Our approach to engagement on natural capital

Investment Stewardship

At BlackRock, investment stewardship serves as a link between our clients and the companies they invest in and is one of the ways we fulfill our fiduciary responsibilities as an asset manager to our clients. We do this through engaging with companies to improve our understanding of their business models and material risks and opportunities. We also engage to inform our voting decisions for clients who authorize us to vote on their behalf. Our sole focus when conducting our stewardship program under our Benchmark Policies is to advance our clients' long-term financial interests.[1]

The management of nature-related risks and opportunities is a component of the ability to generate long-term financial returns for companies whose strategies or supply chains are materially reliant on natural capital.[2] For these companies, we rely on disclosures to assess the board's risk oversight and to understand how nature-related impacts and dependencies are considered within their strategies.

For the purpose of this commentary, BlackRock Investment Stewardship (BIS) has highlighted key components of natural capital that we consider to be most clearly linked to certain companies' ability to deliver long-term financial performance. These themes may not capture all possible natural capital factors that companies may consider material, nor are they necessarily isolated from one another. We prioritize land use, water and biodiversity for engagement, as appropriate, as they are most likely to be, or become, material to companies in the near future. The interconnectedness of these components contributes to the availability of natural capital on which companies and economies globally depend in order to operate effectively.

Natural capital as an investment issue

We refer to natural capital as the collection of natural resources (e.g., geology, biodiversity, water, soil, etc.) that provide value both to the economy, through the production of goods and services, and to society.[3] Some forms of natural capital have market value, including natural resource stocks, such as oil and gas, minerals and timberland.

More than half of global gross domestic product (GDP) – an estimated USD $58 trillion — is moderately or highly dependent on nature.[4] BlackRock's research shows that only a portion of natural capital's value to the economy is priced into markets today.[5] This analysis suggests asset prices could adjust to better reflect both the risks and opportunities linked to natural capital, driven in large part by increasing physical risks.[6]

In addition to these physical risks, the policy response to natural capital stress is growing, especially in Europe, and following the adoption of the Global Biodiversity Framework in 2022.[7] Technological advances and shifts in consumer and investor preferences can also influence natural capital value in the market potentially creating risks and opportunities for companies whose strategies or supply chains are materially reliant on natural capital.

While natural capital is a broad term, we focus on three key components — land use and deforestation, water, and biodiversity — which can affect the long-term financial returns of companies with material exposure. Based on our assessment, companies with material nature-related risks and opportunities stand to benefit from the robust management of these components, which may lead to operational efficiency, management capabilities, and innovation.

NM1224U-4112696-1/4

Land use and deforestation. Given the growing pressures impacting land and forests from which many companies derive their products and services, companies with material impacts and dependencies on land and forests may face financial risks associated with the depletion of these resources. For example, governments in the European Union (EU), have moved to impose tariffs or import bans on consumer goods and agricultural products that are not certified as sustainably sourced.[8] Conversely, there could be material business opportunities in demonstrating responsible and regenerative practices.

Water. A number of economic sectors — such as agriculture, pharmaceuticals, manufacturing, technology, apparel, food, and beverage production — are heavily dependent on fresh water.[9] Companies for which water is essential to their business operations may need to demonstrate that they use this scarce natural resource efficiently given that overexploitation, pollution, or other factors may result in governmental regulations that restrict water availability and usage. For companies with material dependencies on water, this may impact their ability to deliver long-term financial performance. BlackRock's analysis shows that companies that use water efficiently have historically delivered higher returns than companies that are more water inefficient – with a particularly pronounced (and proportional) difference in performance between companies located in areas experiencing water stress.[10]

Biodiversity. Biodiversity refers to the variety and abundance of life on Earth,[11] which is a core component of natural capital and its ability to provide ecosystem services.[12] Biodiversity loss can pose financially material risks to companies in certain sectors. Lower biodiversity makes an ecosystem less productive, resilient and adaptable – meaning it cannot recover as quickly from events such as extreme weather, fires or diseases.[13] While some companies flag this as a risk, and we observe more companies disclosing their approach to natural capital, other companies are at an earlier stage of developing an understanding of the risks to their business models from biodiversity loss.

Natural capital-related risks and opportunities to companies can manifest in several different ways, such as:

Operational challenges. Companies that rely on raw materials as a basic input of production or have significant impacts on nature as part of their production processes may face risks if key ecosystems are degraded or the supply of natural capital is decreased or depleted. For example, poor soil health could lead to lower yields, greater nutrient runoff which may require clean up, and the need for increased fertilizer and/or pesticide application — all of which can increase costs and lower production for agriculture businesses. These operational challenges can also be exacerbated when companies depend on complex supply chains.

