

WHAT'S NEXT AFTER TCFD?

AN OVERVIEW OF NATURE-RELATED FINANCIAL DISCLOSURES

DECEMBER 2022



More than half of the world's GDP, equal to USD \$44 trillion, is moderately or highly dependent on nature.¹ This means that nature-related risks, including those associated with biodiversity loss, could have significant macroeconomic implications. Failure to account for, mitigate and adapt to these implications is a source of risk for individual financial institutions and for financial system stability. However, financial institutions do not currently have the information needed to understand (1) how nature impacts an organization's immediate financial performance or (2) the longer-term financial risks that may arise from how the organization, positively or negatively, impacts nature.

Less than 1% of disclosing companies are reporting nature-related risks, compared to the 97% that report risks related to climate.² To address this disparity, the Task Force for Nature Related Financial Disclosures (TNFD) is developing an integrated risk management and disclosure framework for organizations to report and act on evolving nature-related risks and opportunities.

Over 700 institutions representing 48 countries have joined the TNFD Forum, a global multi-disciplinary consultative group, to support the technical work of the Taskforce. Many large Canadian financial institutions have been forum members, including BMO Financial Group, Canadian Imperial Bank of Commerce (CIBC), CPP Investments, and Manulife Investment Management. Public sector stakeholders are also part of the forum, including the Government of Canada, the Government of Québec, and the City of Mississauga.

WHAT ARE NATURE-RELATED RISKS?

Nature-related risks are potential threats to a business or investor from both its impacts and dependence on nature. These can be physical, legislative, transition, and systemic risks, shorter-term financial risks and longer-term ones. The top three highly nature-dependent industries include forestry, agriculture, and fishing and aquaculture. Low nature-dependent industries include digital communications, banking, capital markets, and the insurance and asset management industries.

INTERNATIONAL REGULATORY LANDSCAPE FOR NATURE-RELATED RISK DISCLOSURE

France not only pioneered mandatory climate-risk reporting (via the French Energy-Climate Law, established in 2019) by investment firms, it again broke new ground by requiring biodiversity reporting in the same sector.³ Article 29 of the French Energy-Climate Law ("Article 29 LEC"), published in May 2021, requires financial institutions to strengthen their Climate and Biodiversity strategies by June 2022. Furthermore, the EU Taxonomy Delegated Act, published in July 2021, requires financial institutions to include biodiversity disclosures in the prospectus for how and to what extent funds take into consideration the environmental objectives (only climate change mitigation and adaptation for 2022) of the Taxonomy. Aiming to set an example ahead of this change, Banque de France, the central bank of France, included biodiversity metrics from Moody's ESG Solutions in its 2020 sustainability report.⁴

Similarly, De Nederlandsche Bank, the central bank of the Netherlands, published a report outlining how biodiversity loss poses an economic and financial risk, including an assessment of the Dutch financial sector's exposure to

biodiversity risk, leveraging Moody's ESG Solutions data, in 2020.⁵

The Sustainable Finance Disclosure Regulation (SFDR), a set of EU rules which aim to make the sustainability profile of funds more comparable and better understood by end investors, was published in December 2019 in the Official Journal of the European Union. Level I of the SFDR was introduced in March 2021. These rules require an asset manager to describe its due diligence policy on how it will take into account the principal adverse impacts on sustainability matters at entity and financial product levels, including investments in assets that pollute water or devastate biodiversity.⁶ The EU Taxonomy is the fundamental cornerstone of a suite of regulations to be launched by the EU to improve and standardize sustainability reporting and it will support the SFDR. While the EU's SFDR regime is set to come into full effect on January 1, 2023, there remains a lot of ambiguity and uncertainty around the day-to-day application of the reporting rules.

In March 2022, the Network of Central Banks and Supervisors for Greening the Financial System (NGFS) issued a statement highlighting the importance of further study, scrutiny, and improved disclosure of nature-related risks. Members of the NGFS include the US Federal Reserve, the Bank of England, and the European Central Bank.

On March 31, 2022, the IFRS Foundation's International Sustainability Standards Board (ISSB) published two draft standards: one sets out general sustainability-related disclosure requirements, and the other specifies climate-related disclosure requirements.⁷ The ISSB's sustainability-related disclosures also provide guidance on identifying and developing appropriate disclosures about sustainability-related risks and opportunities not addressed by an IFRS Sustainability Disclosure Standard using the disclosure topics in SASB Standards and the **CDSB Framework application guidance for water- and biodiversity-related disclosures**.

In June 2022, the European Commission proposed the EU Nature Restoration Law with binding targets on pollinators, wetlands, rivers, forests, marine ecosystems, urban areas, and peatlands.⁸ The new Law aims to bring nature back across the continent to benefit biodiversity, climate, and people.

