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COP-erating on Biodiversity Loss ESG Now Podcast.

December 16, 2022

Mike Disabato: What's up everyone? And welcome to the weekly edition of ESG Now, where we cover how the environment, our society and corporate governance affects and are affected by our economy. I'm your host Mike Disabato, and this week in honor of COP15 that's happening in Montreal, we are going to discuss the market's embrace of biodiversity. Thanks as always for joining us, stay tuned.

There's a new hot topic on the minds of ESG-focused folks. It used to be that most questions were focused on climate change, how emissions could be lowered, the progress of clean tech, issues of climate adaptation, questions around what a warmer planet would do to our economic systems and how to adapt to that future will prevent it. The intention to climate change got so strong that we actually split out climate from our ESG research, which I know is quite wonky, but it's a good example of climate strength in the ESG space. But as the understanding of how our natural systems impact investment priorities get more sophisticated, so too do the topics of interest.

And one topic that's begun to move up the hierarchal pyramid is biological diversity or biodiversity. A functioning and diverse biome underpins every part of our lives. We depend on it for food, medicine, energy, clean air and water, security from natural disasters, economic prosperity. And what you'll notice about that list is it encompasses almost too much. In fact, it almost isn't a list at all, it's just everything out there. So how can an investment community tackle a topic that encompasses everything? That is what we're going to answer in this episode today. And to help me with that, I called up my colleague Arne Klug who covers biodiversity issues for us.

And before we got into the analytical nuts and bolts, what I wanted to understand first was why climate change has been the more discussed topic in the ESG space, and why has it taken a bit longer for the investment community to discuss biodiversity with the same vim and vigor as they have climate change?

Arne Klug: Biodiversity is a very complex topic, right? For example, we don't have biodiversity budget similar to a carbon budget, where having a carbon budget is something you can calculate, you can come up with, right? You can calculate to what extent a company is at risk of meeting, overshooting, undershooting this target. This is not the case for biodiversity. So I guess it's a bit natural that maybe investors and regulators focus on the easier, so to say issues, or at least at the issues and whereas it's easier to assess performance, to assess track record, and earth thrive compared to biodiversity.

Mike Disabato: Biodiversity and climate risk, both important for the survival of our natural world, but one is easier to calculate. Climate can sort of be boiled down to emissions or a company's relationship with greenhouse gases, whether that be favorable or not. But biodiversity is a sprawling beast that touches on all of our natural systems. Biodiversity is a variety of life on the planet. It's plants, it's invertebrates, it's ocean species, it's losses from all sides.

It can be from clear cutting forests for more pastureland or for growing commodities like palm oil and soybeans, or it can be from over fishing or habitat encroachment by cities and towns. But biodiversity loss is as critical as climate change. It threatens humanities food systems and water supplies. And a report by the World Economic Forum found that 44 trillion US dollars of economic value generation is "moderately or highly dependent on nature and its services and is therefore exposed to nature loss." To put that into perspective, global GDP for 2020 was around 85 billion US dollars according to the IMF. So if we want to put a price tag on biodiversity loss or what might happen if our biome is just completely destroyed, that would create destruction to half of our global economic output. So climate change is this nearer threat to our system, but biodiversity loss might be the more dire in the long term.

Arne Klug: So we don't have a global budget to save for this, right? How much biodiversity could be lost? How many species might be lost until really face existential threats to our economy, right? That's something we can't really know because there's so much interconnection. It's such a complex topic really to see. It's hard to say when certain elements are removed, when certain species are extinct what might be the total impact of this kind of loss.

Mike Disabato: But this issue is no longer going unannounced in the financial, regulatory and investment communities. There are a lot of new financial standards and regulations that came into effect this year or were maybe announced this year. For example, the EU disagree to ban the sale of products if they were made or created using land that was deforested after December 31st, 2019. Of course, by the EU, I mean the European Union, if you're unaware.

There's a new standardization of reporting on biodiversity climate related risks that's called the task force on Nature Related Financial Disclosures or TNFD, which is similar to the task force on climate related disclosures or TCFD. And the ISSB or the International Sustainability Standards Board, that is a standards board that sets ESG reporting, disclosures and protocols announced Wednesday, December 14th that ISSB was going to include biodiversity in its standard setting recommendations. And that's quite a big deal in the sustainable finance industry.

There is more, and what we want to do now, because of this kind of regulatory and investor push, is we're going to slowly start building out at MSCI some of our biodiversity factors. And what we started with this week was releasing ones that are important but relatively easy to measure. One factor can identify companies that have physical assets located in areas of healthy forests, species rich areas, or other places of high biodiversity significance. And then another factor that we're looking at can pinpoint companies that are either directly or indirectly contributing to deforestation, which I think that point could use some defining.