Reduced inputs. The challenge of producing more goods with fewer inputs — land, water, minerals, etc. — can also provide opportunities for companies. For example, companies may consider operational techniques that take into account nature-based solutions and the re-use of materials throughout production processes,[14] such as farming practices that sequester more carbon naturally and enrich the soil, or cooling systems that allow for better water circulation, re-use, and return. These practices might decrease costs, mitigate risks, and/or improve reputation among consumers and other key stakeholders.

Changes to government policy and consumer preferences. In addition to operational risks and opportunities, policy changes will likely play a role in determining availability, cost, and access to natural capital.[15, 16] Although policy actions will likely continue to be uneven globally, we anticipate increased measures that encourage more efficient use of resources, such as a price or tax on the externalities from which many companies benefit, or increased prices for natural resources.[17] Other key constituents in companies' value chains — consumers, employees, community members — are increasingly taking into consideration the sustainability and impacts of the companies or products with which they interact. These trends have the potential over time to have material financial impacts on companies.

Community impacts. For some companies, support of key community stakeholders is necessary to be able to operate in certain areas. It can help reinforce a company's reputation and minimize the risk of disruptions to business operations, which can, in turn, contribute to a company's long-term financial success.

Reporting on natural capital impacts and dependencies

Where natural capital is material to the long-term strategy of companies, we rely on public disclosures to assess risk oversight and to understand how nature-related impacts and dependencies are managed. We find it helpful when these disclosures include a discussion of material natural capital risks and opportunities in the context of a company's governance, strategy, risk management, and metrics and targets. This information could be augmented with an evaluation of the business impacts of potential, or unpredictable, changes in the availability of critical natural resources. It is also helpful to hear from companies about how they manage natural capital dependencies and impacts in the context of their value chains.

NM1224U-4112696-2/4

While nature-related disclosures have historically been limited and difficult to compare across companies, private-sector initiatives, such as the Taskforce on Nature-related Financial Disclosures (TNFD),[18] provide frameworks to guide disclosure on material, nature-related impacts and dependencies, alongside associated risks and opportunities, consistent with the Taskforce on Climate-related Financial Disclosures (TCFD) framework, now absorbed into the International Sustainability Standards Board (ISSB).[19]

Given the growing awareness of the materiality of these issues for certain businesses, enhanced reporting by these companies on their natural capital dependencies and impacts, and risks and opportunities would aid investors' understanding. In our view, the TNFD recommendations are useful to companies aiming to build or improve their reporting over time. We also encourage companies to consider the disclosure metrics suggested in the TNFD recommendations where relevant to their business model or the location they operate in, and where possible. We recognize that some companies may report using different standards, as consistent with the norms or regulations in their home market.[20]

Our approach to engagement on material natural capital-related risks and opportunities

When we engage with companies on natural capital, we may discuss the following, as appropriate:

- The natural capital-related risks, opportunities, impacts, and dependencies that management has identified as financially material to the company's business model, and how these have been evaluated in anticipation of increasing levels of stress on essential natural capital.
- The board's role in overseeing management's approach to material natural capital-related impacts and dependencies, and the associated risks and opportunities.
- Whether and how the company sets short-, medium-, and long-term targets for managing material natural capital-related factors and the metrics used, how the company monitors progress against stated goals and how these efforts might contribute to process and resource efficiencies.
- Whether the company has corporate policies or codes of conduct addressing natural capital practices, including whistleblower protections, and mechanisms to oversee compliance and remedy breaches.
- How the company plans for and manages changing requirements for sustainability reporting on natural capital-related impacts, dependencies, risks and opportunities such as the EU's Sustainability Reporting Standards (ESRS) and Corporate Sustainability Reporting Directive (CSRD),[21] given the potential that more jurisdictions will mandate nature-related disclosures in the future.[22]
- The company's supply chain due diligence processes, including how the company is working with key stakeholders or participating in industry-specific initiatives, and how the company identifies and protects against adverse impacts on nature across the supply chain.
- Any material investments in strategic initiatives or research and development to enhance products and/or operations to reduce natural capital dependencies and impacts, including contributions to programs that protect natural capital and/or participation, as appropriate, in industry collaborations aligned with addressing pervasive issues.
- Any efforts to engage with local communities directly impacted by company operations and use of natural capital.
- Any independent third-party assessments of the data and/or approach taken to manage natural capital-related risks including the benchmarking of policies, practices, and performance.

