ROBECO
The Investment Engineers

WHITE PAPER

Navigating the biodiversity landscape

Hunting for decision-useful data

Biodiversity increasingly recognized as material for investors

There is no denying that biodiversity is one of the most important topics for investors today. Almost half our global economy is dependent on nature, but we are depleting it faster than its ability to replenish. Research by the Network for Greening the Financial System (NGFS) and the Dutch National Bank (DNB) suggests that biodiversity loss poses a systemic risk to the financial system and the economy.

Dependencies: How companies rely on biodiversity and the services it provides. Examples include raw materials, water supply, pollination, carbon storage and flood management to name a few.

Impacts: How companies affect biodiversity. Their activities change the quality and quantity of nature through the five drivers of biodiversity loss as defined by the Intergovernmental Science-Policy Platform on Biodiversity and Ecosystem Services (IPBES). These are land and sea use change, resource exploitation, invasive species, pollution, and climate change.

Physical risk: The financial risk as a result of the degradation of these ecosystem services.

Transition risk: The financial risk that results from the misalignment of company action with the increased expectations of regulators, consumers, and investors as regards reducing impact on nature and restoring it.

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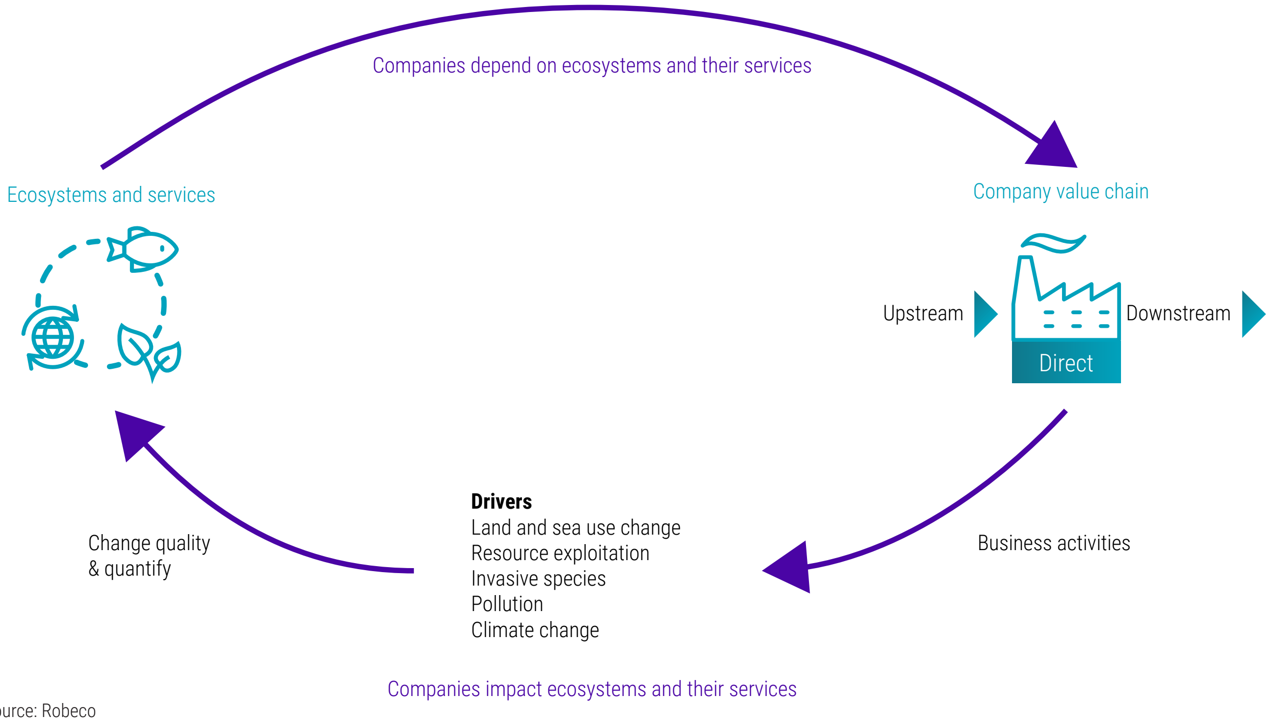
Figure 1 – Relationship between company impacts and dependency with biodiversity



Source: Robeco

Our clients are increasingly recognizing this systemic risk, and nature has accordingly begun to rise higher on their agendas. The results of our 2023 annual Climate Survey show that while biodiversity is a high priority among clients, they struggle with to a lack of suitable data and in-house subject matter expertise.

