The Natural Capital Declaration

Financial sector leadership on natural capital

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Agenda

• What is it?
• Why necessary?
• Theory of change
• Defining natural capital
• How is it set up
• What we aim to achieve
• How we work with others
• Take home points
What is it? (1)

- **Objective**: Finance-led, CEO-endorsed initiative to *mainstream* natural capital in loans, bonds, equities and insurance, as well as accounting & reporting.
- **Focus**: Banks, institutional investors, fund managers, and insurance firms.
- **Process**: *Signatory financial institutions* are working alongside *supporter organisations* guided by proposals in our NCD Roadmap paper.
- **Conveners**: Managed by UNEP FI and Global Canopy Programme.
- **Governance**: Steering Committee chaired & 4 Working Groups.
- **Endorsing**: Signatories (FIs): sign at CEO level. Supporters: sign at director-level
What is it? (2)

- The NCD **does not** aim to put a **price on nature**.

- It **does** aim to put a **price on the (credit) risk** that banks are exposed through loans, investments and insurance obligations.

- The NCD **does** focus on the **global financial sector**. Engagement with wider private sector is through other platforms / organisations (WBCSD, CDP, CBD, etc).

- It does focus on tackling the **technical challenges of calculating the business case** and developing **metrics** for lenders, investors and insurers to embed natural capital. It does not aim to be the next PRI or UN GC.
NCD signatories (September 2013)
Why necessary? (1)

75% of fishing stocks fully / overexploited (MA)
20% of coral reefs destroyed (MA)
US$ 50 billion lost economic benefits fisheries (WB/FAO)
US$ 6.6 trillion in environmental costs externalized to society
USD$ 45 billion “cost of policy inaction” (TEEB) – ecosystem degradation

Science is sound, but financial argument is weak
Why necessary? (2)

- Global derivative markets: 10x bigger than total global GDP
- Bonds markets: 2x bigger than value of all global stock exchanges: USD 95 trillion
- Outstanding sovereign debt equal to about USD 41 trillion (+23% in 10 yrs)

New capital requirements stimulate investors to buy and hold more sovereign debt

Systemic risks related to natural capital; little understood but potentially huge.

Finance and capital markets: Huge lever for change
Why necessary? (3)

### CDOs of subprime-mortgage-backed securities issued in 2005 – 2007

<table>
<thead>
<tr>
<th>Rating</th>
<th>Calculated default rate (%)</th>
<th>Actual default rate (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>AAA</td>
<td>0.001</td>
<td>0.10</td>
</tr>
<tr>
<td>AA+</td>
<td>0.01</td>
<td>1.68</td>
</tr>
<tr>
<td>AA</td>
<td>0.04</td>
<td>8.16</td>
</tr>
<tr>
<td>AA-</td>
<td>0.05</td>
<td>12.03</td>
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<tr>
<td>A+</td>
<td>0.06</td>
<td>20.96</td>
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<tr>
<td>A</td>
<td>0.09</td>
<td>29.21</td>
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<tr>
<td>A-</td>
<td>0.12</td>
<td>36.65</td>
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<tr>
<td>BBB+</td>
<td>0.34</td>
<td>48.73</td>
</tr>
<tr>
<td>BBB</td>
<td>0.49</td>
<td>56.10</td>
</tr>
<tr>
<td>BBB-</td>
<td>0.88</td>
<td>66.67</td>
</tr>
</tbody>
</table>

Source: The Economist: 13 February 2010

- The more indirect a financial product, the more difficult to assess risk
- Implications of getting it wrong are huge
A paradigm shift? The graph shows changes of 33 most important commodities in real prices for the past 100 years. The deflation in commodity prices (over about 100 years) has been offset in just 10 years!!
Likely huge systemic risk

Financial sector huge potential lever for change

Science on ecosystem degradation sound

ESG vs financial analysis

NCD

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Secretariat:

UNEP Finance Initiative
Innovative financing for sustainability

GCP Global Canopy Programme
Theory of Change

• Over-exploitation will cause price volatility and business constraints across the world economy.

