

P4P Podcast Series 1 Episode 13

Charlotte Moore: Hi, welcome to the latest edition of the Pensions for Purpose Podcast.

I'm Charlotte Moore and I'm your host. I'm delighted to welcome Richard Giles, Senior Director of Pensions for Purpose back to the podcast. Hello, Richard.

Richard Giles: Hi Charlotte! It's great to be with you again!

Charlotte Moore: And we're both delighted to welcome Ingrid Kukuljan, Head of Impact and Sustainable Investing at Federated Hermes to the show. Ingrid, I think I have just mangled your surname terribly.

Ingrid Kukuljan: Morning Charlotte, it's fine, I'm used to it.

Charlotte Moore: Could you tell me how we are supposed to pronounce it?

Ingrid Kukuljan: Kukuljan.

Charlotte Moore: Kukuljan, and is it a Finnish surname? Am I guessing correctly there?

Ingrid Kukuljan: Croatian.

Charlotte Moore: Okay, sorry, completely wrong, but at least I was in Europe. Now that we've welcomed Ingrid and Richard to the show, we're going to be discussing nature and biodiversity.

Charlotte Moore: Ingrid, you're back from COP16, the nature focus summit. Can you tell us what were your key takeaways?

Ingrid Kukuljan: Sure, I'll start with the positives, and the most encouraging feature of COP16, which was the strong engagement from the private sector. There were more than 20,000 attendees from all around the world in the blue zone.

We also had the second ever finance day, where there was a significant increase in participation from the finance ministers and this is a great sign, because we need a whole government approach to resolve the issue of biodiversity loss. There was an increasing recognition of the climate and biodiversity nexus, and we also saw the creation of the Cali Fund, which was quite controversial. This is a fund where pharma, cosmetic and agri-businesses, amongst others, or any business that uses genetic resources will need to pay 1% of their profits or 0.1% of their revenues into this fund. 50% of the proceeds will go to indigenous people and local communities.

Lastly, to my delight, TNFD announced more than 500 signatories. That's an increase of 57% since the beginning of the year and this is a great outcome, especially if you consider that 129 of those signatories are financial institutions of which 25% are systemically important banks.

That was the positive side. On the less positive side, there was no agreement on a new framework for monitoring countries progress on delivery of NBSAPs. Those are the national biodiversity plans and

strategies, and there was a stalemate in setting up a new biodiversity fund.

Charlotte Moore: So some positives and some negatives. But do you feel that the positives outweigh the negatives?

Ingrid Kukuljan: Definitely.

Charlotte Moore: Isn't that nice to start our podcast?! With an uplifting part about sustainability and sustainable investing? We don't get a lot of good news these days. So you mentioned the number of signatories that were financial institutions, including systemic financial institutions. Can you talk to us a bit more about why investors should be putting nature and biodiversity at the top of their agenda?

Ingrid Kukuljan: Many reasons, I'll try to summarise it. The basic issue is biodiversity loss and nature degradation that are threatening the stability of global ecosystems and humanity and that has effects on our economies, on our financial systems and in terms of the systemic risk, it's in our opinion, one of the biggest systemic risks that we are facing today.

Ingrid Kukuljan: If you look what has happened since 1970s, so not so long ago, the global wildlife populations have plummeted by 69% on average. Latin America saw an astonishing decline of 94% in the period.

If you look at the ecosystem services, pollination, for instance, those are the basis of our economies and societies, and we depend on nature for everything, air, water, food, medicine and at the end of the day our livelihoods.

It's been estimated that 50% of the global GDP is highly or moderately highly dependent on nature. But the reality is that everyone and everything depends on it to varying degrees. Unfortunately, despite all of this benefit and dependencies, instead of appreciating and protecting nature, we have been relentlessly exploiting it. We have taken its permanence for granted, and we have forgotten this is just another resource which is becoming scarcer by the day.

Today the scientists will tell you that the extinction rate for some species is happening at 100 times faster than the natural evolution rates, which in some instances means that whereas it used to take a thousand years for species to become extinct, it's been reduced to 10 years and according to Professor Dasgupta, in order to maintain the current standard of living, we would need the equivalent of 1.6 degrees today already.

So honestly for investors this should be a main focus, because you really need to start looking at where your dependencies are and your impact on nature given the systemic risk that it poses.

Charlotte Moore: Ok, so whatever positive upbeat feeling I was feeling at the beginning has now been wiped away. The other interesting connection, I think, is the relationship between climate change and biodiversity that we also kind of fail to acknowledge, along with our dependence on natural systems for our wellbeing. Can you talk to us a bit more about that, why are they so interlinked and what should investors be thinking about?

