BRIEFING PAPER:

FINANCE SECTOR SUPPLEMENT

TO THE NATURAL CAPITAL PROTOCOL

The Natural Capital Coalition, the Natural Capital Finance Alliance (NCFA) (formerly the Natural Capital Declaration) and the Dutch Association of Investors for Sustainable Development (VBDO) have agreed to jointly produce a Finance Sector Supplement to the Natural Capital Protocol. The Supplement will provide financial institutions (asset owners, asset managers, banks, insurance companies) with guidance on how to incorporate natural capital impacts and dependencies into their lending, investment and insurance practices and processes.

This Briefing Paper provides an overview of the reasons why including natural capital into their day-to-day decision making will help financial institutions reduce risk and identify opportunities. It also sets out our initial thoughts on the scope, purpose and content of the Finance Sector Supplement. The feedback from this consultation will be used to inform the structure and content of the Finance Sector Supplement. We will start drafting the Supplement in early 2017 and we will formally consult on the Supplement in the period May to August 2017.

We invite comment on the issues and questions in this Briefing Paper. This consultation will run from November 14th 2016 to December 9th 2016.

To provide feedback during this consultation period please complete the survey at https://goo.gl/forms/CO0NSKeHHV1HWml33. Unfortunately due to the timeline, responses received outside of the above electronic survey will not be incorporated.

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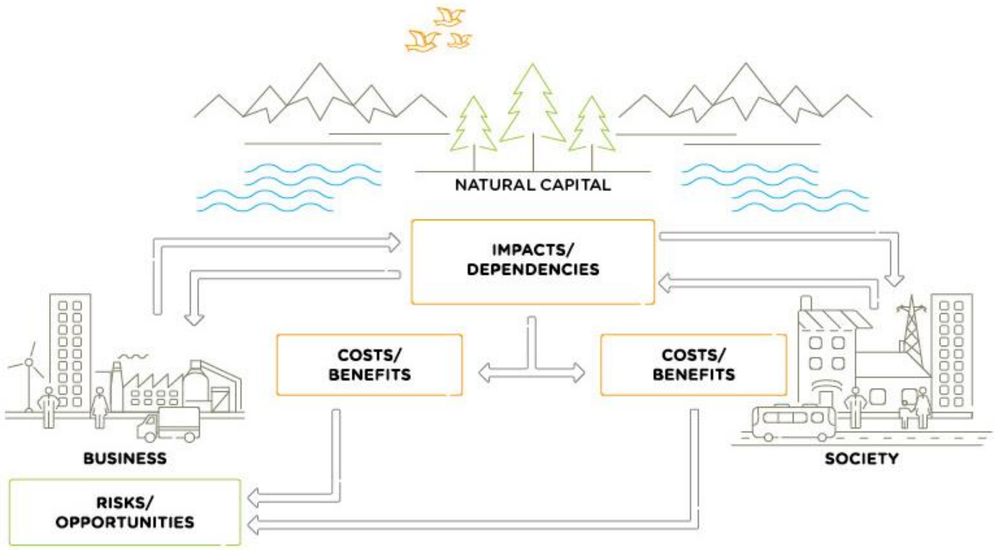
INTRODUCTION

What is Natural Capital?

Natural capital is a term used to understand our relationship with the natural world around us. It refers to the stock of renewable and non-renewable natural resources (e.g. plants, animals, air, water, soils, minerals) that combine to yield a flow of benefits to people[1].

Natural capital is one of several commonly recognized forms of capital. Others include financial, manufactured, social and relationship, human, and intellectual capital. Natural capital supports all of the other capitals by providing essential resources, such as air, water, soil and minerals, and by supporting a healthy planet that underpins thriving societies and prosperous economies.



Financial institutions, like other organizations, have **impacts** and **dependencies** on natural capital, both direct and indirect. **'Impacts'** are the negative and positive effect of their activities on natural capital, while **'Dependencies'** refer to their reliance on natural capital.

Our framing of natural capital as being about impacts and dependencies has important implications for financial institutions:

- It encourages financial institutions to focus on their wider business activities (lending, investment, insurance) rather than solely focusing on their own operations.
- It encourages financial institutions to focus on the potential significance of natural capital to their business activities, rather than seeing natural capital as just being about measurement and reporting.
- It encourages financial institutions to take a more holistic and systems approach to their decision-making.

