Room151 Roundtable

BIODIVERSITY: OPPORTUNITY, RISK & THE LGPS

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Are investors waking up late to the biodiversity emergency? **Room151's** latest roundtable debate examines how the Local Government Pension Scheme (LGPS) needs to respond to biodiversity issues.

Sponsored by Jupiter Asset Management and Impax Asset Management, the event took place at the Gherkin in London. With attendees including those working for the LGPS pools, local government pension funds, local authorities, investment consultancies, advisory firms and asset managers, the discussion looked at both the opportunities and the risks from biodiversity loss for the LGPS.

Room151

ATTENDEES

Chris Dodwell
head of policy and advocacy
Impax Asset Management

Jane Firth
head of responsible investment
Border to Coast

George Graham
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South Yorkshire Pension Fund

Anastasia Guha
global head of sustainable investment
Redington

Gemma James
senior manager, biodiversity and nature
Chronos Sustainability

Gustave Loriot
responsible investment manager
London CIV

Rachel Perini
head of UK institutional
Jupiter Asset Management

Rhys Petheram
fixed income fund manager and head of environmental solutions
Jupiter Asset Management

Scott Thompson
managing director
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Bola Tobun
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London Borough of Enfield

Luke Webster
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BIODIVERSITY ROUNDTABLE: **Opportunity, Risk and the LGPS**

LGPS funds and their pools have been focusing increasingly on climate risk and investments underpinned by sustainability criteria. But there is another, potentially bigger, emergency that needs to be addressed. With biodiversity loss costing the global economy 10% of output each year, it cannot be ignored. **Room151** convened a round table of LGPS practitioners and investment managers to discuss the impact of biodiversity and how they should respond.

In many respects biodiversity loss is the unloved sibling of climate change. The need to combat global warming has been embraced, not universally, but by a growing number of countries and companies. The target set at COP 21 in Paris in 2015 – to pursue efforts to limit global temperature rises to 1.5°C above pre-industrial times – is well understood, and we have requirements under the Task Force on Climate-Related Financial Disclosures (TCFD) and an array of individual net-zero targets.

The same attention has not been paid to biodiversity loss, and the impact here could be much greater. There is a popular meme that shows the major issues impacting the world as a series of waves. Covid 19, which has occupied our attention for the past two years, is the smallest wave, followed by larger waves for recession and then climate change. However, the biggest wave is for biodiversity collapse.

Some figures might put this into perspective:

- More than half of global GDP depends significantly on nature
- Biodiversity loss is costing the global economy 10% of its output each year
- Humanity has caused the loss of 83% of wild mammals and half of all plants
- 60% of all medicines are based on natural organisms

As with climate change, biodiversity loss has significant implications for investors, including those from the Local Government Pension Scheme (LGPS). So Room151 convened a group of senior people working for or with the LGPS. They include those working for the pools, local government pension funds, local authorities, investment consultancies, advisory firms and asset managers.

The event took place at the Gherkin in London and was chaired by Room151's editorial director Mike Thatcher. It was sponsored by Jupiter Asset Management and Impax Asset Management.

Chris Dodwell, head of policy and advocacy at Impax Asset Management, began the discussion by referring to the wave meme. "The meme is absolutely right that we are waking up late to the biodiversity emergency," he said.

Dodwell highlighted the importance of risk. "[Identifying risk] has helped galvanise action on climate change. I think awareness of the impact of climate change is what has actually driven the global response in terms of countries."

He gave the example of how China began to appreciate that it had to respond to climate change when it saw the potential impact on its food crops. The same could apply to the risks from biodiversity loss, including deforestation, increased levels of pollution and, importantly, the regulation that is likely to be introduced to tackle these challenges.

From TCFD to TNFD

Regulation of both corporates and financial institutions could certainly follow from the work of the Taskforce on Nature-Related Financial Disclosures (TNFD), which is the nature-based equivalent of the TCFD.

Impax was part of the informal working group that established the TNFD. Dodwell highlighted the TNFD's beta framework, which helps companies outline and disclose nature-related risks and impacts in alignment with their corporate reporting. He said that TNFD and TCFD were similar in their approaches, but that location was more of an issue for biodiversity loss than for climate change.

"You really need corporates to understand the location of their assets because this will affect biodiversity risks. It isn't like carbon, where you have got one tonne that gets emitted in Bangalore or Birmingham and it has the same impact."

