

# Title: Strategic Discussion - Private Investment in Natural Capital

**Date: 18 May 2022**

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| **Purpose:** | Discussion |
| **How does this link with our corporate priorities of improving biodiversity or delivering nature-based solutions to climate change:** | Stimulating private investment into nature is a key priority of ‘A nature-rich future for all’. **Valuing Nature**By 2026 we will have: Helped to establish values-based, high-integrity environmental markets leading to a strong pipeline of investible nature-based projectsArguably, without a radical transformation in how we pay for nature many of the other priorities in the Corporate Plan will be unachievable. |
| **Summary:** | Scotland needs billions of pounds of investment in its natural capital to meet the challenges of climate change and nature’s decline. This paper describes what NatureScot has been doing to encourage and enable this new investment, articulates some of the novel risks, and sets out priorities for the year ahead. |
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| **Appendices**:  | [Annex 1](#_Annex_1) - Natural capital workstream approach (a paper to SG’s Private Investment in Natural Capital programme) |

## Purpose

1. This paper is for information. It will be supported by a short presentation at the meeting.
2. This paper provides a very short introduction to the topic, summarises NatureScot’s role and action to date and sets out our priorities for the 1st year of the new Corporate Plan.

## Introduction

1. There is a vast gap between the money needed to pay for nature-based solutions and restoring nature and the funds available from public sources and philanthropy. [Economic analysis commissioned by the Green Finance Institute in 2021](https://www.greenfinanceinstitute.co.uk/news-and-insights/finance-gap-for-uk-nature-report/) identified a £15 to £27 billion gap in financing nature-related outcomes in Scotland.
2. There is global recognition that the private sector must invest significantly in meeting climate targets, in adapting to inevitable climate change and in restoring nature. The arguments for this are based in: ethics (polluter pays); economics (the Dasgupta Review); and business reality (businesses and their supply chains are dependent on nature).
3. Interest from business and the finance sector is growing very fast across the world. In Scotland and the rest of the UK most investment is still small scale and enabled by carbon codes (the Woodland Carbon Code and the Peatland Code). But Scotland still has an opportunity to be a leader in this new and innovative nature-positive economy.
4. The Scottish Government has initiated its own programme ([Private Investment in Natural Capital](#Annex1)) to develop ‘values-led, high integrity environmental markets’ in Scotland. ‘Values-led’ makes the explicit link to the Just Transition, and ‘high-integrity’ speaks to the need for credible investment that is not greenwash. This programme, and the concept of values-led, high integrity environmental markets is substantially based on the work of the [Financing UK Nature Recovery initiative](https://financingnaturerecovery.uk/recommendations-%26-roadmap).

## NatureScot’s role and action to date

1. NatureScot has played a pivotal role in advancing the concept in Scotland, convening the many stakeholders required to grow investment in Scotland’s natural capital.
* Led the EELG Green Finance sub-group from 2019, which led to the SG programme mentioned above.
* Leads the Scottish Nature Finance Pioneers network.
* [Commissioned research](https://www.nature.scot/doc/naturescot-research-report-1272-facilitating-local-natural-capital-investment-project-report) leading to a proposal for a Scottish Carbon Fund – now the topic of further SG backed work.
* Collaborating with partners from all sectors on encouraging innovation through thought-leadership, including SNIB and Dark Matter Labs.
* Developed a proposal for the ‘Facility for Investment Ready Nature in Scotland’ (FIRNS) – intended to help projects successfully engage with buyers and investors. A £3m proposal is under consideration in the SG’s resource spending review.
* Engaging with a small number of significant financial institutions and corporates on thematic opportunities, and in the Flow Country Partnership to develop new structures and mechanisms to channel private investment into nature.
* Led the development and establishment of the Scottish Marine Environmental Enhancement Fund ([SMEEF](https://www.nature.scot/SMEEF)), designed to channel contributions from marine industries to enhance marine natural capital.
* Published a [Green Finance Guide for Land Managers](https://www.nature.scot/doc/guidance-nature-based-finance-opportunities-land-managers-scotland).
* Co-developed the [Interim Principles for Responsible Investment in Natural Capital](https://www.gov.scot/publications/interim-principles-for-responsible-investment-in-natural-capital/) with the Scottish Land Commission.