Ingrid Kukuljan: Certainly, as I just mentioned, there is an increasing recognition around climate and biodiversity nexus, and they should not be viewed as two separate problems, which is still the case.

First of all, climate change is one of the five drivers of biodiversity loss. Almost 40% of climate mitigation and adaptation has to come from nature-based solutions. There are two things that need to happen if we are going to remain anywhere near one and a half degrees target.

The first one is that we must stop deforestation, 50% of all the habitable land is already used for agriculture globally and the majority of that is for animal grazing. Commercial agriculture drives 71% of tropical deforestation and emits almost six gigatons of CO2 per annum.

The second thing that needs to happen is we need to redesign our food systems. Lancet published a very interesting analysis where they call for a reduction of meat consumption by 50% to ensure a healthier population first and foremost, and to meet the one and a half degrees target. This is important because methane has a heating effect that is 80 times greater than CO2 and food production is responsible for most of it.

Going back to climate and the one and a half degree scenario, we should cut the methane emissions by 45% by 2030. However, our consumption patterns do not support this. So overall, our food systems account for more emissions than all of the transportation sector combined.

The connection between biodiversity and climate if you want to describe it in a nutshell, is that we are destroying our planet by repurposing forests to produce crops, nearly half of which are for livestock consumption, the same livestock which is filled with hormones, steroids, antibiotics. Everybody knows that industrial farming is a huge problem, which is bad for our health, and the worst of it is that majority of it ends as waste.

Charlotte Moore: Ok, and there is the very important point that you made that nature is going to help us tackle climate change.

Ingrid Kukuljan: Of course, yes.

Charlotte Moore: I don't think that's well known enough yet, that we can use natural systems to help to soak up carbon dioxide and to help us address climate change. It is sort of known, we all know that trees absorb carbon, etc, but there isn't enough emphasis put on that.

Could we maybe switch to Richard now?! Richard, how are you seeing this debate evolve amongst pension schemes? Is there a growing awareness of the importance of addressing the lack of biodiversity and protecting nature and its relationship to climate change, or are we still at the beginning of that journey?

Richard Giles: Yeah, it's pretty hard hitting what Ingrid was saying, so it's hard to kind of follow, but I think there is increasing recognition of the issue amongst trustees. If I put it into my words, some of which is similar to what Ingrid has said, maybe the conversation you'd hear around a trustee table.

I think recognition is a problem. In my lifetime, we've lost 70% of biodiversity and nature contributes. I think the figure I saw was

estimated to be 125 trillion pounds to the global economy through the services, from clean water pollination and climate regulation. So it's a problem and it is a big one. I think increasingly, pension trustees do see that.

I also think they do understand the interconnected nature with climate change and that biodiversity loss aggravates climate change and the other way around that climate change drives biodiversity loss and there's some pretty unpleasant feedback loops in all of that. So I think it's increasing understanding and also the co-benefits of addressing both of these things together.

So for example, mangrove restoration in Asia will absorb CO2 and protect coastlines from storm surges, and provide habitats for marine life, so it adds to climate resilience, but also strengthens the local economies as well. So I think these things are known, but it's still an emerging issue, and it's probably the trustees with more time and more expertise who are able to really get to grips with some of these issues.

Charlotte Moore: Yeah, I think we did a fairly good round up there of the main drivers of biodiversity loss, but is there anything that you want to add to that? And then we could move on to the risks and opportunities for investors, Ingrid?

Ingrid Kukuljan: I mean, the only thing that I would add is, and as Richard mentioned to date, we have only been focusing on climate change, and this has been underwhelming with targets pushed out to 2050 and with nature we don't have the luxury to wait until 2050.

Charlotte Moore: Yeah, so I think maybe we can then get into the risks for investors, and if there's opportunities Ingrid, and how do we make that an investable asset class when you were talking about restoration and reforestation and restoring mangrove swamps that doesn't fit into our classical mindset of investment in terms of returns. We can see the returns from developing a green technology. How do we figure that all into the way investors should be thinking about nature and biodiversity, as well as that kind of risk framework too?

Ingrid Kukuljan: Certainly, maybe I'll start with the risks and give you a couple of examples, but going back to the food systems and climate, perhaps the more data to emphasise where we are at and how critical the situation is. If you look at our world today, livestock accounts for 60% of the mammals, humans for 36 and wildlife for only four. The majority of the water is used for agriculture, and 50% of crops like soy are produced for livestock consumption. Those are huge risks, other examples are our food systems, and also the pricing and inflation that we've had.