Chris Dodwell

Dodwell stressed the significance of the UK government's use of nature as a theme for COP 26 in Glasgow last year – it was one quarter of prime minister Boris Johnson's mantra of "coal, cars, cash and trees".

"You can see pathways to get to net zero in a number of sectors, but I think what had been underestimated was the need for nature to be part of the solution. Effectively you don't get to 1.5 degrees unless you maximise the impact of nature in terms of absorbing carbon, and you effectively stop deforestation."

The potential of nature-based solutions will be a big part of the discussion at COP 15, the UN biodiversity conference, which will hold its in-person sessions in Kunming, China later this year. The conference will look at the implementation of the protocols of the Convention on Biological Diversity (CBD) and seek to create a Global Biodiversity Framework (GBF). One of the key parts of the deal being negotiated is a goal to make 30% of the Earth's land and seas into protected areas by 2030.

Nature-positive economy

Dodwell suggested three approaches to adopt:

1) Break down biodiversity loss into a set of imperatives on which action can be taken

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Chris Dodwell

2) Adopt a multi- or hyper-local approach recognising that many parts of the world have local biodiversity issues in common.
3) Develop a vision for what a nature-positive economy looks like.

The difficulty is that we do not really know what having a nature-positive economy looks like. One way forward has been suggested by FAIRR (the Farm Animal Investment Risk and Return initiative), which is a collaborative investor network that raises awareness of the environmental, social and governance risks and opportunities caused by intensive farm production. Dodwell said that FAIRR

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Gustave Loriot

had recently written to the UN Food and Agriculture Organization (FAO) asking them to develop a roadmap for a net zero nature-positive food system.

"If we were able to get more discussion around what that looks like, you can start to understand who are going to be the winners and losers in the transition. It would also help to ensure that you have accessible information that is science-based and allows investors to make intelligent decisions around where they want to put their money."

Lack of metrics

Asked whether there needed to be a nature-based equivalent to the Paris 1.5°C target, Dodwell highlighted that the international biodiversity negotiations were currently more focused on the agreement of high-level concepts such as Nature Positive and the GBF than metrics. Nature Positive seeks to halt and reverse nature loss measured from a baseline of 2020, so that by 2030 nature is "visibly and measurably on the path of recovery".

But he added: "I think this lack of metrics is an issue. We are still searching for a proxy for carbon. What is that going to look like? I think it will be a set of indicators, rather than one simple indicator."

Gustave Loriot, responsible investment manager at London CIV, mentioned the Nationally Determined Contributions (NDCs) by which each country makes commitments to reduce greenhouse gas emissions and adapt to climate change in the context of national priorities, circumstances and capabilities.

"I think a lot of investment managers and asset owners setting targets is also the result of governments setting their NDCs and net-zero pledges. So are we going to see the same thing for natural capital and biodiversity or will the investment industry leapfrog what governments could do?" he asked.

Dodwell mentioned a pledge supported by investors at COP 26 that aimed to end deforestation by 2030. The GBF requires countries to put together action plans that are similar to NDCs, but they lack the detail of the climate pledges agreed in Paris in 2015.

"So I do think there is a chance that corporates and finance could move ahead of governments. And the good thing about that is you then create a policy space for governments to say, 'actually if we are getting pressure to do stuff from wider stakeholders then this will be a popular thing for us to do'."

"Because at the moment the debate in the Convention on Biological Diversity is still one that I would say was happening ten years ago in climate change."

Monitoring, reporting and verification

Loriot raised the issue of "conservation-type bonds" being created in developing countries, but added: "Monitoring, reporting and verification are always going to be issues. It is even more difficult with natural capital/ biodiversity compared with climate. We are already having such a struggle ensuring that carbon offsets are actually delivering the offsets that they say they are delivering. Natural capital is that on steroids, really."

Jane Firth, head of responsible investment at Border to Coast, pointed out that there was a lack of data to enable investors to dig deep into their portfolios and see what the risk is all the way through the supply chain. She said that both the TNFD and Nature Action100 (due to launch later this year as a nature-based version of Climate Action 100+) would help in this endeavour.

"It is crucial on issues such as this that investors have a joined-up and collaborative approach. So I am looking forward to what comes out of Nature Action 100 and how we can properly get involved in that," she said.