Addressing biodiversity-related impacts and dependencies is more complex than many other sustainability topics

Biodiversity loss is a global issue, albeit with highly localized impacts. Nature encompasses species, ecosystems and ecosystem services. Each of these come with different measurements that we cannot easily aggregate into a single number. We have to accept that we will not have a single measure for biodiversity without making trade-offs and, consequently, different tools will continue to develop to support our understanding of the different aspects of nature for the following reasons:

1. Unlike climate change where we have a single metric (greenhouse gas emissions) and a framework with which to calculate it (The Greenhouse Gas Protocol), we will not have a globally accepted methodology to calculate biodiversity loss and impacts.
2. Biodiversity footprint calculations aim to bring together disparate impacts into one number, but they pose their own challenges, which we will discuss further in this paper.
3. Policy and regulations will not rely on a single measure of biodiversity, and consequently, neither will investments.

We warmly welcome the Taskforce for Nature-related Financial Disclosures (TNFD) recommendations introduced in 2023 that outline the future of reporting for corporates, laying out what information we can expect, and how investors should use this information to inform our own strategy and actions. It will, however, take time to realise a level of disclosure that sufficient to steer investment decisions. There has been a recent explosion in biodiversity data, with the TNFD data catalogue currently containing over 100 different tools. It would seem on that basis that there is no shortage of resources.

In reality, the path forward is less clear. These tools all serve a purpose, whether to understand the state of nature at large landscape levels, or to support detailed on-the-ground assessments. How do asset managers choose which tools to use? The answer depends on the question.

We conducted an assessment of the landscape of available data to so that we can take meaningful action while company disclosure catches up. This paper presents our findings and proposes a future direction of travel. This assessment only focuses on corporate exposure. It does not cover sovereign debt, where we use different datasets.

Our data needs are defined by the questions we want to address. What are those questions?

As an investment manager focused on addressing the need for biodiversity solutions, we have three strategic objectives that require more data for us to be able to address. We want to:

1) Assess our risk exposure:
   a. Which high impact and dependency sectors are we exposed to at a portfolio level and as a firm? What are the financial risks?
2) Inform our investment decisions:
   a. How do we differentiate leaders from laggards? Which companies are transitioning towards no net loss of biodiversity?
   b. What are the material (financial) impacts and dependencies for a company? How are they responding and adapting their business model?
3) Set targets to align our investments with the global goal of no nature loss by 2030, and monitor progress.

We want to fulfil these aims with approaches that are grounded in science and connected to the drivers of biodiversity loss. We need tools that cover as much of our investment universe as possible, namely global equity and debt exposure to corporates. On this basis, we filtered out many of the tools and identified about 20 data providers for an initial assessment. From this shorter list, we drilled down to the most promising candidates for in-depth qualitative interrogations of their methodologies, and quantitative assessments of their data.

During our research, we grouped investment-relevant content into two buckets: sector level assessments, and issuer-level metrics. All remain at an early stage relative to other sustainability-related information available today. Nonetheless, used in the right way, they can add value to the investment process. Moreover, we anticipate that the market will grow and mature significantly in the coming years.

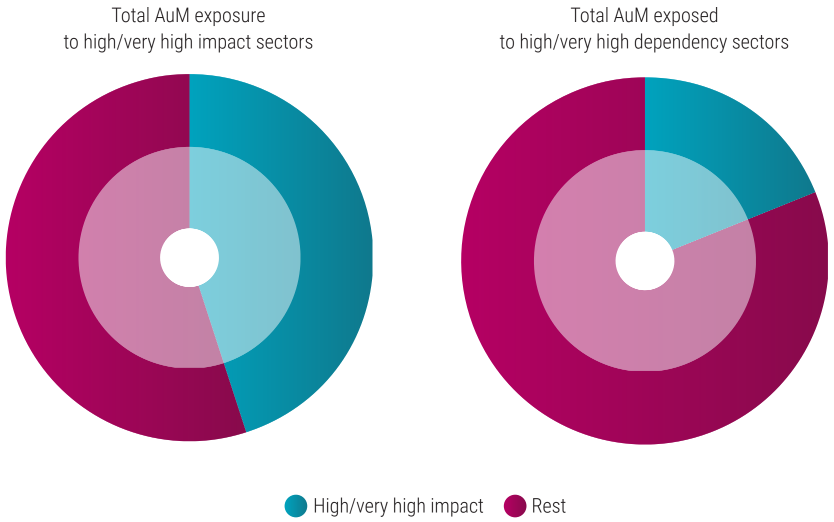
Qualitative approaches to sector impacts and dependencies

