

# True Risk, a future looking approach for natural capital

## Financial institutions & Natural Capital (CoP FiNC)

Summary of an extra meeting at 14th June 2016

### Introduction<sup>1</sup>

The concept of natural capital, all ecosystem services and biodiversity, is getting higher on the agenda of the financial sector. In the Community of Practice Financial institutions & Natural Capital ([CoP FiNC](#)) participants learn from each other about issues such as the dependency, risks and impact of their investments on natural capital. Some financials lower their risks by an exclusion strategy while others chose the dialogue strategy. The (financial) risk-thinking within the sector is usually based on extrapolating risks from the past to the future. Discussion on the 'carbon bubble' and so-called 'stranded assets' show that ecological risks of our planet have financial implications. The central question of the meeting was whether you can include the *ecological risk* in the current risk models and thus bring future ecological risks in the financial risk management. Against this background, CoP FiNC posed the question to the [helpdesk natural capital](#):

*Develop a future looking approach (risk model) to take into account future ecological risks of investments.*

In response to this demand, the helpdesk has written a paper. On June 14, a number of FiNC CoP participants met to respond on the paper. Because the VBDO is working on a similar process, they were asked to reflect on the discussion. Also a scenario expert was invited.

### Presentation Helpdesk Natural Capital

Considerations for a risk model for natural capital are: sphere of influence (the degree of influence of a FI), context specificity (local situation of ecosystem), starting points natural capital (how do you determine ecological boundaries) and the fact that natural capital is not tied to rural or legal boundaries. For a future looking approach these are some (complementary) ways and examples:

- By formulating a goal. For example, based on government policies, One Planet Thinking, planetary boundaries, science based targets, etc.;
- By extrapolating results from the past to the future and formulate a goal from that;
- Draw conclusions from trends and translate it into an approach for now.

The question is what role financial institutions have in identifying and dealing with the risks. Now it's often 'ticking boxes?', but do you take real responsibility as a FI for the consequences of your choices? Is it about 'doing good' or 'doing less harm'? This has to be clear first.

In the advice a number of steps is described and discussed:

#### *Step 1. Risk analysis for compiling portfolios*

- 1.1 Horizon scanning: you can use analysis from scenarios to map trends and certainties and adjust your investments to that. Question is whether you can discover patterns, for example by looking at technological innovations that are mentioned in several scenarios.
- 1.2 Drivers behind the trends: the main influence factors and their development. Focus for natural capital on climate, water and land (and waste).
- 1.3 Sectoral risk analysis: then, determine the impact on business using the gained insights. This results in an overview with hotspots per natural capital theme (climate, water, land) for investment by country (risk areas) and sectors.

Such a risk analysis makes the complexity of natural capital easier to handle. A FI will gain insight into what natural capital is, and how to look at it and how to respond.

#### *Step 2. Risk analysis for individual investments*

- 2.1. Deep-dive local trends and drivers: determine which local trends and drivers there are at sector level and create understanding of expected changes at the local level.
- 2.2. Risk analysis at the local level: look at type of risks around hotspot investment (legal, operational and reputational). The operational risk is most directly linked to natural capital.
- 2.3. Mitigating actions: determine what mitigating actions are required to manage the risks. Use the desired level of ambition as a guide.

First insights are:

- Portfolio development: conclusions from global trends and future scenarios in risk models for the composition of portfolios (regions, commodities, sectors, issues);
- Individual investments: include local trends and recent issues in the risk model for assessing individual investment opportunities.

---

<sup>1</sup> For helpdesk advice & presentations in Dutch and this summary go to [www.amborcreatie.nl/CoP\\_FiNC](http://www.amborcreatie.nl/CoP_FiNC)

## Insights of participants

In dialogue with the CoP FiNC participants the following insights were gathered:

- Turn it around: natural capital is the basis of our economy. What does natural capital need from finance in order to stay vital and productive?
- Setting a quantitative target helps to make choices when the progress on the target is being monitored and reported (the impact and progress is made visible);
- In order to truly understand the impact and to identify risks, it is now necessary to do analyses yourself. But not everything is foreseeable and includable in models;
- Breaking down the concept of Natural Capital into the themes of climate, water and land helps to organise your sustainability policy and implement risk-based commitment and active ownership;
- There is also the risk missing positive impact (the opportunity risk). Find companies that want to contribute to a sustainable transition and bundle them in a fund to spread the risk when they are too small to invest in;
- Data from companies on water dependence and their location is hard to find and there isn't much reporting;
- Working together in the field of risks on standardizing frameworks, data and engagement is necessary. Work also with system players like the Dutch Central Bank on harmonization of data.

## Reflection by other experts

### *VBDO*

There are 3 ways to look to investments and loans: 1. ethical (what to exclude), 2. impact (what to include) and 3. financial. Make these perspectives explicitly in a discussion about how to make a difference as an investor. Starting from the financial ways these days ESG integration is more and more integrated. But ESG is process oriented and not so much on impact (measuring).

### *Scenario expert*

Making future scenarios means working with a mixture of quantitative and qualitative information. It is important to involve several organisations and developments for getting the right information. Scenarios can also be used to try to stir up thinking differently.

### *ARCADIS*

There are GAEZ maps that show different climate scenarios in combination with a number of parameters. With this kind of maps you can lay over each other to look at shifts and trends that affect natural capital. And because financial parties report on climate/CO<sub>2</sub> to DNB and CBS, this could be used as well.

### *Helpdesk natural capital (CREM and ARCADIS)*

The urgency for natural capital is huge. Daily negative impacts provide for a loss that (yet) is not being compensated by positive impacts. If there is one sector that can have impact to turn the tide, it is the financial sector. So as a first step include quantitative data in combination with qualitative analysis in current risk modelling. Follow in further development at first the lines of current risk management models and do not waste time by propagating a completely new approach.

## Conclusions

The sector is on the move and these are some interesting related developments:

- SDG's are in development as leading the way for future;
- Increased working with concepts such as No net loss, planetary boundaries, one planet thinking;
- Climate scenario maps, water scarcity maps/Aqueduct and Forest Watch, etc. are increasingly available;
- EP&L Environmental Profit and Loss accounting methods are increasingly being applied;
- Development of the Natural Capital Protocol (with financial sector guide).

There is a need to move from [transition](#) phase 2 (competition) towards phase 3 (cooperation).

Many building blocks are being developed to determine and to reduce impact on natural capital (or generate positive impact). The art is how to connect them productively. All the information is not accessible to everyone and there are several issues for each theme. There are 'spider web' instruments for investments, but such tools make it more complete and more complex. Therefore cooperation as a 4th theme in addition to climate, water and land, should be organised; cooperation in the field of data, standards framework and engagement.