RBC BlueBay Asset Management

Perspectives on climate change and nature

For Professional Investors Only | Marketing Communication

RI Team

RBC BlueBay Asset Management

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Nature and why it matters to investors

Nature-derived services are important for the global economy. Research from the World Economic Forum (WEF) found that over half of the world's Gross Domestic Product (GDP) is either moderately or highly dependent on nature and its services[1]. For example, fresh water is critical to many businesses, including agriculture, mining, and food retailing; genetic diversity in nature is critical to the pharmaceutical industry; and intact wetlands and forests protect buildings and infrastructure from flooding, storms, and natural disasters.

Nature refers to the natural world. It is generally considered to consist of four realms: land, ocean, freshwater and atmosphere. Each of these differs in terms of their organization and function, and provides an important starting point for understanding how organizations and people depend, and have impacts, on nature[2].

The potential systemic impacts of nature-related factors are also increasingly being recognized. While not a legally binding agreement, the adoption of the Kunming-Montreal Global Biodiversity Framework (GBF) by 188 countries in December 2022 was an important development as it set out goals, targets, and expectations regarding national commitments that aim to halt and reverse nature loss[3].

Despite the global economy's dependence on nature, efforts to quantify related risks and opportunities have been constrained by a lack of consistent and reliable data and methodologies. Recent progress has been made with the release of the Taskforce on Nature-related Financial Disclosures' (TNFD) final recommendations in September 2023[4]. The TNFD provides a voluntary framework and sector-specific guidance for the disclosure of nature-related dependencies, impacts, risks, and opportunities[5].

1 New Nature Economy Report II: The Future of Nature and Business, World Economic Forum, July 2020.
2 Recommendations of the Taskforce on Nature-related Financial Disclosures (TNFD), TNFD, September 2023.
3 COP15: Nations adopt four goals, 23 targets for 2030 in landmark UN Biodiversity Agreement, Convention on Biological Diversity, December 2022.
4 Taskforce on Nature-related Financial Disclosures (TNFD) Recommendations, September 2023.
5 Additional Guidance for financial institutions, TNFD, September 19, 2023.

Description of nature-related impacts and dependencies

The TNFD defines nature-related risks as potential threats posed to an organization, which are linked to its (and wider society's) dependencies and impacts on nature. These can derive from physical, transition, and systemic risks, which may create a disruption in an issuer's activities or value chains, volatility in raw materials prices, adaptation costs, stranded assets, or capital destruction, among others. There are also nature-related opportunities, which create positive outcomes for organizations and nature by creating positive impacts on nature or mitigating negative impacts on nature. These include activities that avoid, reduce, mitigate, or manage nature-related risks, or that actively work to reverse the loss of nature, including through restoration or regeneration of nature, and implementation of nature-based solutions.

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Nature-related impacts consider the interplay between an organization's operations and nature, and how that relationship may result in direct and indirect risks in the form of regulatory, legal, reputational, and market risks. Entities that greatly impact nature – for example, through emissions or waste – may face liability risks due to potential litigation.

Nature-related dependencies consider the extent to which a decline in an ecosystem service may present a financial risk to a business. For instance, organizations whose operations and/or revenues are highly dependent on water availability may face transition and physical risks, which can cause increased costs and/or decline in operations.

Interconnections between nature and climate change

Historically, nature-related risks, including those stemming from biodiversity loss, have tended to be discussed separately from climate change. There has been growing recognition however of the interconnections between nature and climate change. Climate change contributes to water shortages, land degradation, biodiversity loss and other nature-related risks. Healthy and effectively functioning natural ecosystems absorb and store carbon emissions, and help mitigate temperature and precipitation changes, while also enabling climate adaptation. These interconnections are the basis for a growing emphasis on considering nature-related factors alongside climate change.

Biodiversity is a characteristic of nature and natural capital. It can be defined as the variety of all living species on Earth, including flora and fauna, as well as bacteria, fungi and natural ecosystems. Biodiversity loss presents risks to companies as it can affect value chains, increase the cost of inputs and raw materials, disrupt operations, result in legal fines or liabilities, and ultimately affect operations and profitability. The scale of biodiversity loss currently occurring is believed to pose a systemic risk that could affect multiple asset classes and sectors. As a result, there is increasing regulation and policy action by governments to address biodiversity loss, such as the 2023 EU regulation on deforestation-free products, which may pose additional legal or litigation risks for companies.

