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TNFD: A catalyst for biodiversity action

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Key points:

- AXA IM carried out a pilot, testing the LEAP approach of the Taskforce for Nature-related Financial Disclosures
- Below we answer key questions about the pilot and highlight what we learned
- We also examine the main data and methodological limitations and the potential next steps

Biodiversity is a key issue for investors, and for the companies in which they invest. In the wake of the Taskforce for Nature-related Financial Disclosures (TNFD) - a global initiative that provides a framework for reporting and understanding how different organisations impact the natural world - releasing its final recommendations, several corporates and financial institutions have announced they would be early adopters of TNFD.

In a context where biodiversity stands out as both a more complex and less mature issue than climate as well as a key parameter for investors, we tackle a few questions around TNFD, what it means for AXA IM and what we – both AXA IM and our parent company AXA Group - have learnt from a TNFD pilot carried out by the consultant firm I Care by BearingPoint on our behalf.

- *Why are nature and biodiversity strategic priorities for AXA IM?*
- *Is AXA IM engaging with companies to comply with TNFD?*
- *As an asset manager, how do we integrate the TNFD recommendations?*
- *What sectors were selected for this pilot and why?*
- *What have we learnt from this TNFD pilot?*
- *What are the main data or methodological limitations and what does it mean for investors?*
- *Is there a top-down message emerging?*
- *What are the implications for investment decisions?*
- *Are there any next steps?*

1. Why are nature and biodiversity strategic priorities for AXA IM?

The collapse of nature is directly threatening the viability of all economic activities and the stability of the global financial system. Some nature-related physical and transition risks are already becoming reality and affecting business growth and resilience. Understanding and assessing the impacts on nature of investments is therefore key to addressing those risks and identifying potential investment opportunities that can contribute to the preservation and restoration of nature while simultaneously aiming to deliver financial performance.

2. Is AXA IM engaging with companies to comply with TNFD?

TNFD is a voluntary disclosure framework - it is not binding, and corporates do not have to comply with it. In addition, it is not prescriptive: it lays out recommendations which corporates are advised to integrate progressively. This will likely result in the gradual increase in the quality and availability of data reported by corporates, and accordingly in enhanced metrics that hopefully prove useful for investment decisions.

As data challenges are still significant, and as science does not yet model all the different pressures exerted on biodiversity, we believe we must adopt a pragmatic approach and adjust to the current level of maturity when engaging with them on biodiversity. We are only at the beginning of the journey and acknowledge it will be an iterative process.

3. As an asset manager, how does AXA IM integrate the TNFD recommendations?

We decided to run a pilot testing the LEAP approach - Locate, Evaluate, Assess and Prepare. The pilot was run in collaboration with our parent company AXA Group, by the consultant firm I Care by BearingPoint, using data from Iceberg Data Lab.[1]

The LEAP approach is a methodology designed and recommended by TNFD to prepare disclosures by both corporate and financial institutions. It looks at different aspects such as the identification of material impacts, dependencies, risks and opportunities and their prioritisation.

For financial institutions, the LEAP approach aims to identify what is material and should be disclosed, to then inform further steps in biodiversity integration. Given current data limitations, financial institutions can start by targeting a defined set of sectors considered to have the most material nature-related dependencies and impacts. For us as asset managers, it means the Locate pillar can be met through a focus on those specific sectors.

4. What sectors were selected for this first pilot and why?

We selected two sectors for the pilot: agrifood and autos. Agrifood was a clear choice as it is one of the sectors contributing the most to biodiversity loss.[2] It comprises different sub-sectors, from growing crops and vegetables to food manufacturing, wholesale and agrochemicals. We believe it is a key sector for action with many opportunities to reduce negative impacts and even to produce positive impacts, for example by shifting towards more sustainable food systems. The sector is therefore relevant for both risk mitigation strategies in fixed income and impact strategies in both equities and fixed income.