Prior to the recent introduction of quantitative metrics which are discussed in more detail below, investors relied on qualitative approaches to understand the impacts and dependencies on nature. There are two major frameworks that have served to underpin this – ENCORE (Exploring natural capital opportunities, risks and exposure) and the Science-Based Targets for Nature (SBTN)'s sectoral materiality tool. These top-down models provide a qualitative assessment based on sector-specific production processes.

Each model takes different assumptions into account. It is important to be aware, for instance, that ENCORE only includes direct processes, while SBTN provides more nuance by incorporating upstream impacts too. ENCORE and SBTN are useful tools to identify exposure to high impacts and dependencies, highighting which sectors they occur in, and what the main impacts and dependencies are. Both organizations are working to further enhance these models. For instance, ENCORE plans to incorporate upstream impacts and dependencies into the next generation of its model.

At Robeco, we conducted an analysis to assess our exposure to sectors with high or very high impacts and dependencies. We found that almost half our assets under management are in sectors with high or very high impacts, and one-fifth are in sectors with high or very dependencies on at least one ecosystem service. The analysis confirmed our hypothesis that we have an exposure to such sectors, and that biodiversity is indeed a material topic for Robeco.

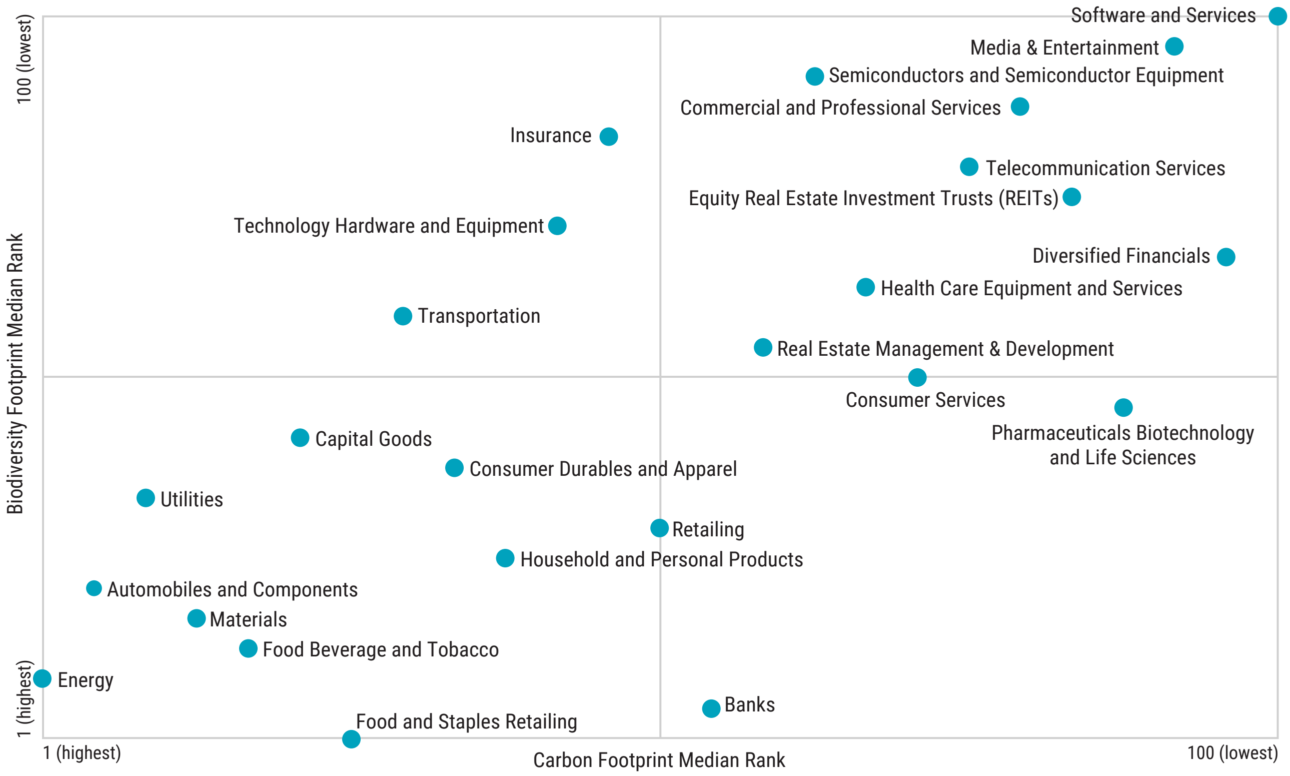
Charts – Robeco's total AUM exposure to high / very high impact and dependency sectors