Climate change is a direct driver of biodiversity and nature loss. As temperatures rise,an increasing portion of species are put at risk of extinction. The Intergovernmental Panel on Climate Change (IPCC) estimates that up to14% of species in terrestrial ecosystems will likely face very high risk of extinction, even if current efforts to mitigate climate change are successful. This figure increases to 29% if average global temperatures riseby 3°C from pre-industrial levels by 2100, and up to 39% if they rise by 4°C by 2100.[6]"

Nature and biodiversity loss exacerbate the negative effects of climate change. This is because healthy and biodiverse ecosystems play an important role in absorbing emissions and heat, thereby helping to mitigate climate change, as well as in improving the Earth's ability to adopt to, and be resilient to natural disasters.

[6] IPCC Report 2022: Climate Change 2022: Impacts Adaptation and Vulnerability. Intergovernmental Panel on Climate Change (IPCC), Feb 2022.

RBC GAM approach to nature

RBC GAM is encouraged by the final recommendations of the TNFD, which we believe will enable enhanced disclosure of material nature-related risks and opportunities. We seek to be transparent about our views and activities and share these through insight articles and reports. We first published our perspective on climate change and nature-related risks in our Climate Report 2022, and enhanced our disclosures in the Climate Report 2023 to include our exposure to nature-related factors.

We may face exposure to nature-related factors through our investments in corporate issuers who are themselves exposed to these factors. For example, issuers in the following industries may face significant impacts and/or dependencies from nature: agriculture, forestry and fisheries, energy, mining, transportation, food and beverages, apparel, utilities, chemicals, manufacturing, and construction[7]. We may also face indirect exposure via our investments in sovereign issuers. For example, economies that are highly reliant on industries such as agriculture, forestry or eco-tourism may face higher risks due to economic dependence on nature-derived products and/or ecosystem services.

RBC GAM's investment teams incorporate material ESG factors into their investment decisions, for applicable types of investments[8]. This may include nature-related factors such as biodiversity and land use, natural resource use, water stress, sustainable forest management and other factors, when financially material to a sector or issuer. Investment teams have their own processes for integrating material ESG factors and for determining materiality, drawing from tools like the Sustainability Accounting Standards Board (SASB)[9] materiality matrix, internal research and resources, speaking with industry experts, and sell-side and external research. They are also equipped with data and insights to manage the risk exposure of their portfolios, with data available on a wide range of factors, including financial and nature-related factors. Investment teams incorporate material ESG factors in a manner that complements their distinct investment approaches and mandates.

Active stewardship is also a pillar of Our Approach to Responsible Investment. We consider material ESG factors in proxy voting and engagement with issuers for applicable types of investments[10].

Since 2020, we have participated in the Investor Policy Dialogue on Deforestation (IPDD), which aims to coordinate a public policy dialogue with authorities and monitor developments to assess exposure to financial risks arising from deforestation. Our investment teams may meet with the issuers in which we invest on an ongoing basis. The specific ESG factors we engage on differs based on several items. For corporate issuers this can include the issuers' operations, industry, size, geographical footprint, and the nature of the investment vehicle for which it is being purchased. For sovereign issuers, material ESG factors can depend on the country's status of economic, social and political development, availability of and dependence on natural resources, and potential regional issues, among other factors. Teams may also prioritize their engagement efforts based on the size of the investment and/ or the level of ESG risk within the portfolio.

Voting responsibly is consistent with our fiduciary duty. It is our policy to exercise the voting rights of the accounts we manage in the best interests of our clients. Our proxy voting activities are governed by our Proxy Voting Guidelines[11] (guidelines) and applicable regional proxy voting policies, which set out procedures for administering our votes, escalating any voting issues, and identifying and managing conflicts of interest. Our guidelines include guidance on how we evaluate nature-related shareholder proposals, and state we will generally support proposals requesting that a company disclose the organization's governance around nature-related risks and opportunities. The guidelines state that as issuers continue to advance their understanding of the materiality of nature-related factors to their businesses, they should consider related disclosures that take into consideration the TNFD recommendations and guidance.

