

## INFORMATION DISCLOSURE AND BEHAVIOR CHANGES REQUIRED OF COMPANIES REGARDING NATURAL CAPITAL

### — SHIFTING THE FLOW OF FUNDS TOWARD NATURE POSITIVE —

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## SUMMARY

- The global discussion on biodiversity and natural capital issues has been intensifying in recent years, and shifting the flow of funds toward nature positive (halting the loss of biodiversity and degradation of the natural environment while achieving restoration and regeneration) is being viewed with increasing importance.
- Under these circumstances, companies may be required even more to disclose information concerning biodiversity and natural capital and to change their behaviors.
- This trend will likely apply not only to the agriculture, forestry, fisheries, and mining industries, which are directly related to natural capital, but to all companies. Companies need to begin considering how they can mitigate and reduce potential negative impacts on natural capital in their business activities.

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## 1. INTRODUCTION

My report in April 2022<sup>1</sup> touched on some of the transitions and fundamental issues in the biodiversity discussion (e.g., in the beginning, it was preceded by the discussion on genetic resources, and in the 2010s, the discussion itself stalled, only becoming re-energized in recent years due to the integration of biodiversity and climate change). Scheduled to take place over this and the coming year are the formulation of the Post-2020 Global Biodiversity Framework (GBF), a global biodiversity goal; the final recommendations on corporate information disclosure frameworks outlined in the Task Force on Nature-related Financial Disclosures (TNFD); and the formulation of the next National Biodiversity Strategy of Japan based on the GBF. Given such developments, this report summarizes recent and intensifying discussions on biodiversity and natural capital, along with the efforts being made by financial institutions and various other companies and their impact on industries.

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## 2. INTERNATIONAL TRENDS IN BIODIVERSITY AND NATURAL CAPITAL

### 2-1. Overview of biodiversity and natural capital

Biodiversity refers to the state in which fauna and flora (the overall composition of all animal and plant species inhabiting a specific area) are in balance, and this comprises one aspect of natural capital. Natural capital is an approach that extends the concept of economic capital (stock) to nature in general, including biodiversity, water, soil, and the atmosphere. Under this concept, companies engage in business activities utilizing the various benefits provided by nature (flow).

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<sup>1</sup>The Role of Financial Institutions in Conserving Biodiversity— Restrictions on Financing to Encourage Changes in Corporate Behavior Will Have Impacts on Various Industries —

In the context of climate change issues, forest conservation is considered an important means of ensuring carbon dioxide absorption. With the growing problem of wildlife losing their habitat due to deforestation, forest conservation is also important for biodiversity. Natural capital, including biodiversity, is on the decline, and this trend poses a threat to the sustainability of companies. The World Economic Forum recognizes biodiversity loss as the third most serious risk after climate change and extreme weather events.

## **2-2. The intensifying discussion on biodiversity and natural capital, and trends in governments around the world**

The Glasgow Climate Pact, adopted at the November 2021 United Nations Climate Change Conference (COP26), also points out that climate change and biodiversity loss are “interlinked global crises,” which has drawn attention to both as a unified issue.

Natural capital-related discussions are also intensifying in countries and regions around the world, with the formation of the GBF, a global biodiversity goal, at the 15th meeting of the Conference of the Parties to the Convention on Biological Diversity (COP15) held in December 2022, as a notable example. In June 2022, the EU published its proposal for a Nature Restoration Law, which aims to restore all terrestrial and marine ecosystems throughout the EU. In addition, at a September 2022 UN General Assembly side event, countries and regions worldwide announced new biodiversity-related initiatives aimed at shifting funds toward nature positive. The initiatives included a significant increase in funding for biodiversity conservation by the German government and the signing of “Political Vision: The 10 Point Plan for Financing Biodiversity” by 16 countries and regions, including the EU.

The draft National Strategy published by the US government in August 2022 included the development of natural capital accounting and environmental-economic statistics to reflect natural capital in national accounts. The US plans to quantify its natural resources and develop statistics to assess the status of its natural resources as an economic indicator alongside GDP. Japan is also planning to formulate the next National Biodiversity Strategy of Japan based on the GBF. Trends in each country and region along with COP15 will also be a focus of attention.