AuM on 29.12.2023
Source: Robeco, Iceberg Data Lab, ENCORE

Furthermore, we compared the biodiversity and carbon footprints to determine whether there was any relationship at a GICS industry group level. As the following chart shows, there is a strong correlation between the rank of the footprints. The industry groups that have a more pronounced negative impact on nature tend to have also have a higher carbon footprint. For example, energy ranks high for both carbon and biodiversity footprints, and conversely, software and services ranks low for both.

Chart – Biodiversity footprint median rank vs carbon footprint median rank



Source: Robeco

Biodiversity footprint: a quantitative approach to sector impact estimation

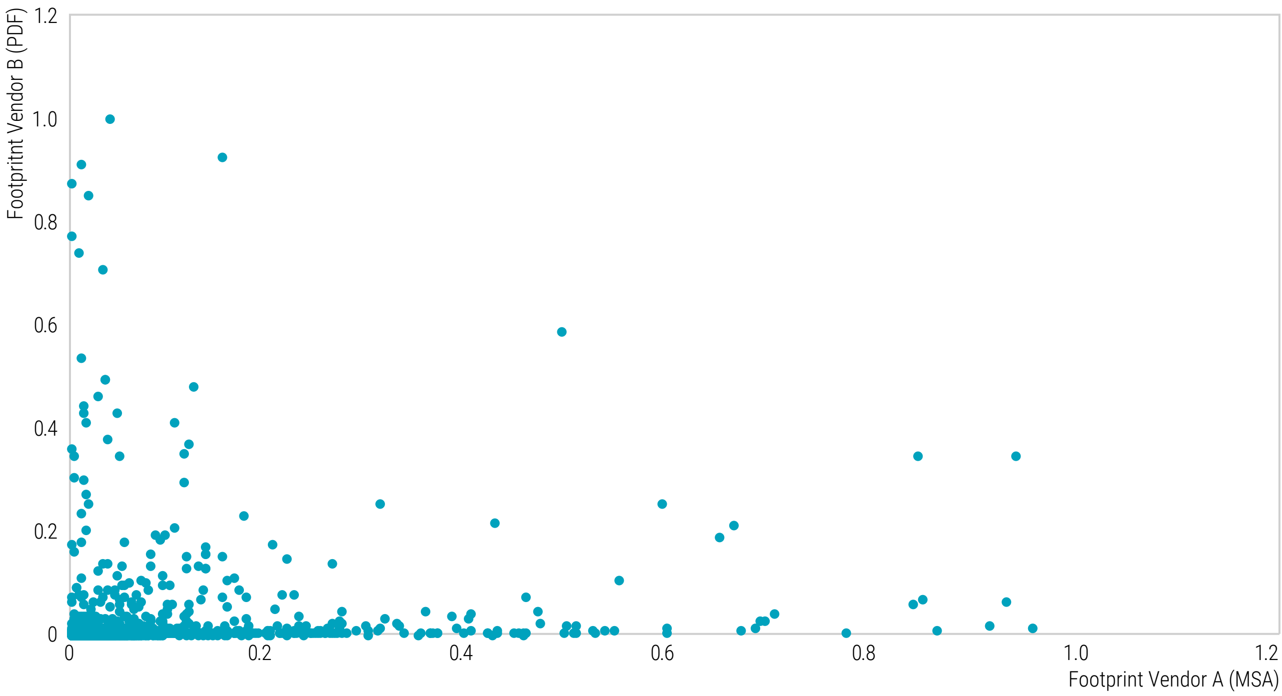
Several providers have started to offer quantitative biodiversity footprint solutions in recent years. This is an attempt to consolidate the impact of multiple environmental pressures across disparate sectors into a single, comparable metric. The appeal of a single number is that it distils all the complexities of biodiversity, making it possible to compare multiple companies and aggregate to portfolio-level figures.