[1] This is the definition presented in the Natural Capital Protocol, page 2. http://naturalcapitalcoalition.org/protocol/

Why should the Finance Sector be concerned about Natural Capital?

Financial institutions are increasingly aware of the importance of understanding and effectively managing the risks and opportunities associated with natural capital. For example, companies may find that their costs increase, that they are subject to greater regulation, or that their business models are undermined as a consequence of their impacts on or dependency on natural capital. Equally, companies may find that they have new business opportunities through, for example, creating new products and services to apply to the challenge of natural capital protection and conservation in light of the inherent value (and benefits) provided by the flow of services from natural capital.

These business risks and opportunities, in turn, create risks and opportunities for the finance sector. Most immediately, they can affect the cash flows, risks, valuations and opportunities at the individual company or project level, with consequences for insurance premiums, project valuations, equity prices or the cost of capital. Natural capital-related risks and opportunities are not confined to individual companies or projects; for example, financial institutions might find that they have significant exposure to water or biodiversity-related risks because of their aggregate exposure to specific geographies, sectors or markets.

> "Failing to consider long-term investment value drivers, which include environmental, social and governance issues, in investment practice is a failure of fiduciary duty."
>
> Principles for Responsible Investment, UNEP FI and UNEP Inquiry into a Sustainable Financial System (2015), *Fiduciary Duty in the 21st Century*

Why Develop a Finance Sector Supplement to the Natural Capital Protocol?

In recent years, many financial institutions have developed tools and methodologies to assess the environmental, social and governance (ESG) risks and opportunities associated with their investment, lending and insurance portfolios. Within this work, many – whether individually or in conjunction with others through initiatives such as the Natural Capital Finance Alliance (NCFA) and the Equator Principles – have focused on specific risks and opportunities associated with natural capital. These efforts have made an important contribution to the finance sector's knowledge and understanding of natural capital. It is, however, increasingly recognised that there is a need to consolidate the work that has been completed to date and to encourage the systemic integration of natural capital considerations into the insurance, investment and lending decision-making processes of financial institutions.

This is not just about company or project-specific analysis and decisions. Financial institutions are looking to assess and manage – both to minimise risks and maximise opportunities – associated with their aggregate (or overall) exposure to natural capital. For example, depending on the institution, they may need to manage the positive and negative implications of resource scarcity, extreme weather events or deforestation (or reforestation).

INFORMING THE DEVELOPMENT OF THE FINANCE SECTOR SUPPLEMENT

There are a variety of tools and methodologies that have been developed to enable financial institutions to better understand certain aspects of the risks and opportunities related to natural capital for their own operations and for their investment, lending and insurance portfolios. Examples include those developed by the NCFA[2] and VBDO[3].

However, at present, there is no single integrated agreed framework that provides financial institutions with a clear introduction to natural capital issues, or with a structured process to identify, measure and value their impacts and dependencies on natural capital. The Finance Sector Supplement to the Natural Capital Protocol aims to address this gap by building a bridge between the Natural Capital Protocol (the globally recognised framework for businesses to integrate natural capital into their decisions), and the tools and methodologies produced by institutions, such as the NCFA and VBDO.

The goals of this high-level consultation are to:

- Understand what would help financial institutions to incorporate natural capital considerations (both downside risks and upside opportunities) into their risk management frameworks, products and services.
- Gather feedback from a technical/practical perspective about how the Finance Sector Supplement should be structured and presented.

> As we begin to develop the Finance Sector Supplement we want your input. The process of development will be collaborative and we encourage participation from all parts of society, although we are clear that it must be led by the finance sector if it is to be relevant and robust.

We are looking for feedback on three key topics:

- The state of play: natural capital in the finance sector.
- The scope of the Finance Sector Supplement
- The structure and content of the Supplement.

In each case, we have prepared a series of questions that set out the issues that we are looking for feedback on. We also welcome wider comment on the Supplement itself and on issues beyond those covered in this Briefing Paper.

[2] http://www.naturalcapitalfinancealliance.org/resources/
[3] http://www.vbdo.nl/files/news/VBDOCREMNaturalCapitalGuide.pdf

A) THE STATE OF PLAY: NATURAL CAPITAL IN THE FINANCE SECTOR

A1. On a scale of 1 to 5 (where 1 is not at all important and 5 is very important), how important is natural capital in your organization's decision-making processes?