## Emerging priorities for Year 1 of A Nature-rich Future for All

1. NatureScot has to shift emphasis from ‘discovery’ mode to ‘delivery’ albeit that learning lessons will be an important function of early delivery.
2. It is already very clear that NatureScot is exceptionally well positioned to focus on the development of the pipeline of investible projects. We have the knowledge, networks and convening power.
3. We may contribute where others are better placed to lead on different dimensions including regulations and incentives, skills and supply chain, data and accreditation and community benefit.
4. We have just commissioned Dominic Llewellyn of [AchieveGood](https://www.achievegood.com/) to work with us for a couple of months, to provide us with insights and advice on our strategy and in particular building a pipeline of projects.
5. Our current assessment is that the priorities for NatureScot are:
* Driving Workstream 2 of the [SG Private Investment in Natural Capital programme](#_Annex_1) and building a pipeline of investible projects.
* Leading the work to transform the funding and financing of peatland restoration and radically scaling up action.
* Operating ‘mini-FIRNS’ funded by NatureScot, the Esmee Fairbairn Foundation and, possibly, HIE to build momentum towards FIRNS in 2023/24. Preparing to host and operate FIRNS if it receives funding.
* Launch and operate SMEEF. Launch is scheduled for 11 May.
* Supporting the Flow Country Partnership.
* Continue to work with major potential investors in Scottish natural capital, notably into native woodland expansion and seagrass restoration.
* Leading the Scottish Nature Finance Pioneers network.
1. We will update the Board on the latest thinking at the meeting.

## Risks

1. Engaging with private capital raises new risks for NatureScot, illustrated most immediately by our role in developing, raising funds for, and disbursing grants from SMEEF. The key novel risks can be characterised in terms of:
* Greenwashing – business and finance using investment solely to benefit their reputation with no significant outcomes for nature and climate
* Ethical and legal traps arising from handling funds from private entities – fraud, tax avoidance, corruption, human rights etc
* Just transition - the consequences of investment, especially in land, for the prosperity and wellbeing of local communities

## Conclusions/Recommendations:

* Is the Board content that it has sufficient visibility of this new area of work?
* Does the Board agree with high level analysis of risk?
* Does the Board agree with the emerging role and priorities for NatureScot? Do these meet the ambition of the Corporate Plan?

## Annex 1

**Natural capital workstream approach**

**Purpose**

This paper outlines an initial approach to establishing workstreams to progress actions set out by the Private Investment in Natural Capital Working Group, drawing on analysis of the Financing UK Nature Recovery (FNR) Initiative’s roadmap recommendations.

**Background**

The Private Investment in Natural Capital Working Group was originally set up in 2020 as a public sector partnership under a commission from the Environment & Economy Leaders Group (EELG) to *mobilise responsible private investment in the restoration and enhancement of Scotland’s natural capital, and so enhance the delivery of urgent SG policy priorities for climate change, biodiversity, environmental quality and the wellbeing economy*. It was co-ordinated by a team in the SG Climate Change Directorate.

In early 2021, the co-ordination role was taken on by the two new natural capital policy posts in the Agriculture & Rural Economy Directorate, alongside joint leadership of the work with the green finance team in DITI. A Directors meeting in September 2021 agreed to extend this arrangement to March 2022 pending clarification of the scale and scope of the work and its political support.

Since September 2021, political and public awareness of the opportunities and risks from natural capital market development has grown substantially, with SG commitment to this work likely to be confirmed through its inclusion as an action in the imminent National Strategy for Economic Transformation (NSET), and through the production of an Interim Statement and Principles on the type of responsible market for investment in natural capital that we want to develop in Scotland.