It is important, however, to recognize that such footprints are estimated using generic top-down models. The two most commonly used metrics are potential disappeared fraction (PDF) and mean species abundance (MSA). Both capture the relative magnitude and direction of biodiversity loss. Biodiversity footprints can be estimated using different input/output databases, such as GTAP for bilateral trade patterns, production, consumption and the intermediate use of commodities and services, and EXIOBASE for estimating emissions and resource extractions by industry and country. These are then linked to environmental pressures models such as the Globio to calculate MSA, and ReCiPe to calculate PDF.

The result is a quantified biodiversity footprint per business activity. The impacts are attributed to individual companies based on their share of revenue from different business activities; it does not provide meaningful information as to how companies are managing those business activities, or the extent to which they are mitigating the impact of these business activities on nature. A recent publication from the TNFD and PBAF provides an overview of different footprinting approaches.

We tested various footprint providers to understand the relative pros and cons of the different approaches and implementations. Our findings show that the aggregate sector ranks based on GICS level 2 were highly correlated, but beyond that there is a great deal of discrepancy among providers, with relatively limited similarity at either issuer or sector-level. For instance, we found a correlation of -2.3% when comparing the MSA and PDF results for the members of the MSCI World from two different providers.

Chart – MSA vs PDF footprint comparison



Source: Robeco

By contrast, the sector median generally shows similar rankings between the two models as shown in the table below. For example, four of the sectors ranked highest by Vendor A are in the top six of Vendor B. Likewise, three of the bottom ranking sectors are the same for both vendors. The notable exception is banks, which moves from fifth most impactful according to Vendor A to least impactful according to Vendor B.

Table – Sector impact ranking comparison between MSA and PDF approaches

Vendor A (MSA)	Vendor B (PDF)
Food and Staples Retailing	Materials
Food, Beverage and Tobacco	Utilities
Energy	Energy
Materials	Food, Beverage and Tobacco
Banks	Transportation
Retailing	Food and Staples Retailing
Household and Personal Products	Automobiles and Components
Capital Goods	Consumer Services
Pharmaceuticals, Biotechnology and Life Sciences	Semiconductors and Semiconductor Equipment
Consumer Durables and Apparel	Capital Goods
Technology Hardware and Equipment	Technology Hardware and Equipment
Automobiles and Components	Real Estate
Consumer Services	Household and Personal Products
Utilities	Retailing
Semiconductors and Semiconductor Equipment	Real Estate Management and Development
Health Care Equipment and Services	Telecommunication Services
Transportation	Commercial and Professional Services
Diversified Financials	Consumer Durables and Apparel
Real Estate Management and Development	Pharmaceuticals, Biotechnology and Life Sciences
Real Estate	Health Care Equipment and Services
Commercial and Professional Services	Media and Entertainment
Telecommunication Services	Software and Services
Media and Entertainment	Insurance
Software and Services	Diversified Financials
Insurance	Banks

