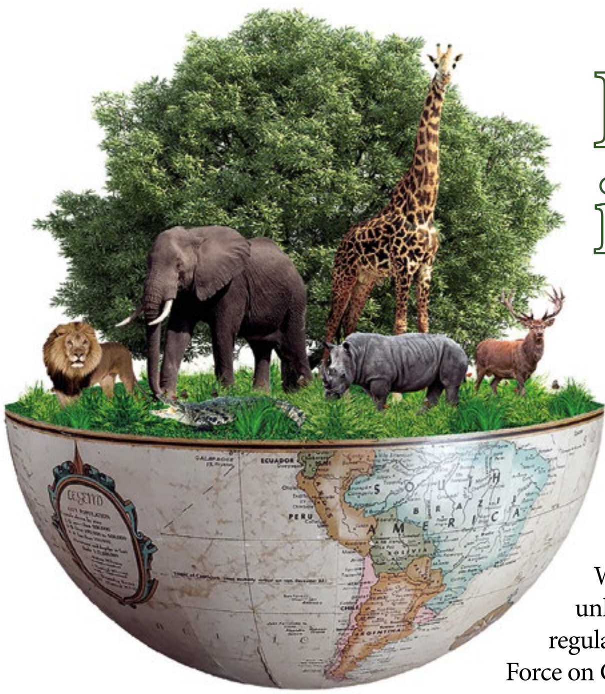

Bringing nature into scope

Summary
• Although most pension funds are aware of the new TNFD recommendations, some observers point out that many have yet to act on them – and that full adoption is unlikely until TNFD becomes a regulatory requirement like TCFD.
• Biodiversity and nature loss have been highlighted among the key sustainability knowledge gaps for many UK schemes.
• Some observers warn that the worldwide deterioration of nature is a source of material risk for institutional investors and that it falls within an investor's core fiduciary duty to assess and address the nature-related risks in its portfolio.

Abigail Williams examines how well positioned and motivated UK pension schemes are to meet the new TNFD recommendations

Following the recent publication of the Taskforce on Nature-related Financial Disclosures (TNFD) recommendations, pension schemes have begun the process of considering how best to coordinate responses structured around the four recommendation pillars of governance, strategy, risk and impact management, and metrics and targets.

Getting started

According to Pensions for Purpose director, Karen Shackleton, most pension funds are aware of the new TNFD recommendations "but few have acted on them" – a perspective confirmed by an investigation into the subject carried out by the organisation.

"Our *Impact Lens* research confirms this inertia. We believe full adoption is unlikely until TNFD becomes a regulatory requirement, like Task Force on Climate-related Financial Disclosures (TCFD). Currently, there's no sign of such regulation, although it may come in due course," she says.

Elsewhere, research carried out by the Principles for Responsible Investment (PRI) on voluntary adoption of the TCFD reveals that many organisations have tended to get started with the 'governance' and 'risk management' pillars because they are able to build on existing internal structures and processes for environmental issues. However, it is taking longer to adopt and implement the 'strategy' and 'metrics & targets' pillars, in part due to the complexity of carrying out processes like portfolio scenario analysis or portfolio emissions measurement.

"In its 'getting started with adoption of the TNFD recommendations' guidance, the TNFD acknowledges that organisations may not be able to report according to all its disclosure recommendations immediately. Instead, it emphasises the need to get started, providing practical steps to do so, and plan for progression over time in the depth and breadth of TNFD-aligned disclosures," says PRI head of climate and environment, Rebecca Chapman.

Elsewhere, the Pension Protection Fund head of ESG and sustainability, Claire Curtin, hopes the changes already seen in the industry to address the TCFD recommendations "will mean companies and investors are better prepared to disclose nature-related financial risks in a clear, consistent and reliable way to help lenders, insurers, and investors make informed decisions if the requirements are introduced".

"This will take time, as it does with all new requirements, which is illustrated in the evolution of our climate change report, having changed from being a largely narrative based view in the first year to this year's more data-driven quantitative report," she says.

Meanwhile, Cardano Advisory director, Lara Rutty, notes that, where schemes have fully engaged in the TCFD framework she has seen "positive and tangible outcomes, including successful accelerations of journey plans to reflect identified climate-related risks".