If we talk about a staple like orange juice in Florida last year, the orange crop was the smallest in 90 years and this was driven by disease, freezing weather, and obviously natural disasters. I.e. the hurricanes. There was a 50% reduction versus 2022 and 93% decline from the peak output in 1998. What happened which is even more problematic, is the fruit is growing smaller than before. This is the trend that will continue, which means that you will need more oranges to produce the same litre of orange juice which means price inflation. This year in Brazil, which is the largest producer of oranges in the world had a problem with their crops, which means that the price of the orange concentrate doubled year on year.

So thinking about that in the full spectrum of food inflation and the pricing, also in terms of the monetary policy. In terms of investors, and corporates alike, you really need to start thinking about the nature related impacts and dependencies in a systematic way, what is your exposure? What do you need to be worried about? In terms of the companies, my impression is that they want to change their practices. We're seeing huge strides forward. They're looking how to incorporate biodiversity as a part of the risk management, and obviously TNFD has been a game changer in this respect.

In terms of the allocators and investors, if you don't start thinking about this, and it doesn't make part of your fiduciary duty, you might end up with stranded assets, suffer financial and reputational risks, and also be invested in suboptimal business models.

Charlotte Moore: Ok, well you've just explained to me why I couldn't buy any pink grapefruit this winter, now I know why there wasn't any in the supermarket shelves. That's a very compelling case you make there about Florida and Brazil and the oranges. Richard, I know there's been a recent report out by the PLSA on nature, what does that tell us?

Richard Giles: I think it's a really positive sign, actually, that the UK pensions industry is taking this issue seriously. So this week the PLSA have issued something to call a nature guide and the subheading for that is 'why biodiversity, loss matters to pension schemes and what to do about it.'

So just in that intention from the from the heading there. I think it's clear that the PLSA see this as an issue that pension trustees should be considering, and the bit that I like most about it was, it had some good examples of actions that trustees have taken and are taking.

There is three that I'll mention, which are; the first is training, and I think there is a massive need for training. So trustees are involved with training which may be on TNFD or integrating biodiversity into their investments and understanding the systemic importance of biodiversity. So that training is something that the PLSA comment on as good or best practice.

The second thing, which Ingrid mentioned is identifying the dependencies between the assets held in portfolios and the dependency on the ecosystem, and there's tools like Encore that are being used by the more forward-thinking pension schemes. The example quoted by the PLSA is Nest, who used the encore tool, and they found 31% of their assets were in high dependence on nature with water-related services being the most critical in their portfolio.

The third example which I like is capital allocation. So another example that they quote is the West Yorkshire Pension fund investing in natural flood management which is to reduce flood risk further downstream, so that is something I point pension trustees and advisers to. The PLSA guidance, which is just out this week. Pensions for Purpose did some work, which I quoted in the paper. George Dollner at the PLSA has done a great job in doing that. Hopefully, that's the start of accelerating pension schemes in the UK and thinking more about this issue.

Charlotte Moore: Thank you very much for that. So there is progress being made at the PLSA and this issue is making its way up the agenda. Ingrid, I think you explained the risks well, could we maybe switch to the opportunities. Are there opportunities within nature and biodiversity for investors and for large institutions, like pension schemes?

Ingrid Kukuljan: There are plenty of opportunities across the economy. First of all, I think the starting point should be to think that a business that incorporates nature risks. It's a more resilient business, and it's also exposed to substantial opportunities.

If you look at three sectors, such as infrastructure, energy and food, which are those that have high dependency in nature. It's been estimated that 10 trillion in business opportunities, can be generated just in these three sectors and they account for 80% of resources at risk of loss.

In terms of jobs, it's been estimated that nature-positive economy could create almost 400 million new jobs. There are plenty of investments to think about, and it's not about the birds and the bees, sustainable waste management, green roofs, carbon capture technologies, regenerative agriculture, environmental remediation, and going back to your initial question about opportunities around the asset classes. In the public markets, the investment opportunities from the point of view to find those companies that are really doing a great job. The companies that we call biodiversity champions in taking nature into account.

The second one is to engage with companies to change their practices. The reason why they need to do this is that they are really the main culprits to nature degradation do lie in the public markets. On the private side, the way that you should think about it is almost like infrastructure, like investments.

Charlotte Moore: Ok, that's interesting. Forestry is something that's talked about a lot within this realm. In fact, we had a very good podcast about that earlier on. There is a lot of attention there isn't there, I think people think about agriculture and forestry straight away when they're thinking about nature.

How do we balance the tensions with both those asset classes, as you mentioned with agriculture, you can create a lot of harm. You talked about regenerative agriculture and with forestry. You have to avoid monocultures, and that you're not actually just causing further loss of biodiversity as well. Is there a way that we should think about those natural investments in a way that is sustaining?