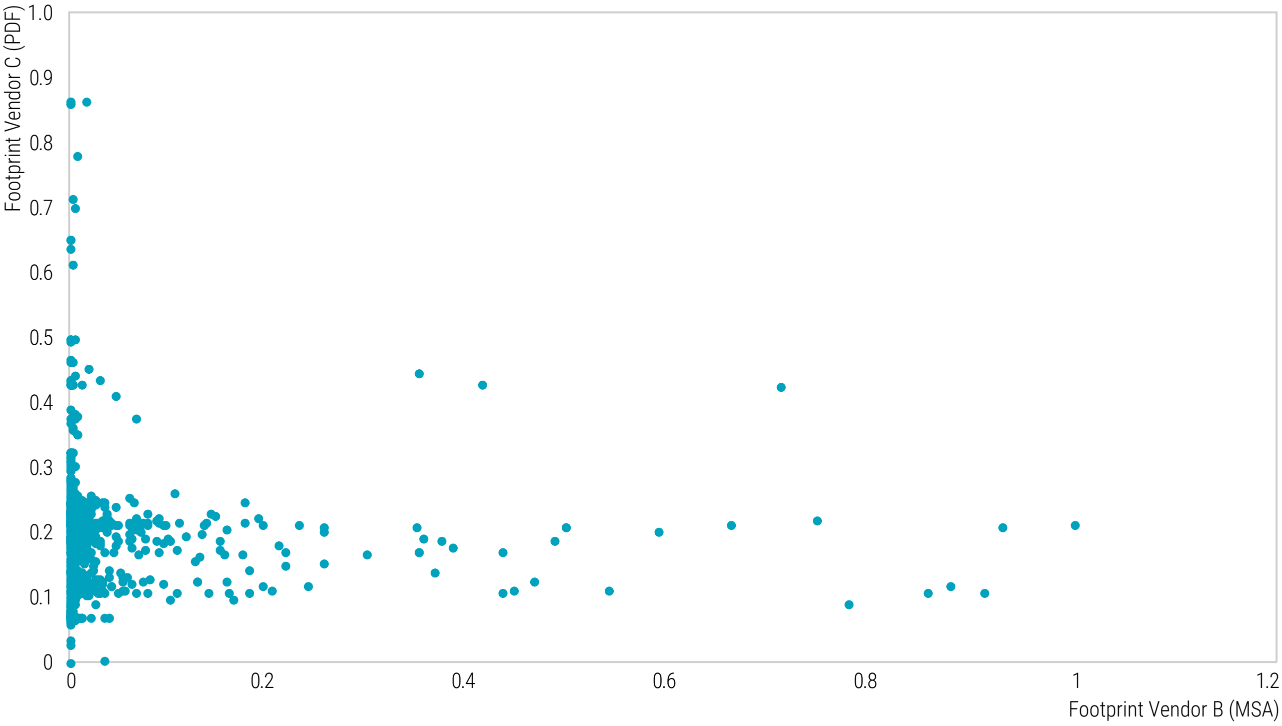
top 5 impact sectors, Vendor A

bottom 5 impact sectors, Vendor A

Source: Robeco

At first glance, one may conclude that the reason for the lack of correlation is due to different footprint methodologies. However, a comparison of two providers of PDF data across the same universe showed little to no similarity, despite being ostensibly the same metrics using the same underlying model, as shown in the chart below.

Chart – PDF vs PDF footprint comparison



Source: Robeco

Our main impression is that, as a model, the biodiversity footprint is highly dependent on the interpretation and implementation. It relies on the quality and structure of input data as well as a swathe of key assumptions, such as direct impacts versus value chain. It is important to highlight that we have found neither MSA nor PDF as per se being better than one another. Instead, they need to be understood and used as tools to achieve a specific purpose, knowing their underlying strengths and weaknesses. All footprint calculations are models based on different assumptions, which naturally lead to different results.

Our analysis found that below the GICS 2 industry group level, revenue was the main determinant of differentiation between companies. As a result, we believe the biodiversity footprint metric is not yet ready for mainstream use at an issuer level, as carbon is today. Data providers are working to improve the models and incorporate company-specific information where they can, though we are in the very early stages, given the level of corporate disclosures. For now, our approach is to use footprints in aggregate at the GICS 2 level.

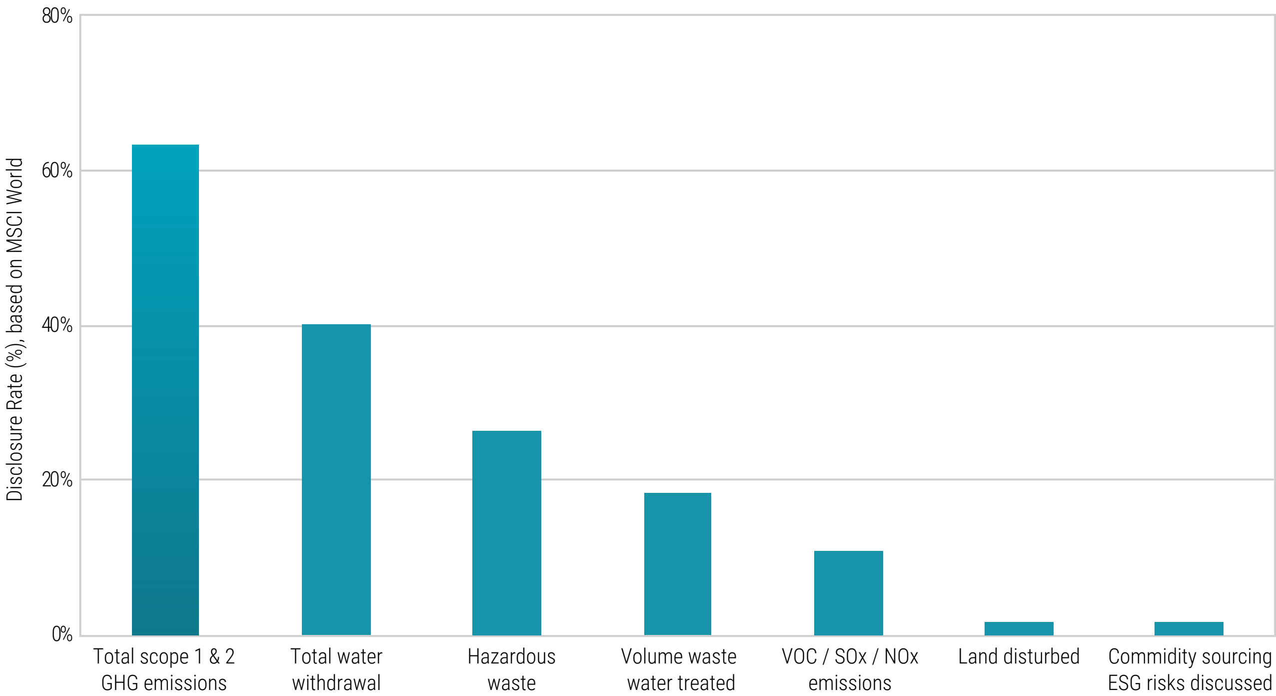
We are encouraged to see the possibility of a connection between biodiversity footprint in specific locations and company assets that will lead to the development of a tool that allows investors to understand the companies' proximity to highly intact ecosystems, as well as the scale of impact on these ecosystems over time.