"TNFD should, at a minimum, encourage trustees to broaden sustainability risk management beyond climate change, and we hope will also drive increased focus on capital allocations that support nature-positive outcomes," she says.

Swift action needed

In its recent response to the DWP and HM Treasury call for evidence on trustees' skills and capability, the UK Sustainable Investment and Finance Association (UKSIF) highlighted biodiversity and nature loss as among the key sustainability knowledge gaps for many UK schemes.

As UKSIF head of policy and communications, Oscar Warwick Thompson, explains, while the association has observed increasing awareness among pension funds of the systemic risks that the "destruction of our planet's biodiversity" poses to the economy, he believes this is an area where "many different actors need to collectively boost their understanding, acting more swiftly to integrate biodiversity considerations into their existing sustainability policies".

In this respect, he argues that further guidance will be necessary, and he expects UKSIF to support many schemes in disclosing their nature-related risks and opportunities in future. Warwick Thompson also highlights understanding and skills gaps among schemes on systemic risks, such as nature loss and social inequalities, and believes that wider work will be needed across the pensions sector, with support from policymakers, to address these material gaps.

"We are optimistic that should schemes' focus on these systemic risks continue to strengthen over time, this would help trustees better fulfil their fiduciary duty," he says.

"At present, the pursuit of sustainability impacts and consideration of systemic risks, such as nature loss, remain largely outside of the current mainstream interpretation of fiduciary duty among schemes. Trustees appear to be more constrained in their interpretation of this duty, primarily focusing on financial risk alone."

Ultimately, Warwick Thompson says UKSIF would welcome the FCA actively evaluating how the final TNFD framework could be adopted seamlessly and integrated as far as possible with existing reporting requirements for pension schemes and other regulated firms, and signal its objectives and clear intent in relation to TNFD's implementation over the coming months.

Commonality of frameworks

In Shackleton's view, the commonality between the TCFD and TNFD frameworks "will undoubtedly help pension funds" as they start to roll out the TNFD recommendations: "It will make the process much less resource-intensive given that governance structures are likely to be similar across the two frameworks. That having been said, measurement of biodiversity is far more complex than for climate, so I would expect more resources to be required when measuring biodiversity risks and opportunities in pension fund portfolios. That could present a challenge for smaller pension funds."

Meanwhile, Chapman says the PRI welcomes the fact that the TNFD disclosure recommendations have remained "well aligned with the broader reporting landscape, including the pillar structure of the TCFD, as well as with the IFRS Sustainability standards, GRI and ESRS".

"This will help streamline reporting for investors and companies and facilitate voluntary uptake of integrated climate and nature-related disclosure," she adds.

The iceberg beneath the waterline

Moving forward, Warwick Thompson urges UK pension schemes, particularly larger schemes, to closely engage with the TNFD's recently finalised recommendations: "We expect many schemes will require support from FCA and regulators to meet the framework's disclosure requirements in time, and we would encourage larger schemes to begin the process as soon as possible in reporting on their nature-related risks and opportunities in line with TNFD."

Elsewhere, Shackleton notes that pension funds increasingly view biodiversity as a greater systemic risk than climate change, "much like recognising the iceberg beneath the waterline, not just the top", and she expects this 'submerged issue' to surface into focus in the coming years. In her view, having a framework that trustees can use can only be a good thing, but pension funds "must be convinced that this is an exercise worth undertaking, with clear benefits".

Chapman observes that the TNFD framework, like the TCFD framework, are 'tools' to "translate the asks and needs from global agreements such as the Paris Agreement and the Kunming-Montreal Global Biodiversity Framework" – which must then be integrated into or aligned within international standards, as well as in regulatory frameworks.

In Chapman's view, these regulatory and reputational risks should encourage pension schemes in assessing and disclosing their risks, opportunities, impacts and dependencies on nature, and to foster transparency and accountability.

"The voluntary uptake of the TNFD disclosure recommendations can build a foundation for pension schemes in this effort," she says.

"Finally, it should be acknowledged that the worldwide deterioration of nature is a source of material risk for institutional investors, as long-term value creation across the global economy is dependent on a wide range of ecosystem services. It therefore falls within an investor's core fiduciary duty to assess and address the nature-related risks in its portfolio, and pension schemes should feel empowered to assess and act on those risks."

Written by Abigail Williams, a freelance journalist