7 The Climate-Nature Nexus, An investor guide to expanding from climate- to nature- data, United Nations Environment Programme World Conservation Monitoring Centre (UNEP-WCMC), Finance for Biodiversity Initiative, April 2022.

8 Certain investment strategies or asset classes do not integrate ESG factors, including but not limited to money market, buy-and-maintain, passive and certain third-party sub-advised strategies.

9 As of 2022, the International Sustainability Standards Board (ISSB) of the IFRS Foundation assumed responsibility for the SASB Standards.

10 This document includes information related to RBC GAM's approach to responsible investment, which does not apply to certain portfolios, asset classes, exposure or security types that do not integrate ESG factors. Portfolios that may not integrate ESG factors include, but are not limited to, money market, buy and maintain, passive, and certain third-party sub-advised portfolios. ESG integration may not apply to securities including, but not limited to, currencies, derivatives, and asset-backed securities. ESG factors are considered by our investment teams to varying degrees and weights, depending on the investment team's assessment of that ESG factor's potential impact on the risk-adjusted performance of the security and/or the portfolio. For funds where ESG factors do not form a part of their investment objective or investment policy, ESG factors are generally not likely to drive investment decisions on their own, and in some cases, may not impact an investment decision at all. RBC GAM has a general approach to active stewardship, proxy voting, and engagement that address ESG matters among other matters. References to active stewardship do not apply to certain investment strategies where proxy voting and/or engagement are not used. Examples of what would not conduct certain active stewardship activities include, but are not limited to, quantitative investment strategies that do not conduct engagements, passive, and certain third-party sub-advised strategies. RBC GAM does not manage proxy voting for certain third-party sub-advised strategies. For clarity, RBC Indigo Asset Management Inc. and its fund products are not covered by the information presented in this document, unless otherwise indicated. For clarity, RBC Indigo Asset Management Inc. and its fund products are not covered by the information presented in this document, unless otherwise indicated.

11 For applicable regions. Our custom Proxy Voting Guidelines are applied in Canada, the U.S., the UK, Ireland, Australia, and New Zealand. In all other markets, RBC GAM applies Institutional Shareholder Services (ISS) local proxy benchmark voting policies.

Overview of RBC GAM's commitments and actions related to nature and biodiversity

Build knowledge and understanding of potential material risks that naturerelated factors, and biodiversity loss specifically, may pose.

- **We share our views through ESG insight articles.** To date, we have published articles on topics including interconnections between climate change and biodiversity, the COP15 conference and other related issues. See here for recent articles.
- **Participated in the United Nations PRI delegation at COP15**, the United Nations Convention on Biological Diversity's global conference.
- **Include content in Our Approach to Responsible Investment** about climate change and nature as systemic ESG factors.

Identify and assess the materiality of nature-related risks to Investments, from the perspective of both impacts and dependencies, guided by the recommendations of the TNFD.

- **Continue to evaluate data and tools** for assessing exposure to nature-related risks, opportunities, impacts and dependencies.
- **Assess and disclose** exposure to TNFD priority sectors, and the associated nature-related impacts and dependencies in our annual climate report. See here for our most recent report.
- **Use location-based data** to identify corporate issuers operating in biodiversity sensitive locations, and assessed whether they have been involved in biodiversity-related controversies. We share this analysis in our annual climate report.

Continue to work collaboratlvely with other investors on nature-related issues through industry initiatives, and to use engagement and thoughtful proxy voting on topics, where relevant[12].

- **Participate in Responsible Investment (RI) initiatives focused on nature.** This includes our continued support of the IPDD and the Farm Animal Investment Risk & Return (FAIRR).
- **Our proxy voting activities** are governed by our Proxy Voting Guidelines, which include voting guidelines on nature-related factors such as an issuer's impact on the environment (e.g., toxic emissions, water risks, environmental liabilities). We vote our shares independently and review these on a case-by-case basis and in line with our guidelines.
- **Conduct individual engagements with issuers on nature-related topics, as appropriate.** For example, the RBC Emerging Markets Equity team has conducted a biodiversity-related review of issuers in which they are invested, and conducted engagements on this topic with issuers.

