on them. So this is broken down into 17 components. Although the first focus was on corporates, the LEAP approach for financial institutions has also been developed as a first version by the task force. Which has a set of guiding questions, scoping guiding questions up front to reflect the particular circumstances, for example, with very large portfolios.

Adam Bass (07:28):

The need for a framework like TNFD might seem well-rooted in the fact that considering biodiversity as part of portfolio management is something new, something foreign for investors. Matthieu, who leads a firm working to develop relevant, comprehensive data on biodiversity as well as other issues, well, he addressed this very issue head on. And in a way that I think many investors will find encouraging.

Matthieu Maurin (07:58):

I may summarize the issue of biodiversity by the fact that, for investors, that everything is new, basically, but nothing is unfamiliar. And what I mean by that, is that everything in new, meaning that when our clients start to approach that domain, they should develop new expertise. Abundance, richness, what are biomes, and the different impact on biomes. Having said that, nothing is unfamiliar, in the sense that to approach and to respond to the question, what can I do as an investor to appraise my impact and biodiversity and act on it? You should have recourse to impact quantification, which is something familiar that we know, for instance carbon footprint. Quantification of an impact. The evaluation of the dependency and impact and links through the value chain that the corporate will have through the end use of its product, through its supply chain. And that the [inaudible 00:09:17], again, familiar concept. And eventually, and more complex, the local impact, the L of your LEAP framework, which is something needed for instance to approach physical risk. Here again, something which is familiar to us.

So we already have a several use case through the integration into strategy and public strategy reporting, such as the first were biodiversity reporting published last year by [inaudible 00:09:56] using our data set, which is a concrete illustration of the use in term of reporting that you have through passive investment and so on. To show that it is doable as of today to integrate that thematic into decision making process of financial institution. At this stage, what remains to be done is to expand the boundaries of the [inaudible 00:10:25] pressures and on the biome, on the impact of specific biome, invasive species, the impact on marine biodiversity, other fishing and so on. On which studies and research should continue to be encourager and funded. We are observing, and we will continue to observe.

Adam Bass (10:48):

So we've heard a bit about the growing number of tools available for investors. We have the TNFD biodiversity framework, and Iceberg's approach to concrete applicable data. But what do investors think about all this? Philippe?

Philippe Zaouati (11:04):

Nature is as important or maybe more important than climate, because this is where we live. And this is where all the economy is developing the product, services, consumption and so on and so forth. And the relationship with nature is a key part of all our issues today. I mean, regarding environments, but also social topics as well. And the relationship between nature and climate has been made very clear by the scientific community with the joint report of IPBES and IPCC, and as a responsible investor, what are our concerns? What we want to do is first of course, to avoid risk and avoid investing in harmful project and companies, and then to redirect money and capital into solution providers. This is exactly what we have done on climate in the last 10 years, investing in renewable energy, investing in clean mobility, clean transportation, hydrogen, and so on and so forth.

This is exactly what we would like to do also on nature. We started from this, we started with the investment on NBS, nature-based solutions, where when we started six, seven years ago to look at this topic, it was for our partnership with the UNCCD. And the idea was to invest in degraded land and to develop agroforestry, new sustainable agriculture models, reforestation, and so on and so forth. And so the idea being nature could be a solution for the climate crisis, basically. And today we are a step further. So we still invest in nature, but not only to be a solution for the climate crisis, but to be a solution for all economy and all development and sustainable development as well.

Adam Bass (13:06):

Clearly, Mirova is not a firm that needs to be convinced of the investment impacts of climate change or biodiversity. So much so, that Philippe takes it a step further.

Philippe Zaouati (13:19):

We are very committed to one concept, which is double materiality. Which I know is not clearly stated in TNFD, but I think that even if it's not stated, I think the philosophy behind, seems to us closest to double materiality than TCFD was for example. So our feeling that TCFD was an interesting tool, but too much focus on financial materiality, risk measurement and not enough on the impact of the company on the climate issue. And I think TNFD is a little bit, it's not exactly what we'll expect, which will be a full double materiality concept, but it's not exactly what TCFD was, which was only financial materiality at the beginning. So there are really a kind of deeper understanding of the relationship between nature and the economy, the relationship between nature and business, which could help not only to measure risk and opportunities, but also to select the companies and the projects, which are positive for the climate, positive for nature at the end of the day. Of course, to do that, we need data.

Adam Bass (14:38):

As the panel's TNFD representative, Emily responded.

