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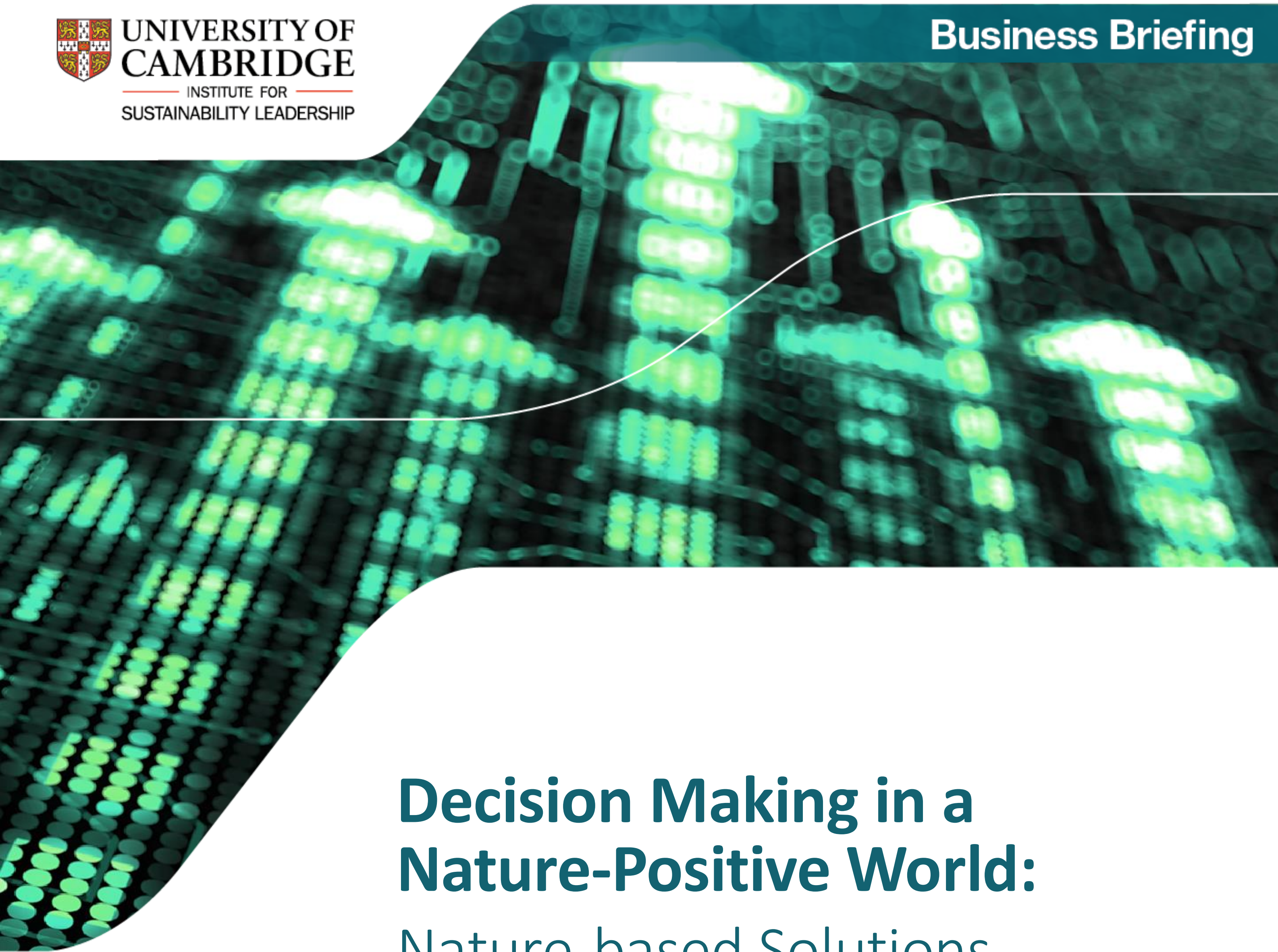

Decision Making in a Nature-Positive World:

Nature-based Solutions and the Finance Sector

The University of Cambridge Institute for Sustainability Leadership

The University of Cambridge Institute for Sustainability Leadership (CISL) partners with business and governments to develop leadership and solutions for a sustainable economy. We aim to achieve net zero, protect and restore nature, and build inclusive and resilient societies. For over three decades, we have built the leadership capacity and capabilities of individuals and organisations and created industry-leading collaborations to catalyse change and accelerate the path to a sustainable economy. Our interdisciplinary research engagement builds the evidence base for practical action.

