BlackRock

Our approach to engagement on natural capital

Investment Stewardship

BlackRock Investment Stewardship (BIS) encourages companies to have sound corporate governance and business practices that support the durable, long-term financial value creation that our clients depend on to achieve their investment goals. As part of our fiduciary responsibilities as an asset manager to act in our clients' financial interests, we assess a range of risks and opportunities that can affect the long-term performance of the companies in which we invest on their behalf. We engage companies to understand their approach to the material drivers of risk and financial value in their business models, provide feedback and raise any concerns. We may signal continuing concerns through our voting, where clients have authorized us to vote on their behalf. In all cases, our voting is intended to advance the long-term financial interests of our clients as shareholders.[1]

The management of nature-related risks and opportunities is a component of the ability to generate long-term financial returns for companies whose strategies or supply chains are materially reliant on natural capital. For these companies, we look for disclosures to assess risk oversight and to understand how nature-related impacts and dependencies are considered within the company's strategy.

For the purpose of this commentary, BIS has highlighted key components of natural capital that we consider to be most clearly linked to companies' ability to deliver long-term financial performance. Our commentary, Climate-related risk and the low-carbon transition, discusses natural capital-related issues through a climate risk lens. These themes are not the only possible categorization of natural capital factors, nor are they necessarily isolated from one another. We prioritize land use, water and biodiversity for engagement, as appropriate, as they are most likely to be, or become, material to companies in the near future. The interconnectedness of these components contributes to the availability of natural capital on which companies and economies globally depend in order to operate effectively.

Natural capital as an investment issue

Natural capital refers to the living and non-living components of ecosystems, such as plants, animals, air, water, soils and minerals, that contribute to the provision of goods and services to people. Some forms of natural capital have market value, including natural resource stocks, such as oil and gas, minerals, and timber. More than half of global gross domestic product (GDP) – an estimated USD $58 trillion — is moderately or highly dependent on nature.[3]

In December 2022, at the 15th Conference of Parties to the Convention on Biological Diversity, 196 governments agreed on a Global Biodiversity Framework (GBF) aiming to address biodiversity loss and restore ecosystems.[4] Certain jurisdictions are also adopting specific legislations to protect nature.[5]

While natural capital is a broad term, we focus on three key components — land use and deforestation, water, and biodiversity — which can affect the long-term financial returns of companies with material exposure.

- **Land use and deforestation**. Given the growing pressures impacting land and forests from which many companies derive their products and services, companies with material impacts and dependances on land and forests may face financial risks associated with the depletion of these resources. For example, governments have moved to impose tariffs or import bans on consumer goods and agricultural products that are not certified as sustainably sourced. Conversely, there could be material business opportunities in demonstrating responsible and regenerative practices.

- **Water**. A number of economic sectors — such as agriculture, pharmaceuticals, manufacturing, technology, apparel, food, and beverage production — are heavily dependent on fresh water.[6] Companies for which water is essential to their business operations may be required to demonstrate that they use this scarce natural resource efficiently. Overexploitation, pollution, or other factors may result in governmental regulations that restrict water availability and usage. For companies with material dependencies on water, this may impact their ability to deliver long-term financial performance.
- **Biodiversity**. Biodiversity refers to the variety and abundance of life on earth,[7] which is essential to a healthy ecosystem and the services it provides. Biodiversity loss can pose financially material risks to companies in certain sectors. While some companies flag this as a risk, and we observe more companies disclosing their approach to natural capital, other companies are at an earlier stage of developing an understanding of the risks to their business models from biodiversity loss.

Natural capital-related risks and opportunities to companies can manifest in several different ways, such as:

- **Operational challenges**. Companies that rely on raw materials as a basic input of production or have significant impacts on nature as part of their production processes may face risks if key ecosystems are degraded or the supply of natural capital is decreased or depleted. For example, poor soil health could lead to lower yields, greater nutrient runoff which may require clean up, and the need for increased fertilizer and/or pesticide application — all of which can increase costs and lower production for agriculture businesses. These operational challenges can also be exacerbated when companies depend on complex supply chains.
- **Reduced inputs.** The challenge of producing more goods with fewer inputs — land, water, minerals, etc. — can also provide opportunities for companies. For example, companies may consider operational techniques that take into account nature-based solutions[8] and the re-use of materials throughout production processes, such as farming practices that sequester more carbon naturally and enrich the soil, or cooling systems that allow for better water circulation, re-use, and return. These practices might decrease costs, mitigate risks, and/or improve reputation among consumers and other key stakeholders.
- **Changes to government policy and consumer preferences.** In addition to operational risks and opportunities, policy changes will likely play a role in determining availability, cost, and access to natural capital.[9, 10] Although policy actions will likely continue to be uneven globally, we anticipate increased measures that encourage more efficient use of resources, such as a price or tax on the externalities from which many companies benefit, or increased prices for natural resources.[11] Other key constituents in companies' value chains — consumers, employees, community members — are, like investors, increasingly taking into consideration the sustainability and impacts of the companies or products with which they interact. These trends have the potential over time to have material outcomes for companies.
- **Community impacts**. For some companies, support of key community stakeholders is necessary to be able to operate in certain areas. It can help reinforce a company's reputation and minimize the risk of disruptions to business operations, which can, in turn, contribute to a company's long-term financial success. For example, for companies whose operations impact Indigenous Peoples' lands and legal rights, a failure to obtain, in advance and on an on-going basis, free, prior and informed consent (FPIC) from those Peoples may expose companies to increased legal, reputational or regulatory risk, in light of various local and international laws and norms governing these relationships.

