

Measuring and Managing Nature-related Risk - As important as Acting on Climate



*Mr. David Craig

For any business to succeed – no matter the sector – measuring risk and performance is critical. Yet there is one thing very few businesses know how to measure, let alone act on to improve – their risk and exposure to nature. As the business world is embarking on setting targets for reducing carbon emissions and meeting its climate targets, unless our dependencies and impacts on all the natural systems is measured and managed, we will neither meet our climate goals or mitigate the exposure to biodiversity and natural ecosystems. This means measuring and managing nature-related risk.

In June 2021, we launched the Taskforce on Nature-related Financial Disclosures (TNFD) to tackle this exact problem. With the backing and endorsement of the G7 and G20, the TNFD aims to help global businesses, regulators, advisory firms, and financial institutions understand the scale of the issue, develop a way of measuring and declaring this risk, and a framework for acting on it.

As you might imagine, it is not a simple task. But we are fortunate to be following in the footsteps of the Task Force on Climate-related Financial Disclosures (TCFD), which since 2017 has beaten a path in helping businesses and financial institutions understand how to measure and disclose climate risk. The extra challenge for us is to be able to harness and measure the sheer scale of our natural world – all the marine and terrestrial ecosystems on the planet.

In essence, the global economy is underpinned by the natural world. According to the World Economic Forum's analysis (WEF) more than half of global economic output – some \$44 trillion a year – is moderately or highly dependent on the forests, oceans, soils, water systems and wider biodiversity that surround us. The WEF's 2021 global risks report held up biodiversity loss as one of the top risks to the global economy.

Whether it's a semiconductor manufacturer reliant on water for cooling, a furniture maker that depends on a sustainable supply of wood, or an agriculture company that needs pollination for crop production, nature impacts are all around, affecting operations, supply chains, jobs, and markets.

In thinking about biodiversity, two important and interlinked points need keeping in mind. First, marine, and terrestrial ecosystems have absorbed 60% of the world's carbon emissions since the industrial revolution began, which underscores that protecting nature is essential to reducing emissions and combating climate change – they go hand-in-hand.

But secondly, nature is rapidly deteriorating – a football field of tropical rainforest disappears every six seconds – and vast amounts of the global economy are exposed to that impact: Moody's has warned that companies with \$2.1tn in debt have a “high or very high” exposure to nature-risk.

In India, over 12% of wild mammals, 19% of amphibians and 3% of bird species face the threat of extinction, while one-third of India's wetlands have been lost in the past 40 years. When it comes to soil degradation, nearly 150 million hectares of Indian territory is affected – an area the size of Mongolia. The impact is clear, and the repercussions for farming communities, food supplies and market prices are devastating, the social impact of nature degradation cannot be ignored particularly for a country like India where it is estimate that 25% of the total workforce is involved in farming.

At COP26, we saw good progress on addressing some of these issues, with nature mentioned in conjunction with climate at a greater scale than ever before. The final agreement acknowledges the importance of “protecting, conserving and restoring nature and ecosystems”. Nature was also a hot topic

at side events and panel discussions alongside the formal negotiations. Finance ministers, central banks, supervisors, and development banks all committed to scale up work on nature issues.

Now, we must go further and faster in aligning the climate and nature agendas if we are to cap global warming AND tackle the spiralling risks associated with nature degradation.

Our first goal is to agree on how businesses can best measure their exposure. Building on the work of the TCFD and existing standards and research, the TNFD is working with 34 Taskforce Members – including senior executives from Tata Steel, BlackRock, Bank of America, AB InBev, S&P, Singapore Exchange, and Nestlé – to build a risk-management and disclosure framework that will allow companies and financial institutions to assess their exposure to nature-related risk, declare it and act on it.

In the first quarter of this year, we will release a beta version of that framework, built around metrics that already exist. It will provide companies, regulators, and others with a meaningful measure – something they can look at and see whether they are performing well or need to improve. For example, if a business has operations that are reliant on water for cooling but there is a sustained risk of drought where it operates, the company would be able to capture that situation and let others know about it, including what it is doing to mitigate the threat. Banks that lend to the business and auditors that evaluate its liabilities would be able to see the declaration and act accordingly.

Over the course of 2022, we will work with our members, as well as leverage the input of the TNFD Forum, a wider group of more than 250 companies, financial institutions, and multilateral bodies, to launch this fully functioning management and disclosure framework. Declarations would initially be voluntary, but the aim, ultimately, would be for them to be mandatory. The overall goal is to bring about a shift in capital allocation away from nature-negative operations and towards nature-positive ones.

This isn't just a U.S. or UK initiative being imposed on the rest of the world. Our Taskforce has purposefully sought input from members from across the globe – Europe, Africa, Latin America, Australasia and Asia, with India a prominent contributor. We have global banks, major regulators, auditors, and globe-spanning corporations, like Tata Steel, or XXX that are actively involved in the design

As co-chair of the India UK Financial Partnership, involving over 60 CEOs, the financial regulators, HMT, and India Ministry of Finance I have seen the opportunity from government and business focusing together to create better economic outcomes. I have also witnessed first-hand the impressive steps the Indian businesses and government are taking to reduce their impact on environment. India now has more large solar generation projects than any other major economy in the world,

which means that it's recent commitment at COP26 that over half of all energy generation will be from renewable sources by 2030 looks not just achievable but transformational, the benefits are not just from energy dependency and CO2 emissions reduction but also massive pollution and air quality improvement. But of course, with such reliance on nature we must all go further. Boardrooms must include nature and environment in their risk-management oversight. Governance must take into account how nature-related risk is being mitigated, both at the operational level and when it comes to longer-term corporate strategy. Senior ESG officers should already be incorporating nature and biodiversity in their management models and hiring the skills and expertise required to manage this going forward.

There is no doubt that this issue will be the next major concern in risk management. Taking steps to understand where the regulatory guidelines will fall is the best way to position any business for the future. It is something that every business can act on right away, with TNFD keen to work with partners – whether via Taskforce Members or its wider Forum – to explain how nature and biodiversity related risk can be assessed and accounted for. In the next few months, once the TNFD has released a first draft of its disclosure framework, boardrooms can start to gauge their exposure and think through what steps will be required to mitigate risks and embed new practices into the business. We welcome the active participation and input from India business in this phase.

No one is pretending this is going to be easy. But the rewards – for nature, climate, for local communities and the global economy – will be vast if we get this right. The focus on climate in recent decades has created significant commercial opportunities, not least in renewable industries. Likewise, a clearer assessment of nature-related risk can spur innovation and opportunity. The World Economic Forum estimates up to \$10tn in new economic activity will be generated by 2030 with a shift in capital towards nature-positive outcomes, this benefit is not just to big business but the rural communities, especially in India, whose very existence depends on the health of our natural ecosystems and how to maintain both their natural and economic productivity.

We will only reap those benefits by managing the risks. We know that without changing the way businesses look at and account for nature and biodiversity, we will never see the changes we need. So, when it comes to tackling nature-risk, we need to get to work right away.

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