Border to Coast is a member of the Investors Policy Dialogue on Deforestation (IPDD) initiative, which provides a forum for investors to engage with public agencies and industry associations in selected countries, including Brazil and Indonesia, on the issue of deforestation. Border to Coast also uses Robeco, an international asset manager, to help with engagement on biodiversity.

Government incentives

Bola Tobun, finance manager (treasury and pensions) at the London Borough of Enfield, said that government incentives were needed

Jane Firth

to help turn around biodiversity loss because "the LGPS is not philanthropic" and returns need to "stack up" to justify an investment.

"The government needs to have some sort of incentive policy because at the end of the day each fund has a fiduciary duty and it is very critical and important for us that whatever we are investing in, we are able to give a decent return."

George Graham, director of South Yorkshire Pension Fund, said he feared that there would be an increasing number of campaigns calling for divestment from companies such as paper manufacturers because of their impact on forestry. He said it was important to be on top of this issue, understanding the nuances and recognising where the risks lie.

However, he added: "We certainly haven't got biodiversity risk on our risk register. I don't imagine that many, if any, LGPS funds have. That is another interesting debate to work out how big the risk is in the risk register and how do you score it? What do you do to mitigate it?"

Rhys Petheram, fixed income fund manager and head of environmental solutions at Jupiter Asset Management, said there had already been a significant divestment debate over Brazilian beef. A number of European supermarkets had stopped selling Brazilian meat products after suggestions that they contributed to the destruction of the Amazon rainforest.

He pointed out the impact this could have on communities in Brazil and that it could lead to farmers cutting their costs through more deforestation.

Investment opportunities

Petheram then gave an analysis of the investment opportunities available in the biodiversity space. First there are the companies that are involved in sectors such as agriculture, water, packaging and building materials, and that offer an alternative to "business as usual". Then there are companies that go further and look for a restoration of natural capital in similar sectors, but also including those involved in recycling.

"Our portfolio looks at environmental solutions from both a climate and natural capital perspective. They are interlinked. You can't solve one without trying to solve the other. So in many senses, our climate change solutions are also solutions for natural capital."

The second area is financial instruments and this, Petheram said, was where fixed income really comes to the fore. "The instrument is adaptable – you can adapt the cash flows, you can adapt the covenants. That is where we have seen a lot of innovation in the past few years – and at the forefront have been green bonds."

A green bond is a fixed-income instrument that is earmarked to raise money for climate, environmental or conservation projects. According to Petheram around 5-10% of the green bond market is deployed for natural capital purposes. This percentage has been stable for some time, but the overall market has grown considerably.

Another fixed-income vehicle involves sustainability-linked bonds (SLBs). These are

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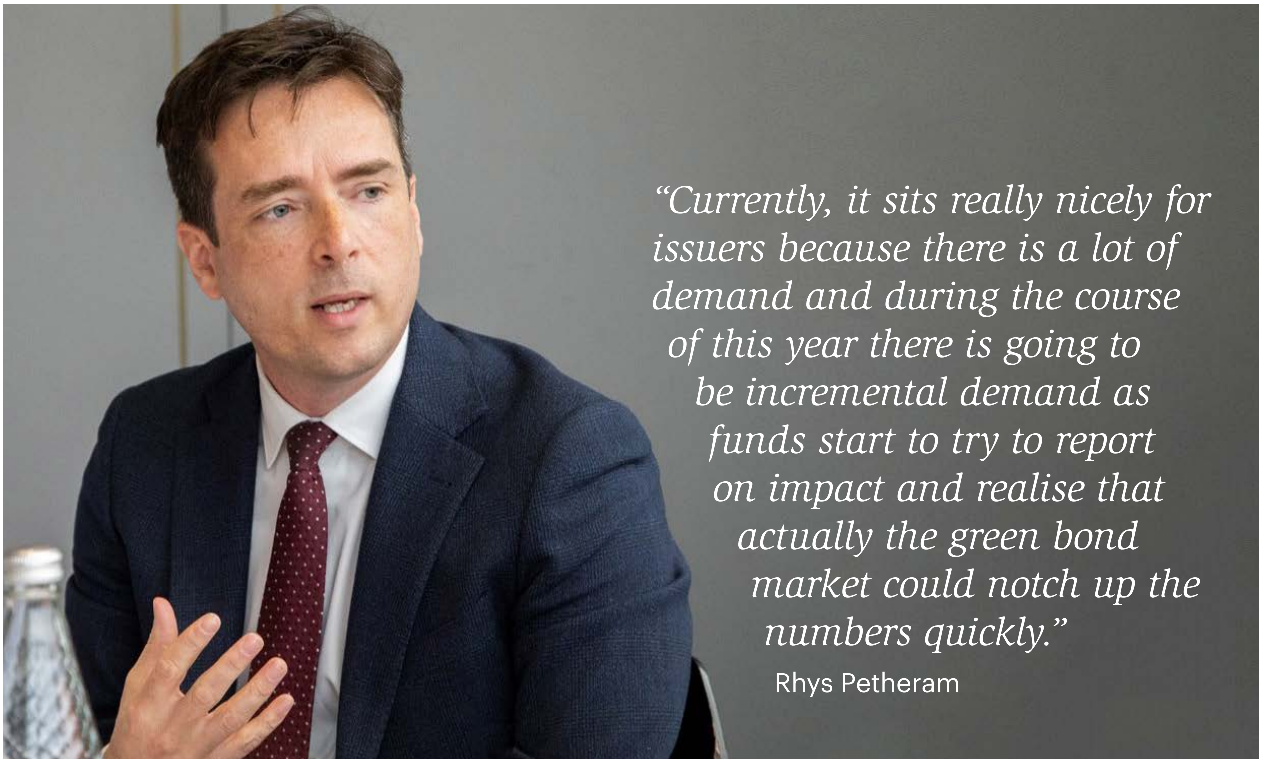


