

The ESG spotlight turns to natural capital



Investors are starting to understand that protecting natural capital is the next big challenge and an essential component of mitigating climate change.

Over the past decade the climate crisis has been the focus of ESG (Environmental, Social, and Governance) investing, but it is not the only issue that investors need to consider. The growing realisation of the importance of “natural capital” – boosted by natural capital agreements featuring prominently at the COP26 conference, and the release of a Taskforce on Nature-related Financial Disclosures (TNFD) preliminary framework – has begun to shift the spotlight.

Natural capital includes the ecosystem services that land, oceans, freshwater and atmosphere provide to society and economies. Over half of the world’s economic activity is highly or moderately dependent on nature. Natural capital is also intrinsically linked with [climate change](#). Preserving a wild area with a diversity of plant and animal life is one of the most effective ways to remove carbon from the atmosphere but, conversely, rapidly increasing global temperatures result in species extinction and a reduction in biodiversity.

The TNFD is aiming to replicate the success of the Taskforce for Climate-related Financial Disclosures (TCFD). However, measures of natural capital are complex and vary by region. Unlike climate change, which has the Paris Agreement at its foundation and a common goal to keep global temperatures to 1.5°C, there is no equivalent universal objective for natural capital. Nonetheless, the TNFD is seeking to understand the interactions between business and natural capital and agree a framework to monitor nature impacts to encourage businesses and investors to minimise negative impacts on nature and maximise positive impacts. The TNFD will create a toolkit for business leaders and the financial community to allocate capital away from nature-negative and towards naturepositive outcomes.

The TNFD published its beta framework on 15 March 2022, and is in a consulting phase ahead of producing the final recommendations in September 2023. Mercer sits on the TNFD forum and is actively involved in providing feedback and input to the TNFD.

What can investors do now?

Investors do not need to wait for the final recommendation of the TNFD to assess allocation to natural capital or engage with companies on natural capital themes in support of their sustainable investment approach. We encourage investors to define how they plan to address the challenge of natural capital and how it differs from [ESG investing](#) - for example, through setting up reporting frameworks to assess the [impacts of their investment portfolio](#) on nature. Investors can then look to incorporate natural capital considerations into their investment beliefs and make nature-positive statements in sustainable investment policies and stewardship policies in order to integrate natural capital considerations into the management of its investment portfolio.

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A key priority of the TNFD is to support natural capital investments, aiming to create opportunities for investors to allocate capital to natural solutions at scale, whilst also making an investment return. Some clients have already made allocations to sustainable forestry and agriculture, as well as into companies and solutions that support ocean health (for example, through reduction of ocean waste). In identifying opportunities it is important to be aware of “greenwash” as we have observed some asset managers exaggerating the benefits of their natural capital funds. We advise clients to conduct thorough due diligence on natural capital investments, especially as many funds have been only recently launched and so will often have a short track record.

It is likely that with the attention surrounding natural capital it will be one of the fastest growing asset classes in the future and demand for nature positive investments will increase as investors implement their climate objectives. Currently, nature-based solutions are one of the few investment opportunities that are net negative in terms of carbon emissions - for example, forest ecosystems are the largest terrestrial carbon sink and we have observed some forestry funds stating an intention to maximise the carbon sequestration potential of their forests, alongside their other financial objectives. Natural capital opportunities will therefore form a vital and increasingly important part of investment portfolios as investors seek to realise their net zero ambitions.

Please [contact a member of the Mercer Sustainable Investment team](#) for more information on the TNFD, implementing biodiversity themes in your investment policies and the emergence of natural capital investment opportunities.

1. The TNFD Nature-Related Risk & Opportunity Management and Disclosure Framework Beta v0.1, TNFD, March 2022

2. Global Forest Resources 2020 Main Report, UN Food and Agriculture Organisation, 2020

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