The automobile sector was chosen to tackle the climate-biodiversity nexus, more specifically through the shift to electric vehicles (EVs). We wanted to have a better view of the share of the upstream impact of raw materials use, as well as the downstream impact through the use of EVs and corresponding greenhouse gas emissions. We also wanted to gauge of the ecotoxicity of extracting and refining metals and minerals, as well as of the impact of the electricity mix of the country where cars are used, more specifically when mostly coal related.

5. What have we learnt from this pilot?

The pilot unsurprisingly confirmed the heightened negative impact of the agrifood sector on biodiversity.

But what is also provided was a heatmap of major risks in each sector, as well as elements of risk mitigation. While there are some limitations on the data to keep in mind (which we discuss below), we were able to draw the conclusion that methodologies are more differentiating with regards to transition risks. Specifically, deforestation risks in the agrifood sector, driven by better visibility of mitigation processes put in place by companies, granularity of available data on key commodities and geographies at stake, can be assessed more robustly.

They are hence not only relevant but also able to be integrated in risk mitigation strategies in the wake of looming regulatory risks on the horizon.

By contrast, low risk gradings can contribute to identifying potential candidates for biodiversity investment strategies, confirming the absence of negative externalities on different fronts.

6. What are the main data or methodological limitations and what does it mean for investors?

Investors need to understand what metrics mean or don't mean. Intensity metrics can be biased by economic denominators, for instance food retailers tend to have more value-added and higher revenues than pure food producers, which tends to make their corporate biodiversity footprint look more favourable. This is also the case in the auto sector through some brand-specific price effects which distort intensity metrics when computed on revenues. Instead, normalizing impact metrics by the number of vehicles produced can give a better view of how corporates compare to each other.

Dependencies are sub sector-based, meaning that it is not possible to discriminate between companies within the same sub-sector. In addition, they do not integrate the upstream or downstream supply chain nor location specificities, because of data limitations. In other words, until more granularity and location data are disclosed by companies (which highlights the role of engagement), the discriminating power of the dependencies indicator will remain limited to sub-sector level.

In the meantime, reducing negative impacts remains the key strategy to managing risks in those sectors highly depending on biodiversity and ecosystem services.

7. Is there a top-down message emerging?

From a top-down perspective, the pilot suggests the shift to EVs could lead to both an increased absolute negative impact and a higher share of land use pressure, driven by the higher need for metals and minerals needed in EV and batteries. In the same vein, it leads to a higher share of water pollution from increased mining.

At this stage one possible conclusion, is that if in some cases, the shift to EVs reduces carbon dioxide emissions, which are one of the main causes of biodiversity loss, it may still be at the expense of biodiversity. This illustrates the complexity of the issue and highlights the importance of systematically monitoring climate and nature in an integrated approach - to integrate both positive and negative impacts. It will avoid potential rebound effects and transferring the impact from one environmental dimension to another.

8. What are the implications for investment decisions?

TNFD is a disclosure framework. Therefore, it cannot presently be used for target setting and is not readily applicable as an investment strategy decision-making tool.

However, our pilot has demonstrated that it is nonetheless the first of the building blocks of a future decision-making tool at portfolio or asset manager level, providing a heatmap of the different risks that investee companies are facing and need to handle.

In the short term, it will be key to inform engagement and investment due diligence, foster enhanced disclosure from companies, and support the integration of nature-related dependencies, impacts, risks and opportunities at issuer level. In the medium term, enhanced and more granular data will feed more robust methodologies and metrics, most probably leading to the emergence of new indicators as well.

At the same time, we believe that biodiversity is multifaceted, entailing a lot of intertwined elements and interlinked pressures. It means that there are significant risks for financial institutions that do not start the process of addressing the impact of their investments on biodiversity and tackling biodiversity risks, including missing out on potential opportunities that are emerging among innovative players.

9. Are there any next steps?

We are reviewing how to extend our pilot, building on the lessons we have learnt and assessing how to gradually better integrate this into our heatmap of risks and future investment process.

Different angles and ideas are being considered to complement these initial insights, on which we will provide further updates.

[1] AXA IM is a shareholder in Iceberg Data Lab.
[2] Our global food system is the primary driver of biodiversity loss (unep.org)

Image source: Getty Images