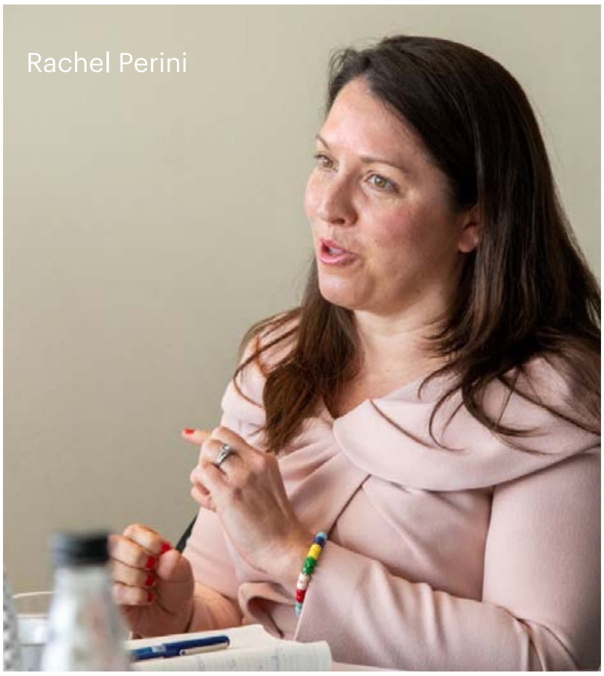
issued with specific sustainability performance targets (SPTs), which contain key performance indicators, for example, "the percentage of recycled materials used in the manufacturing process" by a specific year. If the SPT is missed the bond is subject to a "coupon step-up" clause, meaning the bond interest increases.

SLBs are mainly issued by corporates, but in March 2022 Chile issued the first sovereign SLB. The $2trn bond has two KPIs geared towards reducing carbon emissions and increasing the use of renewable energy. Chile's government is the first to link its official NDC commitment on climate change to a bond issuance.

"The KPIs link quite nicely into what the issuer is actually doing. It can be a useful way to influence government policy in a way that brings in private capital. So I quite like them from that perspective. I prefer them to green bonds issued by governments because one of the weaknesses of green bonds is that they are fungible – the money doesn't typically go into a dedicated account. In the case of a government, this means you are funding the general budget, with an intangible accounting link to green spending or subsidies. This makes it more challenging to see the forward-looking impact."

Sacrifice on returns

Petheram then returned to the issue of the fiduciary duty of those running LGPS funds. He accepted that there can be a sacrifice on returns in some instances, estimated in the green bond market to be about five basis points in aggregate, although this varies across issuers.



Rachel Perini

However, he added: “Currently, it sits really nicely for issuers because there is a lot of demand and during the course of this year there is going to be incremental demand as funds start to try to report on impact and realise that actually the green bond market could notch up the numbers quickly.”