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About this brief

This business briefing highlights approaches that some financial institutions are taking in relation to nature-based solutions (NbS) as strategies to future-proof their businesses against the growing impacts of climate change and biodiversity loss. Financial organisations are beginning to assess and integrate the risks posed by the degradation of nature, and from there, seek NbS opportunities. This briefing provides insights on the finance sector approaches and needs, and their role in supporting businesses and other sectors to better engage with NbS more directly.

The brief also describes the regulatory, policy and operational imperatives that support the adoption of nature-based solutions at scale and the developing approaches from leaders in the sector to support and be part of the solutions necessary for change whilst managing the key priorities of risk.

This is one of a series of sector specific business briefings that CISL has produced to support effective decision making in a nature-positive world. The other sectors include Built Environment and Linear Infrastructure, Food and Beverage, and Water.

What are Nature-based Solutions?

There are many definitions of NbS, but all focus on natural systems and ecosystems to address environmental and societal challenges. Typically, a range of partners, including ecosystem services providers (such as farmers) and buyers (such as water companies), adopt nature-based schemes at a water catchment or landscape scale.

CISL defines NbS as "ways of working with natural systems to strengthen them while solving broader problems such as climate change, health, social inclusion, and more." Nature-positive is the term used to describe a world where nature – species and ecosystems - is being restored and is regenerating rather than declining.

1. Context

The UK and global economies depend on the services that nature provides. The loss of these services – from raw materials and food to climate regulation and flood protection – brings high financial as well as social and environmental risks, with more than half of global GDP highly or moderately dependent on nature[i]. Yet the world's natural resources continue to decline[ii], with 23 per cent of land now degraded and ocean 'dead zones' spanning an area larger than the UK.

Unless this trend is reversed, at least USD 10 trillion of GDP will be lost by 2050 as ecosystem services decline[iii]. Global financial institutions are among sectors exposed to business risks and potential losses as a result, with the Dutch finance sector alone facing an estimated €510 billion exposure[iv].

To avoid irreparable damage, the value of nature must be integrated into every financial decision. This has implications for the finance sector and corporate finance teams. This integration can ensure capital is mobilised away from destructive activities and towards those that restore and protect nature [iii].

The global finance sector is responding to counter nature-related business risks while also taking advantage of a potential "future market for nature". Global institutions are helping develop frameworks to guide financial services firms and drive effective investment in nature conservation. Examples include the International Union for the Conservation of Nature's (IUCN) Taskforce for Nature, which *is developing principles to underpin nature markets*, and the Financing Nature Recovery UK, which has the vision that *high-integrity markets for nature-based environmental services* will become a significant driver of nature recovery across the UK.

> *"Shifting to a sustainable future means that markets need to adequately consider all aspects of nature."*
>
> IUCN Director General, Dr Bruno Oberle

2. Managing nature-related risks and opportunities

Nature has joined climate change as a significant business and societal risk that financiers need to understand. Understanding and managing nature-related risks offers a strategic advantage to financial institutions. Nature-related risks are financially material on a macro[v] and micro[vi] level. We live in a world where we are rapidly degrading nature and the services provided by nature, such as food production and water availability. Pressures such as deforestation are driving these systems to the point of failure, the costs of which are high. For example, the consequences of a further three per cent loss of forest in the Amazon have an estimated cost of USD 257 billion for the region[vii].

The finance sector has long considered sustainability-related risk management and mitigation in its investment strategies. Nature loss becomes a financial risk to such institutions as a result of *physical*, *transition* and *liability risks* that cause negative impacts on[viii]:

- **Companies and governments** to which financial investors are exposed via loans, debt and/or equity holdings and/or revenues from financial services
- **Financial markets**, including commodity and money markets, to which FIs have exposure through investments or financial services (e.g. derivatives).
- **Operations or property** of financial institutions, for example if lack of urban green space exacerbates water runoff causing flash flooding that damages physical assets.