Endnotes

1. BIS' Benchmark Policies, and the vote decisions made consistent with these policies, take a financial materiality-based approach and are focused solely on advancing clients' financial interests. BIS' Benchmark Policies – comprised of the BIS Global Principles, regional voting guidelines, and engagement priorities – provide clients, companies, and others, guidance on our position on common corporate governance matters. We take a globally consistent approach, while recognizing the unique markets and sectors in which companies operate. Other materials on the BIS website might also provide useful context.
2. See BloombergNEF, "When the Bee Stings: Counting the Cost of Nature-Related Risks", December 9, 2023.
3. BlackRock Investment Institute, "Capital at risk: nature through an investment lens", August 2024.
4. Research published in April 2023 estimated that 55% of the world's GDP is exposed to material nature risk. Source: PwC. "PwC boosts global nature and biodiversity capabilities with new Centre for Nature Positive Business, as new research finds 55% of the world's GDP - equivalent to $58 trillion -is exposed to material nature risk without immediate action." April 2023.
5. BlackRock Investment Institute, "Capital at risk: nature through an investment lens", August 2024.
6. Please see previous footnote.
7. For example, the European Union Deforestation Regulation (EUDR) (which was set to go into effect on December 30th, 2024, but is delayed) applies to companies placing relevant commodities or products in the EU market, or exporting them from it. These companies will need to demonstrate that their products are deforestation-free, and not linked to forest degradation, nor illegal harvesting and trade. Also, the Council of the EU formally adopted a new regulation on nature restoration, which puts measures in place to restore at least 20% of the EU's land and sea areas by 2030, and all ecosystems in need of restoration by 2050. Several countries, including the U.S., UK, France, Germany and Australia, have also developed systems that grant credits to projects that restore nature and biodiversity. Source: BlackRock Investment Institute, "Capital at risk: nature through an investment lens", August 2024.
8. Please see previous footnote.
9. For example: World Bank, "Water in Agriculture", last updated on July 26, 2023..
10. **Past performance is not indicative of future results.** Source: BlackRock Investment Institute, with data from MSCI and World Resource Institute, August 2024. Notes: This analysis is based off of the return on assets from MSCI ACWI companies that report on their water withdrawals. BlackRock measures water stress as the regional ratio of total water withdrawals to total water availability, and efficiency is measured by water withdrawal intensity. Companies with less than median average water withdrawal intensity are considered "high efficiency." Regions experiencing water stress are identified using the "baseline water stress" metric provided by the World Resource Institute Aqueduct 3.0 tool. Each company's water stress score is based on the water stress severity across the locations of their assets. BlackRock Investment Institute, "Capital at risk: nature through an investment lens", August 2024.
11. The Convention for Biological Diversity (CBD) defines biodiversity as the variability among living organisms from all sources including, inter alia, terrestrial, marine, and other aquatic ecosystems, and the ecological complexes of which they are part; this includes diversity within species, between species, and of ecosystems.
12. BlackRock Investment Institute, "Capital at risk: nature through an investment lens", August 2024.
13. Nature, Isabel et all, "Linking the influence and dependence of people on biodiversity across scales", 2017. BlackRock Investment Institute, "Capital at risk: nature through an investment lens", August 2024.
14. Nature-based solutions are commonly defined as conservation, restoration, and improved land management practices that increase carbon storage and/or avoid greenhouse gas emissions across global forests, wetlands, grasslands, and agricultural lands.
15. University of Cambridge, "Dasgupta Review: Nature's value must be at the heart of economics", February 2021.
16. World Bank Group, "The Economic Case for Nature", 2021.
17. Please see footnote 5, as well as BlackRock Investment Institute, "Capital at risk: nature through an investment lens", August 2024.
18. The TNFD released its final recommendations in September 2023. TNFD-aligned reporting is not a voting issue.
19. We note that in Europe, under the Corporate Sustainability Reporting Directive (CSRD), nature-related disclosures are already required. See next Footnote for additional information.
20. We also expect more jurisdictions to mandate nature-related disclosures in the future, as is already the case in the EU with the entry into force of the EU Corporate Sustainability Reporting Directive (CSRD) in January 2023 (see next footnote for additional information). Target 15 of the Global Biodiversity Framework (GBF) calls on parties of the Convention to take measures to encourage and enable business to monitor, assess and transparently disclose their risks, dependencies and impacts on biodiversity.
21. Companies subject to the CSRD will have to report according to European Sustainability Reporting Standards (ESRS). "A broader set of large companies, as well as listed SMEs, will now be required to report on sustainability. Some non-EU companies will also have to report if they generate over EUR 150 million on the EU market." The first companies will have to apply the new rules for the first time in the 2024 financial year, for reports published in 2025. Source: European Commission, "Corporate sustainability reporting". Notably, the TNFD and EFRAG have published a helpful mapping of "the correspondence between the ESRS and the TNFD's recommended disclosures and metrics, illustrating the high level of commonality achieved. This assessment highlights that all 14 TNFD recommended disclosures are reflected in the ESRS."
22. As mentioned in the previous footnote, we note that the CSRD has an extraterritorial scope for large, non-EU companies, which will also be subject to the report requirements. Compliance is set to begin in 2028 with the first report expected to be published in 2029. Source: European Commission, "Corporate sustainability reporting".

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