Core issuer-level metrics

Companies report limited information on biodiversity-related metrics today. The TNFD, as well as other regulatory initiatives focused on corporate disclosure such as the Corporate Sustainability Reporting Directive (CSRD), will lead to more data being available for investor use.

The TNFD guidance recommends 14 core metrics that are generally applicable to all sectors. Our assessment found that overall coverage of the MSCI World is very low, though we do see greater data availability for some metrics based on industry materiality. The table below shows the disclosure rate for metrics where there is a reasonable amount of disclosure. It excludes three things: the extent of change in priority ecosystems; the amount of plastic obtained through mechanical and/or chemical recycling used in the manufacturing process; and the levels of drilling waste and hazardous spills, since the availability of this data is virtually zero.

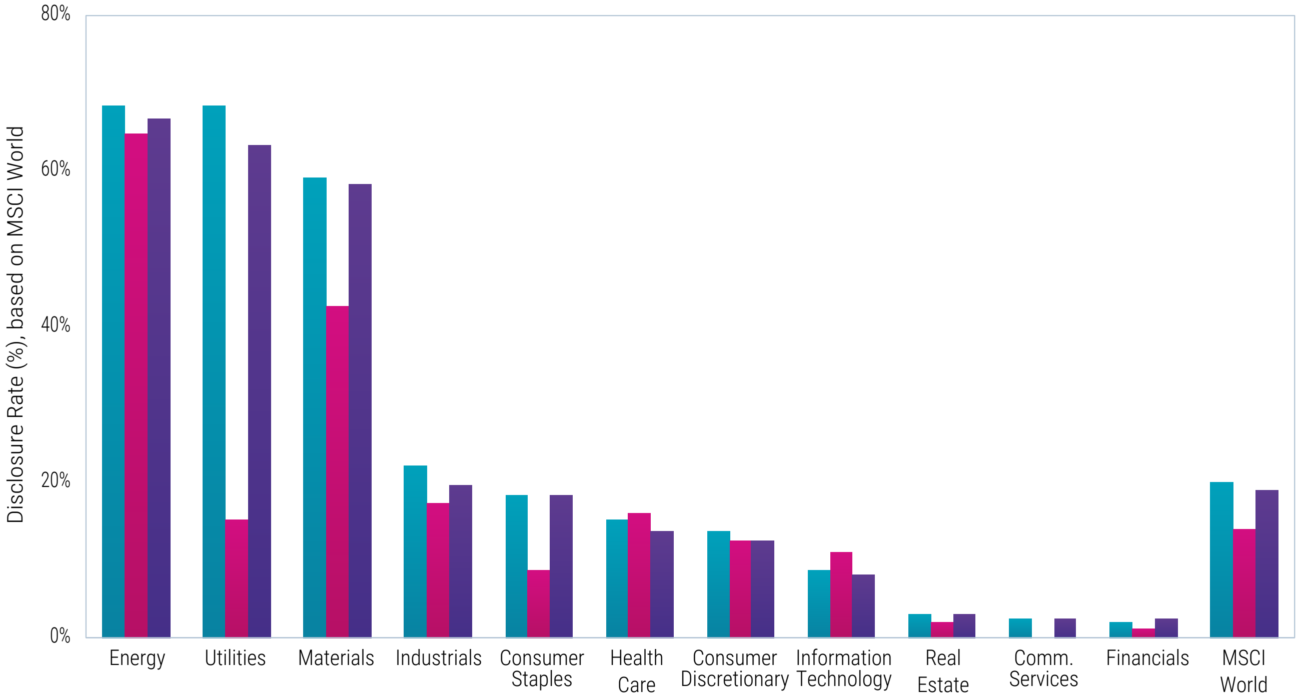
Chart – TNFD core metrics disclosure coverage of the MSCI World