A2. What do you see as the key challenges (or barriers) to integrating natural capital into your organization's decision-making processes?

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A3. Would a Finance Sector Supplement be useful for your organization?

Yes	No

If you answered Yes, can you explain why a Supplement would be useful?

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If you answered No, can you explain why you do not think a Supplement would be useful?

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A4. What do you see as the primary contribution(s) of a Finance Sector Supplement (please tick all that apply):

- Raising awareness of what natural capital is and its relevance to the finance sector.
- Providing guidance on how to incorporate natural capital impacts and dependencies into decision-making processes.
- Providing guidance on how to report on natural capital impacts and dependencies
- Other (please specify) ………………………………………………………………………………
- Other (please specify) ………………………………………………………………………………

B) THE SCOPE OF THE SUPPLEMENT

We are proposing that the Finance Sector Supplement focus on three key sub-sectors, as follows:

- **Banking:** This includes the project finance, corporate lending and underwriting activities carried out by the banking sector.
- **Investment:** This includes both asset owners and asset managers, and their activities including investment (across the range of asset classes), active ownership and impact investing.
- **Insurance:** This includes corporate underwriting and reinsurance, but insurance companies' investment management activities will be treated separately.

The Natural Capital Protocol sets out different levels of organizational focus that can be applied, i.e., corporate, project or product. Our expectation is that the Finance Sector Supplement will supplement these by discussing natural capital at the portfolio level, and at the country level. It will also discuss wider issues such as the stability and resilience of the finance sector, and the impact and dependency of the sector as a whole on natural capital.

B1. Do you agree that the Finance Sector Supplement should focus on the banking, investment, and insurance sub-sectors?

Yes	No

If you answered 'No', can you explain your answer (e.g. why should the Supplement not cover some of these sub-sectors, are there other activities that the Supplement should cover)?

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B2. Do think that we should prepare one overarching supplement for the entire finance sector or separate supplements for each sub-sector?

Together	Separate

Can you explain or expand on your answer to this question?

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B3. Are there specific needs and interests of particular finance sector actors that we need to take into account when developing the Supplement?

Yes	No

If Yes, please list the actor and details of the specific concerns

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C) THE STRUCTURE AND CONTENT OF THE SUPPLEMENT

We expect that the Finance Sector Supplement will build upon the Natural Capital Protocol, and will provide a bridge between the Protocol and the tools and methodologies produced by the NCFA, VBDO[4] and other industry actors active on the subject of natural capital.

The Natural Capital Protocol uses a basic four stage decision making framework of: Why, What, How and What Next[5, 6]. It then uses nine steps to aid in completing a natural capital assessment. It is purposely structured to be integrated into existing business processes and not to be a standalone exercise.

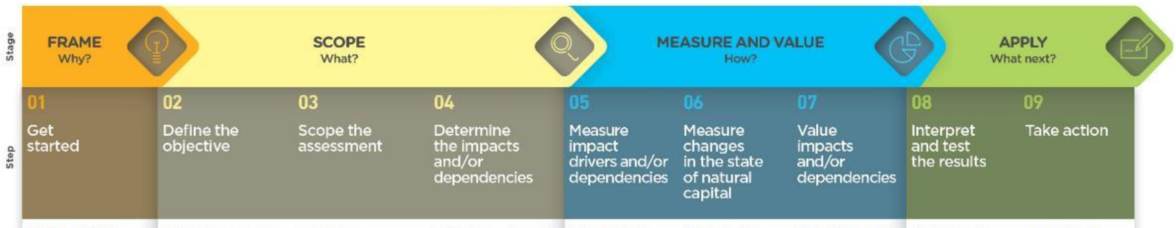

Figure 2: The Natural Capital Protocol Framework

While we have not developed a full table of contents for the Finance Sector Supplement, we see that the Supplement could cover the following aspects:

- The case for the finance sector to integrate natural capital into decision making.
- The specific natural capital impacts and dependencies relevant to the finance sector.
- A harmonised framework for finance sector actors to analyse and assess their risks and opportunities around natural capital.
- Discussion of the contextual factors (e.g. the policy context, developed versus emerging markets, macroeconomic factors) that affect the relevance of natural capital to financial institutions.
- Existing data sources and issues surrounding data (e.g. availability, access, reliability).
- Tools that exist or that are becoming available to assist finance sector actors in their analysis of natural capital risks, dependencies and opportunities.
- Examples and case-studies of how financial institutions have taken account of natural capital in their practices, processes, products and services.
- Examples of natural capital disclosure and reporting.