To reflect this growing awareness and new policy home, the working group has redefined its objective as *to develop a values-led, high-integrity market for responsible investment in natural capital that delivers benefits for local communities, wider society and nature”* over a time span of 3-5 years.

The working group has used the comprehensive set of actions and recommendations provided by the draft [Financing Nature Recovery (FNR) Roadmap](https://financingnaturerecovery.uk/recommendations-%26-roadmap) as a template for market development against which to identify appropriate actions for the Scottish public sector.

From this analysis, it is clear that the scale and complexity of market development requires changes to our current working group approach with a need for:

* Greater clarity of political ownership across economic and environmental portfolios;
* Greater clarity of SG Director and Directorate ownership across economic and environmental portfolios;
* Greater clarity on the role of government in developing these markets, e.g. stimulating investment in new markets, putting effective standards/regulation in place, co-ordinating different parties (i.e. overcoming market failures);
* Improved programme governance with a programme plan, SRO and greater overall resources deployed onto priority market development workstreams and tasks; and
* Improved engagement with a wider range of stakeholders in the public, private and third sectors.

With these improvements in mind, we set out below our recommended approach to this work for 2022/23 onward – with a particular focus on the number, type and content / scope of the required future workstreams.

**Our approach**

1. Programme Management – We will establish a formal programme supported by a Programme Initiation Document (PiD), a Programme Board of SG Directors and senior public agency staff, SRO(s) at Director or DD level, a programme manager, an officer level steering group and a series of officer level workstreams (membership). Joint ownership at ministerial level is now established and this approach must be reflected through joint ownership in our governance.

2. Workstreams – We will establish a series of focused workstreams to accelerate progress on the identified priority actions, and to streamline and connect existing strands to bring a strategic focus. Each workstream will take ownership of a specific theme with associated actions drawn from the FNR analysis and categorisation of the themes / actions therein.

The **workstreams** will be resourced from members and organisations within the existing steering group alongside additional members with subject matter expertise. Collaboration will be at the heart of this work and the existing steering group will draw resource from across the enterprise and environment agencies. While we anticipate that members may participate in more than one workstream, we do not intend to duplicate effort nor to reconvene the entire working group under every workstream. Instead, our aim is to make an expansive set of actions achievable and deliver progress in a rapidly evolving context.

In terms of **timelines**, the priority actions from the workstreams are expected to cover the next 3-5 years, and will align with the ten-year delivery architecture of NSET. Sequencing of priority workstreams and milestones will be drawn up separately. It may be appropriate for the Steering Group itself to take on specific workstreams.

Alongside the workstreams, we will also establish a new **sounding board** of investors, project owners and think tanks to provide expert insight and knowledge. The sounding board will interact with the workstreams as required.

**WS1 – FUNDING AND FINANCING**

The Green Finance Institute estimates that Scotland’s nature finance gap stands at around £20bn for the next decade. Public spending alone cannot achieve our objectives, and action to lever in investment that aligns with our values is critical. The existing market is immature and proven rates of return on projects are currently insufficient to ensure investor confidence. We need to develop a strategy to mature the project pipeline through a temporary funding structure that brings projects closer to market and capture investment.

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| **ACTIONS ALREADY IDENTIFIED** |
| Develop strategic approach to funding structure, FIRNS, impact fund, role of the Bank – as well as draw in other existing initiatives |
| Develop improved understanding of the function of blended finance and the associated risks and benefits |
| Engage with SNIB to discuss further their potential role to supply patient capital, building on 2021 announcement of funding agreement with forestry investment firm |
| Identify and secure funding options for FIRNS proposal |
| Develop principles and options to govern blended finance and other innovative finance models for nature – applicable to all relevant public funding streams |
| Engage with SG Capital Investment Plan to seek inclusion of natural capital |
| Consider the case for development of a “One Scotland” platform for investors and appraise different options |
| Establish the role that private finance can play in supporting biodiversity commitments in NPF4 and the forthcoming Scottish Biodiversity Strategy  |
| Develop liaison with finance industry through Scottish Financial Enterprise, Financial Services Advisory Board, ESG Taskforce and TNFD |
| Build wider links with economic sector through joint SCDI/SG Business Purpose Commission SCDI, SF&D, SNFU, Crofting Federation, Construction Scotland Innovation Centre, ScotlandIS, Scottish Landowners Federation, FinTech Scotland |
| Source pilots/best practice on approach to regulation/tax from across UK such as the Triodos project for Poole Harbour |
| Review carbon offsetting policy (particulalry where public land/support is involved) |