Tobun said that there were other advantages to the fixed-income approach. “Currently, it is a good time for us to go into something like that because a lot of us want to de-risk. We know the equity market is going to fall or reduce one way or another. And going into bonds will be good if you are de-risking.”

Rachel Perini, head of UK institutional at Jupiter Asset Management, offered an important distinction. “It is the difference between ‘impact’ with a capital ‘I’ and ‘impact’ with a lower-case ‘i’. I hear people talk about impact with a lower-case ‘i’ meaning it is about investing in those real-world outcomes but not sacrificing returns. Whereas impact with a capital ‘I’ is more thinking about the impact over the returns – it will completely depend on you as an investor and your objectives.”

Luke Webster, chief investment officer at the Greater London Authority (GLA), looks at the market from both sides. Investment is a big part of his role at the GLA but, as one of the project directors for the London Mayor’s Green Finance Programme, he is also contemplating a large green bond issue late this year.

“So we are definitely hoping that will achieve a pricing advantage versus our general corporate debt. Anybody who issues a green bond is taking on considerable additional cost and

“Anybody who issues a green bond is taking on considerable additional cost and effort to achieve certification, develop their framework and green prospectus. So investors have to reward that.”

Luke Webster


Anastasia Guha

effort to achieve certification, develop their framework and green prospectus. So investors have to reward that," he said.

"The desirability of these kind of instruments will increase over time and certainly not diminish so it is worth taking a small reduction now to have a more valuable instrument for the long run. That is how I would make the case."

Pressure to adopt TNFD framework

Anastasia Guha, global head of sustainable investment at Redington, said a lot of the pressure in the UK to adopt the TNFD framework is coming from pensions minister Guy Opperman. In a joint article with minister for the Pacific Lord Goldsmith in March 2022, Opperman highlighted the role that deforestation is playing in climate change and said that pension trustees and other investors should be taking this into account when making investment decisions.

Guha expected to see an "accelerated process of what we have seen on climate change", with the TNFD taking a prominent role.

"You have started to get all the pieces of the puzzle falling into place. With the TNFD you have got the scenario analyses from the central banks. And the risk framework is probably going to come on board faster. The problem is more dispersed than climate change and more local – both of which are hard. We are not going to get trustees to understand every issue on biodiversity, I think."

Gemma James, senior manager for biodiversity and nature at Chronos Sustainability returned to the issue of engagement through investor initiates such as Nature Action 100 and the IPDD. These, she said offered a "huge opportunity" to change hearts and minds.

"You have an opportunity to bring together some of the fixed-income and solutions guys with the listed equities, because there is a role for fixed-income to be engaging with governments and with the companies. The issues on the ground play out exactly the same. It doesn't matter what asset class you are in, whatever happens on the ground is the same."

With Nature Action 100 in particular, she said, investors will be able to engage with companies, but also make the case to policymakers about the regulatory environment that is required.

Alternative funding sources

As the debate drew to a close, Dodwell predicted a priority would be for the TNFD to include some metrics. This, he said, would help with the engagement process. However, the real challenge was that nature-based solutions were unlikely to generate revenue of their own and so an alternative funding source would be necessary.

"That could be grant funding coming from developed countries to developing countries or coming from the Multilateral Development Banks to fund projects. Or it could be projects that you are deriving a benefit from because it is creating a credit which can be used for a yet to be created nature-related offsetting framework."

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Some funding is likely to be available at COP15 but not at the required scale. "In comparison with the $100bn referred to in the Paris Agreement or even the trillions that are meant to be mobilised through GFANZ [the Glasgow Financial Alliance for Net Zero], it will be a drop in the ocean."

The final word went to Petheram, who said he had been encouraged by the discussion, and particularly the emphasis on a wide range of solutions. No longer is the focus solely on equities, he said, and the inter-relationship between climate change and biodiversity loss is becoming better understood.

"It's really encouraging from that perspective, but there are clear challenges in being able to implement policy and investment frameworks that are coming our way over the next few years. We are probably where climate change was seven, eight or nine years ago. But the rate of change is incrementally faster."