BIODIVERSITY FINANCE FOR GLOBAL INVESTORS

Loss of biodiversity is now considered as serious a problem as climate change, and investors increasingly realize that they have an essential role in species conservation. In September 2022, one of Britain's top asset managers, Schroders, pointed to the next big theme in responsible investing: biodiversity, without which the planet has "no route to net-zero".

Biodiversity and land use has become a vital issue in the Environment Pillar of the MSCI ESG rating model. In October 2022, MSCI ESG released the methodology for calculating key issue scores for biodiversity and land use.⁹

On November 7, 2022, the International Finance Corporation (IFC) issued the world's first guidance to help investors, financiers, companies, and governments identify investments that protect and rehabilitate biodiversity and ecosystems.

During the COP27 Biodiversity Day on November 18, 2022, Federated Hermes announced a partnership with environmental impact investment adviser, Finance Earth, to co-design a blended finance strategy to invest in high-integrity nature-based solutions across land, coasts, rivers, and seas in the UK.¹⁰

THE STATE OF NATURE-RELATED RISK REGULATION IN CANADA

Over 300 firms with combined annual revenues of \$1.5 trillion have urged governments to mandate nature-related disclosures ahead of the 15th Conference of the Parties (COP15) on biodiversity, hosted in Montreal in December 2022.

The Government of Canada has been active in pushing for increased global ambition and concrete actions to address the dual crises of climate change and biodiversity loss. The *Greening Government Strategy*, created in 2017 and updated in 2020, commits the Government of Canada to transition to net-zero carbon and climate-resilient operations, and reduce environmental impacts on waste, water, and biodiversity.

Canada's 2021 Annual Report on the 2030 Agenda and

the Sustainable Development Goals announced the establishment of the **Natural Climate Solutions Fund**, which will invest \$4 billion over the next ten years in the following initiatives:¹¹

- A Two Billion Trees Program led by Natural Resources Canada (\$3.19 billion)
- Nature Smart Climate Solutions led by Environment and Climate Change Canada (ECCC) (\$631 million)
- Agricultural Climate Solutions led by Agriculture and Agri-Food Canada (\$185 million)

To meet Canada's 2030 target and lay the groundwork for net-zero emissions by 2050, under the 2030 emission reduction plan, the Canadian Government will invest an additional \$780 million in the Nature Smart Climate Solutions fund to deliver further emission reductions from nature-based climate solutions.¹²

Indigenous peoples are well placed to support natural climate solutions as stewards of their traditional territories. Therefore, Indigenous knowledge has a vital role to play in supporting natural climate solutions in Canada.

In January 2022, the Bank of Canada and Office of the Superintendent of Financial Institutions (OSFI) released the results of a pilot project on climate scenario analysis. This pilot was an important step in helping Canada's financial sector identify, measure and disclose climate-related risks.

The importance of standardizing disclosure of climate-related financial risks has recently gained recognition. However, nature-related financial disclosure has not been mentioned in the 2021 Annual Report on the 2030 Agenda of the Government of Canada.

IS CANADA READY IN TERMS OF ACCOUNTING STANDARDS?

The value of natural assets is a sound economic driver and serves as the backbone of the Canadian economy. According to Natural Resources Canada, an infographic states that "in 2020, natural resources, directly and indirectly, accounted for 15.5% of Canada's nominal GDP," with the most significant natural resource being energy. However, the dollar value of the goods and services

provided by ecosystems is not recognized in the financial statements of public sector entities in Canada.

Nature capital is the subject of an accounting push. A recent consultation letter submitted by the Intact Centre, KPMG, and the Municipal Natural Assets Initiative to the Public Sector Accounting Board (PSAB) calls for recognizing the financial value of nature assets.¹³ However, Canada is not ready to count nature into its accounting frameworks, for the current accounting handbook prohibits considering natural assets to be tangible capital assets, a crucial barrier. Both the Canadian Public Sector Accounting Board and the International Public Sector Accounting Standard Board (IPSASB) have projects underway to look at ways to address this shortcoming.

Internationally, countries, including the United Kingdom and the United States, have taken steps to value nature in their national accounting systems. In June 2021, the British Standards Institution (BSI) issued its first standard, BS 8632, aimed at helping businesses and public sector bodies measure the extent and value of their impacts on nature.¹⁴ In November 2022, at COP27 in Egypt, the Biden-Harris Administration released the Nature-Based Solutions Roadmap, an outline of strategic recommendations to put America on a path that will unlock the full potential of nature-based solutions to address climate change, nature loss, and inequity. This marks the first time the US has developed a strategy to scale up nature-based solutions.