**WS2 – PROJECT PIPELINE**

The natural capital project pipeline is nascent, and models for risk and return structures are only beginning to emerge. Establishing a mature project pipeline that demonstrates the scale of revenues available from nature-based projects will be critical to meeting our objectives.

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| **ACTIONS ALREADY IDENTIFIED** |
| Set out approach to establish project pipeline at scale |
| Review existing project pipeline and identify priorities for engagement |
| Complete CivTech peatland project on prioritisation of investment and work with sponsor team to ensure the solution / platform maintains an investment focus |
| Develop and implement FIRNS |
| Identify one or more RLUPs pilots to focus on the opportunity from private investment  |
| Review existing network of other regional/local delivery frameworks and identify priorities for public sector support |
| Develop approach to project registry in Scotland and clarify its purpose (for example Is it a market registry like the UK Land Carbon Registry or something more informal like a list of projects seeking funding?) |
| Consider potential of aligned approaches to public land as a framework for securing private investment |
| Complete public land spatial data project and conduct analyses of strategic natural capital investment opportunities (e.g. hotspots of public land, networks of public and third sector land) |
| Review the nine pillars within the £1 billion Routemap and develop project case studies |
| Clarify potential of existing regional and local initiatives in Scotland to produce outcome targets for nature recovery and environmental improvement and economic activity  |

**WS3 – MARKET GOVERNANCE**

To establish a high-quality, values-led natural capital market, we need to ensure that our regulations and incentives align with our goals, and that we work in collaboration with like-minded partners. Close and effective engagement with UKG will be central to the effectiveness of this workstream – this will present resourcing implications that the workstream will need to consider.

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| **ACTIONS ALREADY IDENTIFIED** |
| Develop ideas for Environmental Market Governance in Scotland to feed in to Options paper OR Engage with the Pollination Group to commission this work (pending funding renewal)  |
| Further develop the Scottish principles through engagement with the wider investor network including GEFI and TNFD |
| Engage with UKG to investigate the opportunities for the operation of existing carbon codes and the development of new codes (including considerations of those other than carbon) and offsetting policy |
| Consider UK natural capital market role of other UK policy liaison groups (e.g. IUCN Peatland Group, Defra “Stacking & bundling” Group)  |
| Clarify the UKG and SG legal roles for environmental market rules and standards (via commissioning work or engagement with SGLD)  |
| Clarify devolved powers for regulation across economic and environmental sectors (via commissioning work or engagement with SGLD) |
| Clarify devolved powers for regulation and ‘supporting fiscal measures’ across economic and environmental sectors |
| Engage with Financial Conduct Authority to understand how carbon market (including voluntary markets) can function and be regulated (as a derivatives market) |
| Establish good working relationship and connections with Green Finance team in Defra and other key contacts such as GFI and EKN |
| Engage with tax policy leads in SG/UKG to clarify tax treatment of land |

**WS4 – SUPPLY CHAIN**

Build a supply chain which can service the emerging domestic project pipeline in Scotland s well capture the economic opportunity of catering to a global market. This includes focus on nature data and tech companies, potentially building a cluster and conducive eco-system as well as advisory and consultancy services through engagement on the TNFD.