Gemma James

SAFEGUARDING BIODIVERSITY: **Taking a leaf out of climate initiatives**

By **Rhys Petheram,** *head of environmental solutions*, and **Laura Conigliaro,** *analyst, environmental solutions*, **Jupiter Asset Management**

Consider these alarming facts. About 150 million tons of single-use plastic is produced worldwide annually, but just 9% is recycled. A rubbish truck a minute ends up in the ocean.

Over 50% of global GDP depends on nature, yet humanity has already severely altered over two thirds of ecosystems. Humans are depleting natural stocks and flows far more quickly than the planet can replenish them and this entails serious consequences for the natural world and the global economy.

Natural capital is the world's stocks of natural assets including air, water, geology, soil, and all living organisms, including biodiversity within and between species and ecosystems. Each component is interconnected with impacts on one affecting the others.

For example, air pollutants such as sulphur dioxide (SO2) and nitrogen oxides (NOX) emitted by fossil fuel electricity generation and petrol vehicles ultimately degrade soil and aquatic systems and their biodiversity as acid rain.

An interconnected world

Climate change and natural capital depletion, of which biodiversity is one component, are also closely interconnected. It is key for investors to understand this dynamic to ensure coherent integration into their investment strategies.

A recent joint workshop report by the Intergovernmental Panel on Climate Change and the Intergovernmental Science-Policy Platform on Biodiversity and Ecosystem Services emphasise key elements investors and policymakers should keep in mind as they integrate biodiversity into the investment process.

Climate change and biodiversity loss share common drivers through human activities, and failure to address them both carry the risks of sudden, irreversible impacts due to positive and negative feedback mechanisms, which continually amplify or reduce a given effect. Permafrost melt is an example of a positive feedback: the melting releases methane, bringing about more warming, which then melts more permafrost, and the cycle continues.

Climate change poses a direct threat to nature and its contributions to people, with the extent of the impacts depending on our choices today. For example, ranchers deforesting the Amazon exacerbate climate change and degrade areas of high biodiversity value, which in the long term puts in peril a main water source for themselves and their livestock. Some companies have developed solutions to address this challenge. Trimble, which provides solutions for the automation and integration of land registries and deforestation monitoring forests, is one such firm. The company provides advanced versity goals with other SDGs

location-based software solutions for satellite and geo-positioning including GPS, laser, optical and inertial technologies.

Comprehensive approach

Effective actions to address climate and nature carry social benefits, and efforts to address biodiversity frequently have climate benefits. However, measures that address one factor in isolation – whether climate, nature, or social – tend to result in non-optimal solutions and this is particularly true for measures narrowly focused on climate mitigation. A case in point is deriving biofuels from crops such as corn or palm, which provide a cleaner fuel for vehicles than petrol, but come at a high cost to society and nature.

These findings compel us to integrate material biodiversity issues into our investments, alongside other stewardship priorities. It also compels us to mainstream biodiversity issues, as well as social factors, into our climate-related stewardship activities.

This is a tough feat, but we can be encouraged that much of the learnings from climate action can be directly applied to natural capital, including biodiversity. We believe investor approaches to biodiversity can draw from the guidance for climate action of the Paris Aligned Investment Initiative, taking a dual focus on opportunities to reduce impacts on biodiversity and nature and investment in biodiversity solutions.

Building on our legacy

Jupiter has taken steps to engage on natural capital, such as by participating in collective engagements led by the FAIRR Initiative and the Investors Policy Dialogue on Deforestation (IPDD). Jupiter is also signatory to the Finance for Biodiversity Pledge, which commits the firm to protect and restore biodiversity through our finance activities and investments and will require us to set firm-level targets and report publicly on our progress before 2025.

Jupiter has a range of funds for which investing in companies and issuers directly addressing environmental challenges such as natural capital and biodiversity restoration are a formal objective in addition to sustainable returns for clients. This means our investments must promote a sustainable objective, such as the protection and restoration of biodiversity and ecosystems, while also doing no significant harm to other environmental and social objectives. We are committed to building on our 30+ years of legacy investing in companies solving the world's impact on nature.

JUST TOO COMPLEX?

Addressing biodiversity loss and the role of investors

By **Julie Gorte,** *SVP, sustainable investing,* and **Chris Dodwell,** *head of policy and advocacy,* **Impax Asset Management**

We are losing biodiversity at unprecedented rates, in real time. US$44 trillion in economic value generation – more than half of global GDP – depends significantly on nature.[1] We rely on nature for our food, our livelihoods and our protection. But the connections between our welfare and nature are frequently hidden: for example, how many of us know that 60% of all medicines are based on natural organisms?[2]

The current rate of biodiversity loss is unsustainable and nothing less than a global emergency. To address these problems, we need collaboration and innovation in finding and scaling up solutions.