As described in the recent CISL Handbook for understanding and identifying nature-related financial risks[viii], the financial risks of biodiversity loss and land degradation begin with human activity that drives nature loss. As nature is damaged and put at risk, its capacity to provide the ecosystem services on which companies depend decreases, this creates physical risks.

These physical risks to companies have implications for those providing finance and investment, and knock-on impacts to those dependent on them as sources of tax revenue, and can disrupt activities or the value chain and create raw materiality price volatility[ix]. Vulnerability to an ecosystem service decline is, therefore, a vulnerability to investors, lenders, insurers, governments, and connected companies and, by extension, a source of potential financial instability.

Transition risks can occur as a result of regulatory or market efforts to protect nature, for example, creating stranded assets. They can include shifts in consumer or investor sentiment, disruptive business model innovation, technological changes and abrupt introduction of public policies[vi]. Despite their positive impact on nature, such policies can cause economic harm to some companies and, in turn, those financial institutions (FIs) connected to them.

Liability risks are associated with emerging legal cases related to nature loss which could occur if parties who suffer loss or damage from environmental change seek compensation. These claims could include fines, legal fees, insurance, and reputational costs.

Physical, transition and liability risks can reorientate portfolios and economic activity. As a result, financial flows could be redirected to restore nature to provide benefits to people and drive a transition to a nature-positive economy.

Figure 1: Framework for identifying nature-related financial risks[vi].

Financial institutions and companies want to understand how nature impacts an organisation's financial performance and are looking for ways to consider the longer-term nature-related financial risks that may result from decisions made by an organisation. Financial institutions are beginning to consider how to incorporate nature-related risks and opportunities into their strategic planning, risk management and asset allocation decisions. However, they require information to flow from companies to do this, which currently is not necessarily available. The Taskforce on Nature-related Financial Disclosure (TNFD) aims to enable financial institutions to report on their dependence and impact upon nature by developing a risk management and disclosure framework for organisations to report and act on evolving nature-related risks[x]. They aim to support a shift in global financial flows away from nature-negative outcomes and toward nature-positive outcomes. They take a double materiality approach and focus on impact and risk, broadening the consideration of change for the Finance sector[xi].

There are opportunities ripe for the taking - the World Economic Forum (WEF) estimates that protecting and restoring nature could result in USD 10.1 trillion of economic activity.

Depending on where a financial sector firm plays a role, managing nature-based risks may be a key priority and/or offer a potential future opportunity. Managing existing nature-based risks and opportunities allows firms to deliver market approaches that manage and catalyse investments such as nature offset markets, including those linked to carbon markets.

Financial institutions stand to gain by taking a proactive approach that embraces the development of nature-positive capital markets and integrates stewardship of nature into local and global economies. In doing so, they can also drive change and progress across other sectors that are key to achieving a zero carbon and nature-positive global economy.

3. Regulatory and policy drivers provide both incentives and deterrents

National and global action to address the loss of natural resources is intensifying as policymakers recognise the links between the dual climate and nature crises. In the UK, the Government's 25 Year Environment Plan (25YEP) lays out a roadmap and stringent targets to improve air and water quality and protect biodiversity. Across Europe, the EU Green Deal seeks to deliver a modern, resource-efficient and competitive economy that achieves no net greenhouse gas emissions by 2050 and decouples economic growth from natural resource use[xii]. Globally, UN negotiations are underway on a new post-2020 Global Biodiversity Framework that nations are set to agree on in 2022.

Financial institutions, while not on the frontline of nature protection in the same way as the agriculture and food and beverage sectors, face growing pressure to support and be part of the solution. For example, corporations across relevant sectors are adopting science-based targets for nature (SBtN) and new disclosure requirements through frameworks such as the Global Reporting Initiative (GRI), Task Force for Nature Related Financial Disclosures (TNFD) and IUCN Global Standard for Nature-based Solutions.