Ingrid Kukuljan: I think this comes down to the choice of your project operators, and who you invest in. There has been an emergence of new fund managers or existing fund managers entering the space, but what you should look for is operators that have been around for a long time, and have been doing this for a long time, and those for instance that are involved in regenerative agriculture will tell you that this is nothing new now that a fancy word is being applied to it.

Charlotte Moore: I know that you've also been involved in the creation of the global biodiversity credit market, Ingrid. Could you tell us a bit more about what helps to address the questions around risk return and

getting something out of this asset and moving away from a conservation mindset too?

Ingrid Kukuljan: Yeah, that's correct. So in June 2023, President Macron started this initiative, which was supported by the UK and French governments. It was an independent organisation, and our aim was to create high integrity, biodiversity credit markets and to help unlock significant financial flows through biodiversity credits. We actually had our launch during COP16, and there are 21 high level principles, and one of our main objectives was to avoid the shortcomings of the carbon markets, especially with regards to the market governance. As you probably know, carbon credits have suffered from lack of transparency, uniform regulation, and independent oversight, and all of this has resulted in reputational concerns for companies and has actually stifled the development of the voluntary market. Our principles call for high integrity markets via verifiable outcomes, independent oversight and involvement of indigenous communities and local people in the management of the projects and in the revenue sharing.

I think one of the key characteristics of what we have designed is that we don't support offsetting, and what we mean by this is that buyers of biodiversity credits are expected to access their impacts and dependencies of nature, actually have a nature strategy in place, and describe how they will address this in line with the mitigation hierarchy and the compensation for negative impact, i.e. offsetting can only happen if there is no other option.

Ingrid Kukuljan: We also don't believe in secondary markets. At present, we see the units as non-fungible and very much localised given the nature of biodiversity.

Charlotte Moore: Okay, thank you for that explanation. Richard, I know that Pensions for Purpose have a research project into nature and biodiversity at the moment. Can you tell us a bit more about that?

Richard Giles: Yeah, I want to finish on a more upbeat note, recognising the kind of seriousness of the conversation, but from the research which we carry out by talking to 20 large UK pension schemes about their current practice, and the report will be available in a month or two.

There's five areas that we report on. So they are integration into sustainable strategies, governance and resource, allocation, and risk and opportunities, which we've talked about, reporting and then engagement with asset managers and just a couple of things I want to highlight. The first is that of those schemes surveyed, 67% were now incorporating biodiversity into their sustainability priorities. Often within the environmental pillar alongside climate concerns. So I think that's encouraging it's at 67%.

The other point is asset owners are increasingly assessing their managers on their nature-related strategies and the risks within portfolios. That was a finding that we came to. So I look at the climate example and as Ingrid said, it's taken a long time to get to where we are with pension schemes considering climate. My glass-half-full perspective is we can get there a lot more quickly with nature and biodiversity, because we can learn a lot of the lessons from climate. TNFD looks at TCFD, risk and opportunities, and all of the other ways of thinking about these issues.

We've been down that path with climate, so I'm optimistic that pension schemes can accelerate their thinking on these issues more quickly than was possible with climate. I just wanted to leave on that more positive perspective. I think things are starting to happen, and we can really accelerate the discussion amongst UK pension schemes.

Charlotte Moore: I think it's been a very good and interesting discussion, and we've certainly covered a lot of material. Ingrid, what would you like the listeners to have as their key takeaway, which they have at the very front of their brain from this podcast? Richard, I'm going to ask you the same question too. So Ingrid?

Ingrid Kukuljan: So given that we are talking about the pensions and finance industry, I think the finance industry needs to step up on all the fronts. So far it's been the main contributor to channeling capital towards nature destruction, now it needs to reverse this and actually start thinking about how they can channel the capital positively towards protecting and restoring nature and it's very important for future returns.

Charlotte Moore: Because if we don't take care of this in 10 years, we won't be talking about returns any longer.

Ingrid Kukuljan: Exactly.

Charlotte Moore: That's a very important takeaway. Richard, what would your takeaway be?

Richard Giles: Mine would just be simply, this is a massive issue, possibly as big as the climate issue, and totally interconnected with the climate crisis that we're facing. So pension schemes who are thinking about climate, if they can think about biodiversity at the same time alongside and appreciate the risks with what's happening on biodiversity loss, are in the same ballpark as climate and give it the same level of attention.

Charlotte Moore: Thanks to you both Ingrid and Richard, for those excellent insights. I think it's been a really fascinating and awakening discussion of how we need to take nature and biodiversity very seriously.

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