Emily McKenzie (14:42):

It's always struck me that when you think about nature, as the timeframe for investors considerations of nature risks extends into the future, it's very clear that your impacts on nature can affect your dependencies. And we are all dependent, whether you are a corporate or a citizen or a government, all of us are dependent on nature for a huge variety of services. So even if you take a narrow enterprise value lens, there's sources of risk to enterprise value, as well as to broader society. So for me, and I know we have this debate between the language of single and double materiality, I'm sure will continue to attract attention. But what we've been seeing is this convergence, and absolutely, as you said at the heart of the TNFD framework is a recognition that both, you need to understand both your dependencies and your impacts on nature to have a meaningful understanding of risks and opportunities.

Adam Bass (15:36):

Much as you can't escape the convergence Emily just mentioned, any discussions about biodiversity and climate quickly become difficult to pull apart, but what are those actual connection points?

Philippe Zaouati (15:48):

There are different ways to answer to the question. The first way would be the scientific way. And I'm not a specialist of the topic, we need to explain that of course there is a link, because climate is one of the reason biodiversity is collapsing today. It's probably about 30, explained about 30 to 40% of the explanation of the impact on biodiversity. So climate has an impact on biodiversity. This is the first obvious link. And of course, on the other hand, the question of nature and deforestation, for example, has some impact on climate. But I think there is another way to answer to your question, which is the fact that if you want to look at the businesses really broadly, you need to integrate both biodiversity and climate.

It's a way to look at the economy with a better lens. I mean, clearer. If you look only at climate, you do not understand that our economy, the business is dependent on nature, and climate is a part of this, but it's not the whole of this. And this is the most important thing to understand. It's not just, we are emitting too much CO2, and we have to decrease it. No, it's a question of, we are building an economy which is based on extraction, which is based on deforestation, which is based on a use of nature, which is an overuse of nature. And that's the topic. And we need to create a new economy, which is different, which take into account the fact that there are boundaries in the planet, and we have to take it into account and to building the economy within these boundaries.

Emily McKenzie (17:47):

In my previous role, had the privilege of supporting Partha Dasgupta descriptor on the Dasgupta review, which was making exactly these points that our economy and all of us are embedded in the natural world. We're not separate from it. And so we have to understand those dependencies and connections.

Matthieu Maurin (18:04):

What science is telling us is that climate change is the fastest growing source of impact on biodiversity. And so the two are integrated, which means that you can't take care of biodiversity in your strategy, if you don't take care of climate at the same time. Maybe we can meet two profiles that I meet from time to time, the cost conscious, let's say. Telling us, okay, I'm already integrated climate into my action framework reporting and so on. So I'm good with biodiversity with one stone, two birds. Even if the image is not very natural friendly, actually. But it doesn't work. It's not good enough to only look at the climate angle to draw conclusion from a biodiversity impact standpoint, because you have some sector with limited climate impact, but which may have significant biodiversity impact. Such as textile, such as tourism, resort operation in Christian areas, and so on.

Having said that, I also meet the pragmatic, that analyst from time to time telling me, okay, so in that case, I jump for biodiversity is the most holistic approach. And so I will take care of climate at the same time. And it doesn't work either, because again, the merit order is not the same. Meaning that when you look at the priorities from a climate standpoint, priorities is to stop the use of fossil fuels, coal most especially. And the ranking of actions will not necessarily be the same if you rank the first thing to do in term of biodiversity from that angle. So actually the two issues are interrelated, but should be addressed in parallel.

Adam Bass (20:24):

Looking ahead then, whether it's in parallel with climate or trying to catch up, how quickly might investors get to where they need to be on biodiversity? Will it be faster than it was with climate?

Matthieu Maurin (20:37):

Having moved myself from the field of climate to biodiversity, it goes much faster indeed. And goes much faster, because as I said in my remarks, all the concept and the toolbox are there actually. And so investors are already familiar with what [inaudible 00:21:00] footprint is, for instance. And for a second reason, sustainability is at the core of an investor like Mirova, but we are discussing with other investors, for which going into ESR was a development for them, something new. And now the difference between, now where we are engaging about diversity with them, and five years ago, if we were starting to engage with them about climate, is that they have teams, they have dedicated teams. And that change many things in terms of bandwidth, resources, decision making, or integration into processes and so on and so on. So yes, my feeling is that, and that's a good news, things will move much faster and we will be capable of learning the lessons from everything we've done on other thematics, such as climate during the last 10 years. And that's obviously also true for ESG [inaudible 00:22:16] provider. Absolutely, yes.

Adam Bass (22:19):

That's all for this week. A big thank you from Joe and me to Emily, Matthieu and Philippe, and to all of you for listening. If you'd like to hear more about how investors are working to turn net zero promises into concrete plans, you can view the entire Capital for Climate Action Conference at msci.com/on-demand. You can also type climate action conference into the site search field, or go to msci.com/perspectives-podcast, and check out the related content for this episode. Until next time. I'm your host, Adam Bass, and this is MSCI Perspectives. Stay safe, everyone.

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