Governments are being encouraged to introduce policies and regulations to reduce activities that harm biodiversity and remove subsidies that incentivise nature loss and harm the environment, creating an important complementary role for the financial sectorxiii. Central banks and financial supervisors could also play a role in supporting the development of tools and solutions to support the implementation of the Global Biodiversity Framework's 2030 target to put biodiversity on a path to recovery, particularly with regard to policy dialogue. Those with appropriate mandates could provide governments with independent assessments of the financial implementation related to the Framework. These could cover real economic aspects, such as the reform of harmful subsidies and other financial system sectors, including financial regulation.[xiv]

The network of central banks and supervisors for greening the financial system (NGFS), launched at the Paris One Planet summit in December 2017, has acknowledged that nature-related risks could have significant financial and macro-economic implications in its recent report from March 2022[xi]. It includes five policy recommendations proposed to central banks and financial supervisors to help them fulfil their mandates in the face of biodiversity loss:

1. recognise biodiversity loss as a potential source of economic and financial risk and commit to developing a response strategy to maintain financial and price stability;
2. build the skills and capacity among central bank and supervisory staff as well as market participants to analyse and address biodiversity-related financial risks;
3. assess the degree to which financial systems are exposed to biodiversity loss by, for example, conducting assessments of impact and dependency, developing biodiversity-related scenario analysis and stress tests;
4. explore options for supervisory expectations for financial institutions' governance, risk management, strategy, disclosure and financial conduct concerning biodiversity-related financial risks and opportunities; and

5. help build the necessary financial architecture for mobilising investment for a biodiversity-positive economy, including considering how central banks' monetary policy operations and non-monetary policy portfolio management should be conducted in the context of biodiversity loss.

As a result, the industry is shifting its philosophy and approach to operations.

Leading finance companies know that a prosperous business relies upon nature and its ecosystem services. As they make investments based on sustainability criteria, they are beginning to recognise that the 'E' in 'ESG' (environmental, social and governance) is about protecting biodiversity and nature, as well as the global climate and that the two are interlinked[xv].

Consequently, the soaring growth of green funds and sustainable investment portfolios provides a significant opportunity to allocate capital in ways that support innovations that can reverse nature loss. Broad-based global ESG investments totalled around $35 trillion in 2022 and are predicted to reach $50 trillion by 2025[xvi]. During the global pandemic, sustainable investments also outperformed their market counterparts[xvii], giving investment banks and asset management institutions an incentive to continue to expand their ESG offerings and investments.

To support and scale the development of portfolios focused on nature-positive outcomes, CISL has created a *Handbook for Nature-Related Financial Risks* and related sector-specific case studies. Together, these tools help financial institutions identify specific nature-related financial risks in their portfolios, and how biodiversity loss and land degradation may affect their investments.

There is a clear move to more collaborative and more innovative approaches.

To date, firms across the Finance sector have mainly progressed ESG investments and investor offerings individually and independently. Some pockets of collaboration, including CISL's Centre for Sustainable Finance, have consolidated understanding and alignment on the urgent need for action and the broader role the Finance sector can play.

Given the scale and complexity of the challenge, financial firms increasingly recognise the need to embrace collaboration and share learning across governments, society, cross industry sectors and finance. For example, the Luxembourg government and Global Landscapes Forum have jointly launched the Luxembourg-GLF Finance for Nature Platform, which aims to shift financial flows towards land-use models that are sustainable, equitable, inclusive and profitable[xviii].

4. Accelerating engagement with nature

While not on the frontline of nature protection in the same way as the agriculture and food and beverage sectors, financial institutions face growing pressure to support and be part of the solution.

Nature loss poses risks to the financial sector via the businesses they invest in, lend to, advise and insure[xix]. Financial services firms have the opportunity to help solve strategic business and environmental challenges by investing in and promoting nature-based solutions at scale. They can lead by integrating nature into decision making, managing nature-related risks and catalysing capital reallocation that protects and restores nature. To be successful, they need businesses to demonstrate the progress they are making in delivering on their commitments to becoming nature-positive and to offer up investable propositions that can move financial flows away from those which harm nature, to those that protect and enhance it. With greenwashing becoming a growing concern, investors will begin to take a closer look at the sustainability claims made by companies and improve their verifications processes.

Financial firms stand to benefit as they pursue expanding nature-based markets triggered by regulatory and investor pressures and rising risks from climate change and nature degradation and seek to meet their carbon targets.

Finance leaders within corporates and across the finance sector can be a catalyst for change and help avoid irreparable damage by integrating the value of nature into every financial decision.

Better engagement between the finance sector and corporations is needed to unlock financial flows and shift the balance towards long-term investments in sustainable practices.

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