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| **ACTIONS ALREADY IDENTIFIED** |
| Establish a baseline assessment of economic opportunity ideally at the national and regional level  |
| Complete CRF project on Local economic impacts of natural capital investment, and consider the supply-chain implications (esp. in terms of practical on-the-ground delivery of NC investment) |
| Identify the existing nature and scale of supply chains for natural capital improvement (including financial & technical consultants/advisers, contractors, satellite/earth observation data/mapping, regulatory functions, community/stakeholder engagement) |
| Assess the likely scale, and gaps to be filled, in order to deliver on Scotland’s natural capital ambitions to 2030+ and the anticipated additional £20bn investment |
| Identify how can these gaps be addressed (eg business development/diversification, entrepreneurship, commercialisation, innovation) to help create high-skill/high value businesses and jobs in Scotland |
| Identify any role/opportunities relating to inward investment |
| Explore potential connections that could be made to the Supply Chain Development Programme |
| Identify actions for the skills supply system to support this growth (eg building on the Green Jobs Fund, Climate Emergency & Rural Economy Skills Investment Plans) |
| Develop an overview of the potential for job creation, including the identification of any skills shortages which may hinder sector development  |
| Complete CRF projects on Scotland Carbon Fund (SCF) and associated price floor mechanism, consider learnings and potential regional pilot of SCF and wider natural capital outcomes |

**WS5 – DATA AND ACCREDITATION**

High-quality, decision grade data and accreditation processes are vital to ensure a high-integrity market, help meet our the environment and climate change goals, attract high-integrity investors who share our ambition and values. After ascertaining an improved evidence base of the current picture, this workstream will examine existing (and alternative) methods of accrediting the impact of investment in natural capital.

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| **ACTIONS ALREADY IDENTIFIED** |
| Identify existing activities and establish data needs for Scottish pipeline and market (eg. including improving our understanding of RESAS IDDP) |
| Produce recommendations to address existing data gaps, engage with JNCC |
| Clarify the devolved approach to nutrient and flood mitigation standards |
| Incorporate this requirement into the Scottish Biodiversity Strategy/CAP Replacement/ARIOB processes for future policy |
| Set out a benefit and risk analysis of a Scottish accreditation system |
| Learn from accreditation models developed elsewhere in Europe and internationally (NatureScot to summarise French model by end of 2021) |
| Organise HIE convened session on regional project data needs |
| Review available data for a range of accreditation models (eg. LEAF, NCAPP) |
| Engage with Digital Scotland and fintech sector to get a better understanding of the opportunities from digital assets |
| Develop an improved understanding of the links to UK, European and international accreditation schemes (eg. BSI and their sustainable finance strategic advisory group programme, BEIS green finance work) |

**WS6 – IMPACT AND BENEFITS**

We are committed to the development of a high-integrity, values-led natural capital market where communities are empowered and benefit from investment. The interests of communities must be represented both now and in the future. This workstream looks to assess models of capturing community benefits.

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| **ACTIONS ALREADY IDENTIFIED** |
| SG interim statement and set of principles on responsible markets |
| Raise this issue as an action for the “Natural Capital approach to public land’ group chaired by NatureScot  |
| Learn from the National Park Revere project and Argyll & Bute community wealth building project |
| Learn from Enterprise Agencies use of social impact measurement toolkit |
| SLC Report on land market operation by Summer2022 |
| Further consideration of community benefit principle in development of carbon codes and the wider ecosystem |
| Further consideration of community benefit principle in VDL funding  |
| Inclusion of secondary markets within scope of SG/SLC work on Just Transition/community benefits |
| Investigate the opportunities and schedule for further improvements to the operation of existing carbon codes such as to include wider benefits |
| Build an evidence base around the economic development benefits of natural capital improvement and identify the additional economic activities that can be secured locally and nationally |
| Explore mechanism for distribution of community benefits (for example as part of the Argyll project and other initiatives underway within HIE) |
| Complete CRF project on Local economic impacts of natural capital investment, and consider the magnitude / scale of GVA and FTE impacts of specific NC investments (woodland creation, peatland restoration, saltmarsh restoration and regenerative agriculture).  |