Arne Klug: And if you say direct contribution, think of a goldmine operator in the tropics or a company producing palm oil in Indonesia or having a cattle ranch in Brazil. Indirect contribution focuses on the use of commodities that drive deforestation, palm oil, soy, beef, timber.

Mike Disabato: We looked at those companies and found out of the near 3000 companies in our global universe, 140 had a potential direct contribution to deforestation and 283 operated in areas of high biodiversity significance. Food product companies were by and large the highest contributor to deforestation or operating in biologically sensitive areas.

Arne Klug: At the same time, we have seen that many companies do not have really robust policies and programs in place to manage forest loss, which can be risky, of course.

Mike Disabato: Basically, they're flying blind. A company might not even know they are exposed to deforestation risks until they are pinged for it by us or an NGO or someone else watching the area. For example, while 94% of food producers and 86% of food retailers were flagged by us for direct or indirect contribution to deforestation, we found that only 12% and 18% of them respectively had disclosed a policy. Lack of supply chain transparency is a common problem in our globalized world.

Arne Klug: Basically to trace where certain commodities or certain products were cultivated, right? If the soy was grown in the tropics or another region of the world, right? And for this, I think we need better supply chain monitoring because the risk are often the supply chain. That's really like a key thing we found out, and I think really makes sense to have really robust due diligence programs, supply chain monitoring programs and certification, and to ensure that the deforestation risks are minimized.

Mike Disabato: Palm oil is actually a really easy example. Palm oil is in everything. It's in Ritz Crackers, it's in shampoo, it's in chocolate, it's in baby formula. And most palm oil sustainability certifications are only down to the mill. The mill is a facility that produces and processes palm oil from palm fruits that were themselves produced at a plantation. But many palm oil sustainability certifications don't extend to that guarantee that the palm plantations themselves aren't engaging in deforestation. And that's where the deforestation occurs, where you actually have the plants. So if a company that uses palm oil says, "Well, we have certification to the mill, but not to the plantation." Then that is a gap in their supply chain transparency.

And a lot of companies have made pledges to try and limit deforestation, but as Arne noted, that supply chain transparency can be a difficult problem to fix. So they might have these ideals, but the practices are not there, which is where some of these regulations that I mentioned have come under scrutiny. The EU, for example, they may set a regulation to limit deforestation, but do they have the tools to ensure that it is followed if there's less supply chain transparency out there than is needed? Do they have the partnerships on the ground that would help support local communities that rely on the commodities produced in biodiversity sensitive areas? These are some of the questions that are actually being addressed at COP15 or the 15th meeting of the conference of the parties to the UN Convention on Biological Diversity that is happening in Montreal, Canada at this moment.

Arne Klug: There are really high hopes that the COP15 conference will be what Paris was for climate change because the world basically missed the biodiversity goals for the last decade. And so these new proposed goals are quite ambitious. Some countries really want, for example, to suggest to protect 30% of global land and sea space on our planet. And I mean these goals could then be converted into national goals, leading to more regulatory pressure on companies and so on.

At the same time, we have to be realistic. I think if you look at climate change, setting goals is one thing, reaching these goals, it's a different thing, right? And so interesting to see what kind of commitments will be made at COP15 to meet these new biodiversity goals. Because what people are saying, it's really might be the last chance to really prevent a major loss, maybe the kind of mass extinction which is ongoing caused by humankind. So I think really high pressure, higher expectations to basically address the issue and let's see what will be the outcome. We will know next week how the framework will look like in the end.

Mike Disabato: We actually have some people on the ground at COP15, and they are encouraged by what they're seeing. And I know these conferences sometimes feel like a frustrating dance that ends up just making everyone dizzy and one leaves feeling a bit disappointed. But COP15 is trying to set out a pretty radical set of priorities for countries to adhere to. Conserving 30% of the world by 2030, having better communication and cooperation with Indigenous communities that are some of our world's best forest protectors, and figuring out how developed countries, who have largely already cut down their forests can financially support developing countries to keep that biodiversity intact, since developing countries is where a majority of biodiversity is left in our world.

And there's a real push to get countries to up their financial pledges for environmental conservation. Such commitments could spur more alignment of investment portfolios with global biodiversity goals and also add pressure on companies to improve the sustainability of their supply chains. And to do that, as what Arne mentioned, the best place to start might be using geospatial mapping and understanding where the deforestation risks are for companies and where those risks may lie.

And that's it for the week. I wanted to thank Arne so much for discussing the news with an ESG twist, and I wanted to thank you for listening. This is our last episode of the year. It's been a pleasure. We'll be back in 2023 with more ESG takes and weekly updates and all that that you enjoy. If you like what you heard, don't forget to subscribe or review us or do whatever you need to do to get our podcast up on the streams. That's important. We like that and we appreciate you doing that. I'll talk to you in 2023, and thanks for everything.

Speaker 3:

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