• Growing need to address exposure to indirect risks from natural resource constraints and pollution issues embedded in financial products.
  – Stranded assets: fishing stocks
  – Systemic risks: depletion natural capital affecting economic growth

• Correcting price signals to address the external costs of business will be increasingly important to credit risk, valuations, protecting investment returns.

• Signatories will integrate natural capital factors into loans, investments and insurance products to strengthen management of risks and opportunities and become more resilient to environmental pressures.
Defining natural capital

• *The stock of ecosystems that yields a renewable flow of goods and services* [that underpin the economy and provide inputs and benefits to businesses and society such as food, fiber, water, energy, timber, climate security].

• Sub-set of environmental, social and governance (ESG) considerations that can be material to financial institutions through loans, investments or insurance contracts.
How we are set up

NCD Steering Committee
WG Chairs, Supporters

Secretariat
UNEF FI, GCP

NCD Advisory Network
Information Providers, GOs, Scientific Community

WG I
Understanding Impacts/Dependencies
Chair: Rabobank

Project Manager
Global Canopy Programme

WG II
Embedding NC in financial products
Chair: Banorte

Project Manager
Natural Value Initiative

WG III
Natural capital accounting
Chair: National Australia Bank

Project Manager
KPMG

WG IV
Natural capital disclosure/reporting
Chair: Nedbank

Project Manager
CDP
What we aim to achieve (1)

Outline of objectives for implementation 2013-2015

• **Develop metrics**: Develop practical tools, guidance, methodologies, frameworks and indicators for financial institutions to understand, embed, account for and report on natural capital factors.

• **Encourage progress**: Build capabilities for signatory financial institutions & encourage progress towards implementing the NCD commitments.

• **Increase number of signatories** in key areas: asset owners, fund managers, insurers, development/banks and credit rating agencies.
<table>
<thead>
<tr>
<th>1. Understand</th>
<th>“How exposed is my institution?” / “How material is natural capital for my company?”</th>
</tr>
</thead>
<tbody>
<tr>
<td>2. Embed</td>
<td>“How can I integrate natural capital in different types of loans, bonds, equities, insurance products?”</td>
</tr>
<tr>
<td>3. Account</td>
<td>“Bringing natural capital into a company’s (financial institution’s) financial accounts”</td>
</tr>
<tr>
<td>4. Disclose</td>
<td>“How to meaningfully combine sustainability with financial reporting”</td>
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</tbody>
</table>

- Working Groups will develop and test metrics and tools through a series of pilot projects.
- Pilot Projects will help FIs to ‘learn by doing’ - building practical knowledge and internal capacity on these issues.
Examples of NCD Pilot Projects

Incorporating natural capital in client performance and credit risk assessments (IFC)
1. Develop and test methodologies to map impacts and dependencies (WG1) across loan books/portfolios.
2. Develop methodology to create risk-based premiums for FI clients.

Guidance to address deforestation risk in soft commodities policies (with UN-REDD Programme)
Develop guidance to address deforestation and forest degradation caused by agricultural production: oil palm, soy, beef and timber.
E-RISC: Environmental Risk Integration into Sovereign Credit Analysis

France: SCR: AA+ / CDS 97.50
Japan: SCR: AA- / CDS 70
Brazil: SCR: BBB / CDS 107
India: SCR: BBB- / CDS 326
Turkey: SCR: BB / CDS 142.50

% of Gross Domestic Product

Source:
A) Global Footprint Network calculations based on UNCTAD data for 2010
B) Global Footprint Network calculations
CRA: S&P sovereign credit ratings / CDS: Credit Default Swap data from Markit
How we work with others? (1)
How we work with others? (2)

NCD supporters (September 2013)
Take home points

• NCD is the only initiative that focuses exclusively on the finance sector

• Unless economic and financial arguments are more sound difficult for governments and businesses (incl. finance) to change policies, investment and decision-making

• We’re just at the starting grid mainstreaming natural capital: success NCD will depend on changes made by FIs following new evidence & metrics

• We always welcome opportunities for new partnerships

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