WHAT IS TNFD?

The Taskforce on Nature-related Financial Disclosures (TNFD) was formally launched in June 2021 in response to a growing appreciation for the need to factor nature-related risks into financial and business decisions. The nature-focused TNFD builds on the work of the Task Force on Climate-related Financial Disclosures, which focuses on climate risk management and disclosures. The TNFD adopts the same pillars as the TCFD, seeking to provide comparable, financially relevant, decision-useful information. However, instead of addressing climate risks, the TNFD is focused on ensuring that nature-related risks and opportunities are understood and effectively communicated. By aggregating the best tools, materials, and information available, the TNFD aims to allow financial institutions and companies to incorporate nature-related

risks and opportunities into their strategic planning, risk management, and asset allocation decisions, and to promote worldwide consistency for nature-related reporting.

The TNFD Framework indicates how the Taskforce seeks to maximize the consistency and language of its recommendations with the TCFD and other standard setters, such as the new International Sustainability Standards Board (ISSB) and international and national regulators.

OVERVIEW OF TNFD FRAMEWORK DEVELOPMENT

The TNFD is currently in its mission design and development phase and is adopting an open innovation approach that encourages market participants to co-create a risk management and disclosure framework. The framework will involve iterative prototyping and the successive release of updates to a beta test version based on market feedback and pilot testing from March 2022 to September 2023. In this regard, the beta framework will be the product of a development process to improve the framework's relevance, usability, and effectiveness. After four rounds of beta testing, the TNFD plans to release its final recommendations for the framework in September 2023.

Who has been involved in the beta framework testing?

Commencing on June 1, 2022, and continuing through June 30, 2023, corporate and financial institutions interested in exploring how the Framework might apply in their specific organization can pilot test the Framework independently or through collaborative efforts (e.g., with industry peers or between a financial institution and an investee company).

Three iterations of the beta framework have been released, the first (v0.1) in March 2022 and the second version (v0.2) in June 2022. The third beta version was released in early November 2022. A brief review of the first three beta frameworks is presented below:

TNFD framework beta v0.1

The first beta release of the Framework seeks to provide recommendations and guidance on nature-related risks and opportunities relevant to a wide range of market participants, including investors, analysts, corporate executives and boards, regulators, stock exchanges, and accounting firms. The release comprises three main components:

1. Foundational guidance, including key science-based concepts and definitions, to help a wide range of market participants understand nature and nature-related risks and opportunities;
2. Disclosure recommendations aligned with the approach and language of the climate-related guidance developed by the TCFD; and
3. Practical guidance on nature-related risk and opportunity analysis for companies and financial institutions to consider incorporating into their enterprise risk and portfolio management processes.

In addition to the draft disclosure recommendations, the TNFD has developed simple, science-based step-by-step guidance for an integrated, nature-related risk and opportunity assessment process called LEAP (locate, evaluate, assess, prepare).

The LEAP process involves four core phases of analysis broken down into 17 steps, each framed by a guiding question.¹⁵

- **Locate** your interface with nature
- **Evaluate** your dependencies and impacts
- **Assess** your risks and opportunities; and
- **Prepare** to respond to nature-related risks and opportunities, and report to investors.

For example, the guiding questions for LOCATE the Interface with Nature include:

- 1) [L1: Business footprint](#) – *Where are our direct assets and operations, and our related value chain (upstream and downstream) activities?*
- 2) [L2: Nature interface](#) – *Which biomes and ecosystems do these activities interface with? What is the current integrity and importance of the ecosystems at each location?*
- 3) [L3: Prioritization](#) – *At which locations is our organization interfacing with ecosystems assessed as being low integrity, high biodiversity importance and/or areas of water stress?*
- 4) [L4: Sector identification](#) – *What sectors, business units, value chains or asset classes are interfacing with nature in these priority locations?*

TNFD framework beta v0.2

This v0.2 beta release of the TNFD framework builds on v0.1. The three core components of the framework have not changed in v0.2. However, based on feedback from a range of market participants and other stakeholders, beta v0.2 makes several enhancements based on the market feedback and three significant additions:

1. A first draft architecture for metrics and targets, and draft guidance on, and an illustrative set of, dependency and impact metrics.¹⁶
2. An initial approach to specific guidance and recommendations to respond to different organizations' needs. Its initial structure enables organizations to choose any of the three entry points:¹⁷
 - 1) sector/geography;
 - 2) type of product/asset class; and
 - 3) biome/ecosystem
3. An update to LEAP-FI (LEAP approach for financial institutions). This early prototype of LEAP-FI focuses on the assessment of nature-related risks and opportunities in relation to financed activities (e.g.,

debt and equity investing, trading and insuring). Complex financial products such as derivatives are not included within the scope of the LEAP approach.