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## **3. FINANCIAL INSTITUTION TRENDS IN BIODIVERSITY AND NATURAL CAPITAL**

### **3-1. The role of financial institutions**

Financial institutions have influence over industrial circles, including control over the industry-wide flow of funds. In response to requests from governments, investors, NGOs, and other entities, they have also played a major role in addressing climate change by restricting the flow of investments and loans to industries with high GHG emissions and encouraging numerous companies to disclose their GHG emissions and change their behaviors.

While shifting the flow of funds toward nature positive is being viewed with increasing importance in the world, financial institutions are expected to play the same role in restoring natural capital that they do in addressing climate change.

For example, the US plans to develop environmental-economic statistics, as mentioned in section 2.2, and the statistics could be adopted as economic indicators by countries other than the US and incorporated into the TNFD information disclosure framework. In that case, those countries might also accelerate their efforts in requesting companies to disclose information and change behaviors to improve the numerical values required to achieve their targets.

At this point, it is expected that financial institutions will encourage behavior change by requesting companies to disclose information and imposing lending restrictions, just as when addressing climate change.

### 3-2. Efforts by financial institutions

Financial institutions have been working to address climate change by promoting changes in corporate behaviors aimed at reducing GHG emissions, such as limiting the financing of coal-fired power generation and other high-emission industries. They have also been encouraging information disclosure in line with the TCFD framework, a basis formed by public agencies and financial institutions in various countries at the request of the G20 Finance Ministers and Central Bank Governors Meeting in 2015.

In regard to natural capital, including biodiversity, most of the 30 banks<sup>2</sup> designated by the Financial Stability Board (FSB) as critically important to the global financial system have stated that they will conduct meticulous due diligence when considering financing specific industries and businesses and will limit the financing of business activities that have a negative impact. In Figure 1, the “changes in land use” and “development in regions to be protected” apply to protected areas and regions rich in biodiversity. These categories could be relevant to all industries and even companies outside such industries directly related to natural capital as agriculture, forestry, fisheries, and mining. Companies may be subject to limitations if they either engage in business activities in or near such regions or do business with companies that are active in such regions.

**Figure 1. Cases of restrictions in the world's major banks' lending policies related to biodiversity and natural capital**

Agriculture, forestry, and fisheries	Changes in land use	Conversion of high conservation value (HCV) forests into agricultural land
		Use of first-generation biofuels produced on either recently deforested land or land classified as HCV or high carbon stock (HCS)
		Land reclamation via logging or conversion of native tropical forests, virgin forests, and primary tropical forests
		Development and expansion of plantations on peatlands and etc.
		Development and expansion of plantations in areas specified as protected by UNESCO, the Ramsar Convention, the International Union for Conservation of Nature (IUCN), etc.
	Forest risk commodities	Soybean cultivation in the Amazon and Cerrado regions
		Beef production in the Amazon and Cerrado regions
		Palm oil plantations
	Use of fire	Slash-and-burn agriculture, and land reclamation via burning
	Pesticides	Use of pesticides classified 1A or 1B by the WHO
	Fishing	Commercial whaling
		Shark finning
Drift nets, deep sea trawling, fishing with explosives or cyanide		
Animal welfare	Trade and manufacture of fur products	
	Caged livestock breeding	
Mining	Development in regions to be protected	Petroleum and gas projects in the Arctic
		Petroleum projects in Esmeraldas in Ecuador, the Amazon, etc.
		Petroleum and gas projects in the Peruvian Amazon
		Petroleum projects in the Amazon Basin
		Deep sea mining projects
		Peatland development
	Unconventional projects	Shale gas mining, surveying, and renewal in Europe
		Surveying and producing oil sands, tar sands, ultra-heavy crude oil, etc.
		New projects of petroleum, gas, oil sands, hydrocarbons, etc.
		Projects relating to surveying, development, construction, and expansion of unconventional petroleum and gas
	Technology	Disposal of tailings in rivers and shallows
		Coal mining using mountaintop removal (MTR)
Hydraulic fracturing (fracking)		

Source: Compiled by MGSSI based on information disclosed by the banks

<sup>2</sup> The 30 banks on the 2022 list of Global Systemically Important Banks (G-SIBs) published by the FSB (roughly 80% are U.S. or European banks; the list includes 3 Japanese megabanks)

In the future, in response to the increasingly intensifying global discussion, both lending restrictions and due diligence may be expanded in scope and subject to stricter rules, and all companies that make use of natural capital will be required to take action.