Those responsible for allocating private sector capital have a significant role to play. A high proportion of investments in physical assets is already constrained to some degree by environmental considerations, for example through environmental impact assessments. However, current practice often takes little or no account of 'system-wide' effects, such as the potential consequence for the health of wider ecosystems of the damage to a single site. Meanwhile, investors seeking to avoid harming biodiversity typically lack both the information and the tools for effective risk analysis. And the absence of economic tools to support the restoration of individual habitats is holding back significant investment opportunities in nature-positive solutions.

Confronting the issue: Some lessons from environmental action

Biodiversity loss is intrinsically hard to tackle, not least because we simply don't understand

nature well enough. And it is hard to protect what we don't understand, especially when biodiversity loss has so many drivers. These include changes in land and water use, the direct exploitation of nature, climate change, pollution and invasive species. This makes it difficult to attribute the causes of damage, or to identify actions to mitigate losses.

Addressing the issue is also complicated by the absence of clear, common definitions surrounding what constitutes biodiversity loss, and by the lack of metrics. Unlike climate change, for which greenhouse gas concentrations in the atmosphere are a measurable indicator of progress, biodiversity has no simple global measure and its losses are typically local and habitat dependent.

Despite this, some of the lessons learned from our experience of environmental management over the decades may serve as a guide to build upon in confronting the biodiversity crisis in five main areas:

- **Joint international action.** Successful efforts to tackle environmental challenges have often involved multiple government stakeholders pooling their knowledge and resources, and agreeing collective action.
- **Effective market-based approaches.** Many environmental problems reflect market failure, which can only be addressed by regulation or other government action.
- **Useful metrics.** Metrics are vital to tackling environmental issues. Only by tracking levels of pollutants in our air and water have we been able to inform and enforce policy solutions.
- **Impact assessments.** We have much to learn from the well-established practice of environmental impact assessments. These techniques could be readily extended to encompass a broader array of biodiversity challenges.
- **Blueprints for action.** Lessons can be applied from the success of policy roadmaps that have guided long-term changes in corporate behaviour and investment linked to environmental goals.

Charting a course forward

Although the search for answers to this challenge is at an early stage, there are some fundamental principles that could lay the foundation for progress in stemming biodiversity losses:

- **Breaking down the challenge.** To confront biodiversity loss effectively, we need to disaggregate the umbrella topic into a set of specific 'Biodiversity Imperatives' for analysis.
- **Taking a 'multi-local' approach.** Many parts of the world have local biodiversity or ecosystem issues in common, and hence a 'multi-local' approach, in which multiple policymakers coordinate their actions, can be effective.
- **Creating a shared vision.** This should help us identify nature-positive solutions, for example new markets linked to ecosystem services. Where developing economies are important custodians of natural capital, they must be at the heart of solutions. Key to this will be a shared vision of the economic and financial opportunities that can be generated by addressing biodiversity loss. Initiatives like the Natural Capital Investment Alliance, of which Impax is a member, can help catalyse and scale-up nature-based opportunities.
- **An effective role for investors.** To reduce and potentially reverse biodiversity loss will require effective collaboration between the public and private sectors, so those responsible for financial institutions have a vital role to play in supporting the development of solutions. Investors should seek to analyse and manage biodiversity-related risks and consider opportunities. They should also target progress through engagement activities and proxy voting. For example, recently more than 30 financial institutions, including Impax, have committed to use their best efforts to eliminate forest-risk agricultural commodity-driven deforestation activities at the companies they invest in or lend to by 2025.

We are only in the foothills of developing the policy frameworks that adequately addresses the challenge of biodiversity loss but the window for taking effective action is closing. Over the coming months, we'll be exploring the risks this global issue poses to investors as well as the role that policymakers, companies and financial institutions can play in addressing this grave threat to our prosperity and wellbeing.

[1] World Economic Forum, 2020. WEF_The_Future_Of_Nature_And_Business_2020.pdf (weforum.org)

[2] Sunil Mathur and Clare Hoskins, 2017. Drug development: Lessons from nature (Review) (spandidos-publications.com)


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