

## Natural Capital Declaration Pilot Project 1 (Summary)

# Understanding natural capital risks for financial institutions and embedding them in credit risk assessment

This flagship project aims to provide NCD signatories with the business case, approaches, and tools to integrate natural capital into their operations from the investment risk perspective, thereby strengthening financial health of their portfolios while contributing to the broader agenda of sustainability and responsibility in the financial sector.

### Project Objectives

- a Develop evidence-supported business case for natural capital as a material risk for financial institutions.
- b Identify approaches and methodologies for evaluating natural capital risks across the portfolios of financial institutions.
- c Develop approaches to embed natural capital considerations into credit risk assessment.

### Project Structure

The project consists of two inter-connected phases that support the objectives of NCD Working Groups 1 and 2 (see graphics, next page).

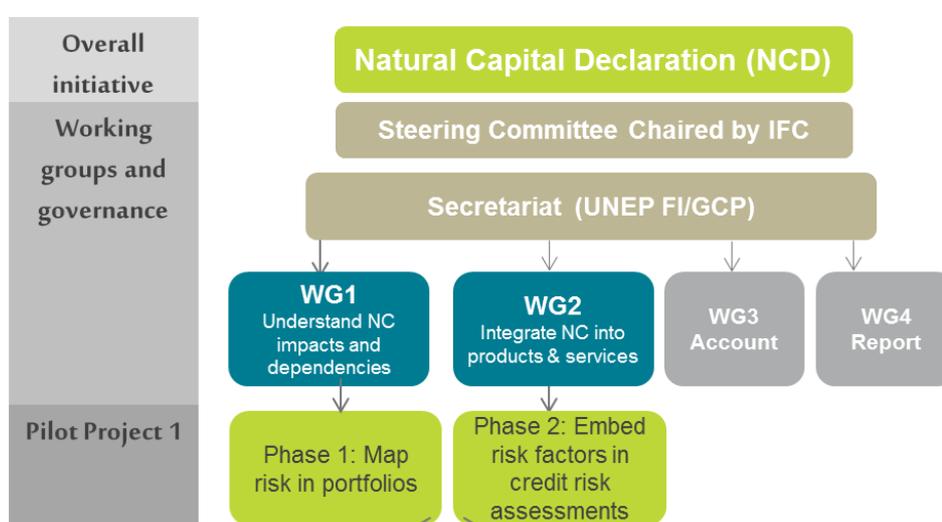
**Phase 1** will develop and test a methodology for mapping of risks associated with natural capital impacts and dependencies across FIs' portfolios. This phase is under NCD Working Group 1 chaired by **Rabobank**.

**Phase 2** will develop methodology and guidance to embed natural capital considerations into credit risk assessment. This phase is under NCD Working Group 2 chaired by **Banorte**.

Under each phase, two work streams (banks and investors) will ensure customized approaches for different asset classes.

## Core Outcomes

- Phase 1** Financial institutions are more aware of the materiality of natural capital risks they are or may be exposed to in their loans and investments – as a result of natural capital impacts and dependencies of their clients/portfolio companies – and have adequate tools to understand and assess these risks.
- Phase 2** Financial institutions understand how key natural capital performance indicators translate into credit risk; Financial institutions have access to approaches and methodologies to embed natural capital parameters into credit risk, as well as to create risk-adjusted premiums (performance-based cost of capital for investees).



## Governance and Management

**IFC** is the lead signatory on the overall project and work stream 1 (banking) and NCD Secretariat will play an active role in project management, consolidation of project results, publishing and disseminating the outcomes. Third-party service providers will be engaged at various stages to help deliver concrete outputs. Working Group chairs and project managers will help facilitate collaboration and coordination, and the NCD Advisory Network will provide independent technical guidance, inputs, and feedback on project outputs.

## Project Partners

To date, the following NCD signatories have joined the project as active participants:

Work stream 1 (Banking): **IFC** (work stream lead and overall pilot project lead), Banorte, National Australia Bank, Unicredit

Work stream 2 (Investing): Calvert, CDC, Pax World

Other NCD signatories are welcome to join the project.