TNFD framework beta v0.3

The third iteration of the TNFD beta framework, released on November 4, 2022, contains significant updates and enhancements. The latest framework has expanded TNFD's draft disclosure recommendations to adopt a **double materiality lens**, incorporating dependencies and impacts on nature, risks, and opportunities to reporting organizations, providing additional guidance on metrics to support this analysis.

CONCLUSION

As global leaders prepare for the United Nations Biodiversity Conference (COP 15) in Montreal this December, the rally to prioritize nature in policy and investments is driving progress. The TNFD, a global, market-driven, science-led, and government-backed initiative, aims to develop a practical disclosure framework that enables financial institutions to assess, manage and report on their dependencies and impacts on nature. It also helps assess nature-related risks and opportunities, with the ultimate goal of supporting a re-direction of global financial flows away from activities that harm nature and towards activities that benefit nature.

Corporate disclosures related to nature lag far behind those for carbon emissions. As first movers, EU regulators and global rating agencies have been proactive in supporting nature restoration across the continent to the benefit of biodiversity, the environment, and people. However, there remains a lack of a global standard for nature-based financial disclosure. The final release of a new TNFD framework in September 2023 may serve to fill this gap.

Endnotes

- 1 World Economic Forum Report 2020. <https://www.weforum.org/reports/nature-risk-rising-why-the-crisis-engulfing-nature-matters-for-business-and-the-economy/>
- 2 Disclosure Nature's Potential. Corporate responses and the need for greater ambition, 2021. <https://portals.iucn.org/library/sites/library/files/documents/2021-038-En.pdf>
- 3 See Law on Climate and Energy, 2019. Energie et climat https://www.assemblee-nationale.fr/dyn/15/dossiers/alt/energie_climat
- 4 Responsible Investment Report 2020. Banque de France, March 2021. <https://publications.banque-france.fr/en/liste-chronologique/responsible-investment-report>
- 5 Indebted to nature. van Toor, Joris et al. De Nederlandsche Bank and PBL Netherlands Environmental Assessment Agency, June 2020. <https://www.dnb.nl/media/4c3fqawd/indebted-to-nature.pdf>
- 6 Regulation (EU) 2020/852 of the European Parliament and of the council, June 2020. <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32020R0852&from=EN>
- 7 The ISSB is a standard-setting board for ESG reporting established in 2021. <https://www.ifrs.org/groups/international-sustainability-standards-board/>
- 8 Nature Restoration Law, June 2022. https://environment.ec.europa.eu/topics/nature-and-biodiversity/nature-restoration-law_en
- 9 MSCI ESG Ratings Methodology: Biodiversity & Land Use Key Issue, October 2022. <https://www.msci.com/documents/>
- 10 Biodiversity round-up: Federated Hermes launches UK nature-based strategy: <https://www.responsible-investor.com/biodiversity-round-up-federated-hermes-launches-uk-nature-based-strategy/>
- 11 Nature Smart Climate Solution Fund, October 2022. <https://www.canada.ca/en/environment-climate-change/services/environmental-funding/programs/nature-smart-climate-solutions-fund.html>
- 12 2030 Emissions Reduction Plan: Canada's Next Steps for Clean Air and a Strong Economy <https://www.canada.ca/content/dam/eccc/documents/pdf/climate-change/erp/Canada-2030-Emissions-Reduction-Plan-eng.pdf>
- 13 "Getting Nature on the Balance Sheet: Recognizing the Financial Value Provided by Natural Assets in a Changing Climate" by Intact Centre on Climate Adaptation, KPMG, and the Municipal Natural Assets Initiative, coupled with a consultation letter submitted to the Public Sector Accounting Board (PSAB) that is jointly signed by 71 financial industry leaders and leading academics, October 2022.
- 14 Natural Capital Accounting for Organizations. Specification. June, 2021. <https://knowledge.bsigroup.com/products/natural-capital-accounting-for-organizations-specification/standard>
- 15 The LEAP Nature Risk Assessment Approach, November 2022.
- 16 In the v0.2 beta release, the Taskforce has prepared an initial approach to metrics and targets. This includes a design concept of 'core' and 'additional' Disclosure Metrics, which will be required for disclosures, as well as Assessment Metrics for internal assessment using the LEAP approach.
- 17 "Entry point" is part of the scoping questions prior to the LEAP approach. They mean to help financial institutions prioritize and focus their effort as they assess their financial portfolios.

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