## 4. IMPACT ON INDUSTRIES AND COMPANIES

### 4-1. Efforts by companies

With the announcement of legislative proposals to restore natural capital and the global trend of shifting the flow of funds toward nature positive, companies are increasingly being required not only to halt losses but also to aid in moving toward recovery. While companies are already incorporating biodiversity into procurement policies and acquiring certifications for risk management, some companies regard this as a business opportunity and have begun working to provide products and services designed with conservation in mind (Figure 2).

**Figure 2. Efforts by major companies related to the protection of biodiversity and natural capital**

Europe	Nestlé (Switzerland)	Sales of plant-based brand food products such as alternatives for meat, fish, eggs, and dairy products
	Unilever (UK)	Sales of plant-based food products, and development of processed food products using algae proteins
	L'Oréal (France)	Development of a shower head capable of reducing water usage by up to 60%
	Tesco (UK)	Sales of private brand (PB) plant-based food products and establishment of in-store displays of plant-based food products, etc.
The Americas	PepsiCo (US)	Sales of plant-based protein snacks and beverages
	Walmart (US)	Sales of PB products such as organic foods and clothing made from environmentally friendly materials
	Starbucks (US)	Providing beverages and food made using plant-based dairy and meat products
Japan	Fast Retailing (Japan)	Sales of jeans made using technology that reduces water usage during processing by up to 99%
	AEON (Japan)	Sales of environmentally friendly kitchenware, organic/plant-based food products, and other PB products designed for sustainability

Source: Compiled by MGSSI based on information disclosed by the companies

In terms of disclosure of relevant information, Kirin Holdings conducted a trial disclosure in July 2022 in the form of the “Kirin Group Environmental Report 2022,” based on the LEAP (Locate, Evaluate, Assess, Prepare) approach to evaluating nature-related risks and opportunities as presented in a draft released by the TNFD in March 2022. In the report, the company noted that if Sri Lankan tea leaves, on which the company relies heavily to produce its tea products, are not sustainably available, there is a risk that the product concept will fail and that, in regard to wine, turning derelict land into vineyards could provide an opportunity to create high-quality grasslands.

### 4-2. Future outlook

Driven by the growing global discussion on natural capital, trends in various countries, restrictions on lending by financial institutions, and the TNFD's move to establish a disclosure framework, the movement to demand companies to disclose relevant information and change their behaviors may accelerate in the future. In particular, the demands placed on industries directly related to natural capital—agriculture, forestry, fisheries, and mining—will inevitably increase, considering the policies on lending restrictions imposed by major banks around the world. However, all companies will eventually need to take action as companies that do not make use of natural capital in their business activities in any way are rather in the minority.

Companies should keep a close eye on trends such as lending restrictions imposed by financial institutions in light of the global trend toward shifting the flow of funds toward nature positive. At the same time, they will need

to consider the whole natural environment in an integrated manner, including the conservation and restoration of natural capital, sustainable consumption and production, and measures to address climate change.

Once the framework for disclosing natural environment-related information has been formulated, TNFD-supporting companies will be required to specify how their business activities, including any relevant value chains, depend upon and impact natural resources and ecosystem services. Subsequently, they will need to disclose information on nature-related risks and strategies for conservation and restoration opportunities. Moreover, heightened levels of social awareness may increase the demand for disclosure, even among companies that do not support the TNFD. In addition, if many countries begin to use natural capital accounting and environmental-economic statistics in the future, governments will likely demand companies to improve their numerical figures.

The breadth of the subject matter (i.e., the entirety of the natural environment) will require significant time and effort from companies. They will need to specify the scope of its dependence and impact along with any risks, consider opportunities for conservation and restoration, and address an increasing number of matters. Since there is no single indicator for natural capital, such as GHG emissions for climate change, the following may be used as indicators: the amount of water used, the degree of water and soil contamination, and the number of endangered or rare species of plants and animals. Companies will likely need to pay close attention to these indicators and begin to consider how they can mitigate and reduce potential negative impacts on natural capital in their business activities, taking into account the scope of lending restrictions imposed by financial institutions, the draft TNFD framework, and precedents set by other companies.

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