C1. Do you agree that the Finance Sector Supplement should follow the decision making process of the Natural Capital Protocol (Steps and Stages) set out above?

Yes	No

If you answered 'No', can you suggest an alternative structure or logic for the Supplement?

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[4] See Notes 3 and 4 above.
[5] http://naturalcapitalcoalition.org/protocol/, pages 4-5.
[6] The Natural Capital Finance Alliance's Working Groups (WG1: Understanding, WG2: Embedding, WG3: Accounting, WG4: Reporting) follow a similar structure. See further http://www.naturalcapitalfinancealliance.org/ncd-working-groups/

C2. Do you agree that the supplement should cover all of the aspects set out above?

Yes	No

If you answered 'No', can you indicate which aspects are of less relevance?

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Can you suggest any other aspects that you think we should include in the Supplement?

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C3. Please suggest relevant tools which should be reviewed and referenced here with links.

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D) ADDITIONAL COMMENTS

D1. Please provide any other comments or suggestions you would like to make about the Finance Sector Supplement here.

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ANNEX 1 DESCRIPTION OF THE PARTICIPATING ORGANIZATIONS

Natural Capital Coalition (the Coalition)

The Natural Capital Coalition has developed the Natural Capital Protocol (hereafter "the Protocol") to make natural capital visible in business decision-making. The Coalition has grown considerably over the last year and is now made up of over 200 organizations from a wide range of stakeholder groups including conservation, science and academia, business, associations, standard-setting, finance, accountancy and policy/government. Whilst the Coalition is primarily directed towards developing solutions for business, it is also, as its name suggests, a broad 'Coalition' creating a space where all interested parties from all stakeholder groups can work together to create vibrant societies and productive economies through the inclusion of natural capital in decision-making.

The Coalition's Natural Capital Protocol and associated sector guides have been developed through a unique collaborative process, with 38 organizations coming together under contract to develop something for the public good. The final Protocol, along with sector guides for the Apparel and Food & Beverage sectors, was launched in July 2016. The Protocol aims to support better decisions by including business interactions with nature, or more specifically natural capital, in decision-making. It is not a disclosure framework.

The Protocol is freely available at http://naturalcapitalcoalition.org/protocol/.

Natural Capital Finance Alliance (NCFA)

The Natural Capital Finance Alliance (NCFA) – formerly known as the Natural Capital Declaration – is a global finance-led initiative to integrate natural capital considerations into financial products and services, and to work towards their inclusion in financial accounting, disclosure and reporting. It is signed by the CEOs of more than 40 financial institutions, and is actively working with more than 40 supporting (non-financial) organizations to develop methods to implement the four commitments outlined in the 'Natural Capital Declaration'.

This is being done through a steering committee of signatories and supporters and four working groups, supported by a secretariat formed of the UN Environment Finance Initiative (UNEP FI) and the Global Canopy Programme (GCP). The NCFA is actively engaging with financial institutions to develop a range of tools to facilitate integration of natural capital factors into financial products and services and to strengthen financial institutions' management of natural resource and environment-related risks and opportunities.

The Finance Sector Supplement on Natural Capital is part of the NCFA's approved 2016-18 work programme. NCFA Working Group 3, under which the Supplement falls, aims to support the commitment to "Work towards building a global consensus for the integration of Natural Capital into private sector accounting and decision-making; supporting, where appropriate, the related work of the Natural Capital Coalition and other stakeholders."

Dutch Association of Investors for Sustainable Development (VBDO)

The VBDO is a multi-stakeholder organization whose goal is to make capital markets more sustainable. It is an independent association with members such as different types of financial institutions, consultancy firms, NGOs and trade unions. It is a member of Eurosif and the Global Sustainable Investment Alliance (GSIA) and has close ties to other SIF-organizations.

VBDO worked with the consultancy CREM to publish guidance on natural capital for investors in early 2016. This *Guide on Natural Capital & Financial Institutions* provides practical guidance to financial institutions that wish to take their interactions with natural capital into account in their investment management through responsible investment strategies such as exclusion, active ownership, ESG integration and impact investing.