## Expected Inputs from Participating NCD Signatories

Financial institutions participating in this project will have a unique opportunity to lead innovation in what can help transform the way the financial sector assesses and manages environmental risks and makes investment decisions. The participating signatories will actively collaborate by providing inputs and feedback. This includes collaboration to develop methodology(ies)/framework/guidance and testing them in their own operations. They will also participate in selecting service providers tasked with producing key project deliverables. The institutions shall communicate outputs internally and engage relevant experts, as well as share aggregated results and learning from methodology testing with other participants and, as appropriate, publicly, to enable global knowledge creation. To the extent possible, participating institutions will strive to provide financial contributions to the project, which would be supplemented by funds from other sources.

### What is natural capital and why is it important?

Natural capital is the Earth's living and non-living natural assets such as soil, air, water, flora and fauna. Maintaining the stock of natural capital in the long term is essential to sustaining the flow of goods and services valuable to our societies and economies. In order to do that, governments and companies need to develop models that clearly show what value nature underpins, how it supports their economic and financial well-being and how they will be impacted if that value deteriorates and is eroded over time. Global attention to natural capital has increased in connection with the push for the "green economy" and growing environmental pressures.

Governments are applying environmental economics to include the value of nature in a country's wealth along with traditional macroeconomic measures, such as GDP. In the private sector, there is a growing consensus that value of companies will increasingly factor in their ability to sustain themselves and their supply chains in the long term given growing natural resource constraints. Therefore, many companies are also working to better understand, manage, and value their impacts and dependencies on natural capital.

### Challenges and opportunities for the financial sector

Financial institutions are yet to systematically evaluate differences in how companies are positioned within their sectors for changing operating and supply chain conditions. For the financial sector, incorporating natural capital considerations into operations means a breakthrough innovation in risk management. As natural capital constraints continue to grow across sectors, so will associated credit and investment risks. At present, however, there are limited approaches for financial institutions to assess and quantify the natural capital risks they face in their portfolios and factor them into creditworthiness analysis of loans, investments and insurance products. On the opportunity side, supporting smart use of natural capital by investee companies offers financing institutions a new sustainable investment stream and more resilient risk return profiles. Financial institutions that pioneer such approaches will be able to reduce risk and better adapt their business models in the green economy.

**The Natural Capital Declaration** is the unique collaborative initiative that brings together financial institutions across commercial and development banks, asset owners and fund managers, as well as insurers worldwide to tackle these issues, collaborate, and innovate.

## Project Budget and Timeline

The project is expected to be implemented over a period of 21–22 months with an estimated budget range of \$800,000–\$1,130,000. Detailed budget estimates are available in the Pilot Project Work Program document.

## Further Information

A detailed Work Program for the pilot project has been developed in consultation with several NCD signatories, supporters, and other experts. The Steering Committee approved the project for implementation in December 2013.

## Contacts

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## About the Natural Capital Declaration

The NCD is a financial institution-led and CEO-endorsed initiative to integrate natural capital considerations into financial products and services, and to work towards their inclusion in financial accounting, disclosure and reporting.

The NCD has been convened by the UNEP Finance Initiative and the Global Canopy Programme that together form the NCD Secretariat. At this time, the NCD has been signed by 45 financial institutions at the CEO level and by 34 supporting (non-financial) organizations.

One of NCD's key goals is to deliver robust, tangible, and practical solutions for the financial sector to manage risks and seize financing opportunities related to natural capital. This is to be achieved through four NCD Working Groups – and associated Pilot Projects – focusing on different aspects of how the financial sector can incorporate natural capital considerations in its core operations and thus play a greater role in the green economy. [www.naturalcapitaldeclaration.org](http://www.naturalcapitaldeclaration.org)

## About IFC

IFC, a member of the World Bank Group, is the largest global development institution focused exclusively on the private sector. We help developing countries achieve sustainable growth by financing investment, mobilizing capital in international financial markets, and providing advisory services to businesses and governments. Environmental and social sustainability is at the heart of IFC's business model. IFC's Performance Standards on Environmental and Social Sustainability also serve as the basis for the Equator Principles. [www.ifc.org](http://www.ifc.org)