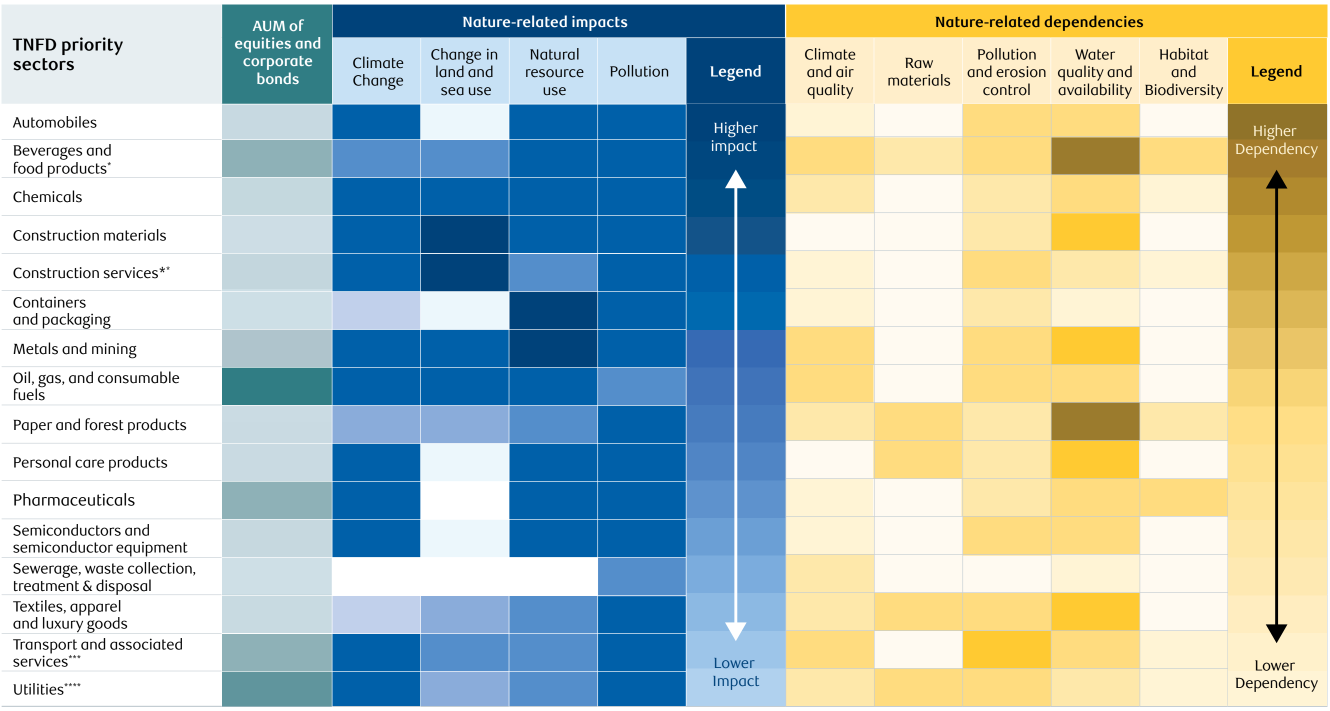
Provide transparent reporting and continue to enhance disclosures.

- **First published our perspective on climate change and nature-related risks** in our Climate Report 2022.
- **RBC GAM is encouraged by the final recommendations of the TNFD.** We disclose the two core metrics recommended for asset managers by the TNFD.

[12] In certain instances involving quantitative investment, passive and certain third-party sub-advised strategies, there is no direct engagement with issuers by RBC GAM.

Based on this analysis, the most significant nature-related impact of these investments across all sectors is related to pollution, and the most significant dependency is on water quality and availability. It is worth noting that the materiality of any risks related to this exposure is influenced by the actions taken by issuers to mitigate the risk and if, or how, this affects the valuation or price of securities (see Figure 1).

Figure 1: RBC GAM equities and corporate bond investments in TNFD priority sectors, and nature-related impacts and dependencies



*includes agriculture
**includes manufacture of metal products
***includes passenger airlines
****including electric utilities, gas utilities, independent power and renewable electricity producers, and water utilities

Source: RBC Global Asset Management as at December 31, 2023

RBC BlueBay Asset Management (RBC BlueBay) represents RBC Global Asset Management (RBC GAM) outside of North America and invests across fixed income, equities and alternatives. RBC BlueBay proactively engages in many aspects of responsible investment. The initiatives outlined within this report encompass our entire asset management business globally.

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