Source: Robeco, Bloomberg

For example, as shown in the chart below, the disclosure rate for air emissions is generally higher for those industries with combustion activities, due to the fact that it is financially material.

Chart – TNFD air emissions core metrics disclosure coverage of the MSCI World



Source: Robeco, Bloomberg

The core metrics give an indication of the potential exposure that companies have. This allows for comparison among peers, but does not provide insight into how well companies are responding and managing their risks. The overall conclusion remains that we have decent data coverage on climate and pollution metrics but not yet on the other drivers of biodiversity loss.

Conclusion

We're not done hunting. The biodiversity data landscape is overwhelming and it requires continued effort to navigate it properly. From our work so far, we have a number of useful insights for this quest:

Careful use of the data to reach correct interpretations

Unliked carbon, biodiversity cannot be easily understood or summarised into a single number. There are useful datasets and models to understand impact and dependencies at the sector level. They help to define priorities, for example in a sector portfolio heatmap, but they are not appropriate for steering investment decisions at issuer-level.

To steer investments, we need to combine biodiversity data sources with other issuer level data

Footprint data is useful to identify priority sectors and, within each sector, which drivers of biodiversity loss are most material. We can then combine these insights with other issuer-level data to assess how companies contribute to the key drivers of biodiversity loss in their industry, and how well they mitigate their contribution. For example, in the pulp and paper sector, land use change is the key driver of biodiversity loss, and we can approximate mitigation by companies by measuring their share of revenues from recycled sources and their share of materials extracted from certified sustainable sources. Likewise, biodiversity loss from the chemicals sector is driven by pollution, water consumption and land use change, which we can approximate by measuring waste reduction, use of recycled materials and share of revenue from substances of high concern. We take this hybrid approach in our biodiversity investment framework to identify leaders from laggards.

Less is more

With a focus on a limited number of sectors, where data coverage is generally better, investors can address a large part of their biodiversity footprint, and also leverage their existing work in the same sectors around climate change. Given the nascent state of the data today, we determined that our best approach to enhancing our processes would be to focus on the most important sectors in terms of nature. We combined the high impact sectors based on the TNFD and Nature Action 100 with those sectors where we have highest risk exposure based on assets under management. This led to us defining chemicals, food, metals and mining and textiles and apparel as the priorities for our ongoing investigation into better data. This includes, for instance, an inquiry into how might we use geospatial data to inform the localised impact of mining companies within our portfolios.

The goal of this paper has been to show that the biodiversity data landscape is a challenging one, though with a promising future. One thing is for sure: the complexity and volume of biodiversity data will only continue to grow. As more investors explore the market, we expect the development of off-the-shelf solutions that allow for steering investments. That is not the case today. Having said that, we firmly believe that there is enough useful data to guide investment decisions, stewardship activities and development of investment policies.

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Additional information for investors with residence or seat in Singapore
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Additional information for investors with residence or seat in Spain
Robeco Institutional Asset Management B.V., Sucursal en España with identification number W0032687F and having its registered office in Madrid at Calle Serrano 47-14º, is registered with the Spanish Commercial Registry in Madrid, in volume 19.957, page 190, section 8, sheet M-351927 and with the National Securities Market Commission (CNMV) in the Official Register of branches of European investment services companies, under number 24. The investment funds or SICAV mentioned in this document are regulated by the corresponding authorities of their country of origin and are registered in the Special Registry of the CNMV of Foreign Collective Investment Institutions marketed in Spain.

Additional information for investors with residence or seat in South Africa
Robeco Institutional Asset Management B.V. is registered and regulated by the Financial Sector Conduct Authority in South Africa.