Reporting on natural capital impacts and dependencies

Where natural capital is material to the long-term strategy of companies, we look for public disclosures to assess risk oversight and to understand how nature-related impacts and dependencies are managed. We find it helpful when these disclosures include a discussion of material natural capital risks and opportunities in the context of a company's governance, strategy, risk management, and metrics and targets. This information could be augmented with an evaluation of the business impacts of potential, or unpredictable, changes in the availability of critical natural resources. It is also helpful to hear from companies about how they manage natural capital dependencies and impacts in the context of their value chains.

While nature-related disclosures have historically been limited and difficult to compare across companies, private-sector initiatives, such as the Taskforce on Nature-related Financial Disclosures (TNFD),[12] provide frameworks to guide disclosure on material, nature-related impacts and dependencies, alongside associated risks and opportunities, consistent with the Taskforce on Climate-related Financial Disclosures (TCFD) framework and the approach of the International Sustainability Standards Board (ISSB).

Given the growing awareness of the materiality of these issues for certain businesses, enhanced reporting on a company's natural capital dependencies and impacts, risks and opportunities, would aid investors' understanding. In our view, the final recommendations of the TNFD may prove useful to some companies as they build or improve their reporting over time. We also encourage companies to consider the disclosure metrics suggested in the TNFD final recommendations where relevant to their business model or the location they operate in, and where possible.[13] We recognize that some companies may report using different standards, which may be required by regulation. In addition, some industry groups have developed their own nature-related disclosure standards, which may be useful for certain sectors.

When we engage with companies on natural capital, we may discuss the following, as appropriate:

- The natural capital-related risks, opportunities, impacts, and dependencies that management has identified as financially material to the company's business model, and how these have been evaluated in anticipation of increasing levels of stress on essential natural capital.
- The board's role in overseeing management's approach to material natural capital-related risks and opportunities.
- Whether and how the company sets short-, medium-, and long-term targets for managing material natural capital-related factors and the metrics used, how the company monitors progress against stated goals, and how these efforts might contribute to process and resource efficiencies.
- Whether the company has corporate policies or codes of conduct addressing natural capital practices, including whistleblower protections, and mechanisms to oversee compliance and remedy breaches.
- The company's supply chain due diligence processes, including how the company is working with key stakeholders or participating in industry-specific initiatives, and how the company identifies and protects against adverse impacts on nature across the supply chain.
- Any material investments in strategic initiatives or research and development to enhance products and/or operations to reduce natural capital dependencies and impacts, including contributions to programs that protect natural capital and/or participation, as appropriate, in industry collaborations aligned with addressing pervasive issues.
- Any efforts to engage with local communities directly impacted by company operations and use of natural capital.
- Any independent third-party assessments of the data and/or approach taken to manage natural capital-related risks including the benchmarking of policies, practices, and performance.

Endnotes

1. This commentary should be read in conjunction with BIS' Global Principles and regional voting guidelines. Other materials on the BIS website might also provide useful context.
2. See BloombergNEF, "When the Bee Stings Counting the Cost of Nature-Related Risks", December 9, 2023.
3. Research published in April 2023 estimated that 55% of the world's GDP is exposed to material nature risk. Source: PwC. "PwC boosts global nature and biodiversity capabilities with new Centre for Nature Positive Business, as new research finds 55% of the world's GDP - equivalent to $58 trillion - is exposed to material nature risk without immediate action." April 2023.
4. United Nations Environment Program, UN Biodiversity Conference (COP 15), December 2022.
5. For example, the 2023 EU Nature Restoration Law and the EU's regulation on Deforestation-free products.
6. For example: World Bank, "Water in Agriculture", last updated on October 5, 2022.
7. The Convention for Biological Diversity (CBD) defines biodiversity as the variability among living organisms from all sources including, inter alia, terrestrial, marine, and other aquatic ecosystems, and the ecological complexes of which they are part; this includes diversity within species, between species, and of ecosystems.
8. Nature-based solutions are commonly defined as conservation, restoration, and improved land management practices that increase carbon storage and/or avoid greenhouse gas emissions across global forests, wetlands, grasslands, and agricultural lands.
9. University of Cambridge, "Dasgupta Review: Nature's value must be at the heart of economics", February 2021.
10. World Bank Group, "The Economic Case for Nature", 2021.
11. For instance, the 2023 EU Nature Restoration Law.
12. The TNFD released its final recommendations in September 2023.
13. We also expect more jurisdictions to mandate nature-related disclosures in the future, as is already the case in the European Union with the entry into force of the EU Corporate Sustainability Reporting Directive (CSRD) in January 2023. Target 15 of the Global Biodiversity Framework (GBF) calls on parties of the Convention to take measures to encourage and enable business to monitor, assess and transparently disclose their risks, dependencies and impacts on biodiversity.

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