Nature Investment Hub

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What is the Role of Policy in Encouraging Investments in Nature in Canada?

Regulatory clarity and policy innovation can be important drivers to create new ecosystem service markets and motivate nature investment.

Authored by the Nature Investment Hub team. Nature Investment Hub publications do not necessarily reflect the views of Hub partners or funders.

Many conservation finance success stories stem from effective policy and regulation. This can include clear requirements that signal to businesses how to meet compliance, providing assurance that their strategies and spending will be aligned with regulations. Another example is funding programs that require innovative accounting and tracking of environmental impact, which – when presented with new data related to natural capital – motivates improved management of natural resources. Effective policy and regulation can also enable the creation of new markets and provide assurance that there will be demand for the ecosystem value stream being produced. For example, putting a cap on carbon emissions and a price on carbon provides clarity for those investing in nature-based carbon projects, conveying to investors that there will be both demand for offsets and some assurance on the price they can return on their investment. This explainer looks at the importance of regulatory clarity, the current policy gaps in Canada, and the enabling conditions needed to foster increased investment in nature.

Regulations Leading to Markets

Several examples of conservation finance instruments implemented in the United States (U.S.) – some of which have resulted in multi-billion dollar nature markets – stem from policy or regulatory changes that currently lack parallels in Canada. This gap highlights the need for policy clarity and innovation, in order for Canada to attract investment and realize its environmental, economic, and social benefits.

- **Stormwater Credits** – Credits are generated from ecosystem restoration and purchased by developers who are reducing the permeability of the land they are developing. In the U.S., this policy established a price floor for credits as well as a guaranteed government buyer if credits are not sold on the open market. This means that credits are purchased at a guaranteed minimum price, which significantly reduces the risk of taking on restoration activities, and allows project developers to invest at scale and attract external investors. There are several municipalities in Canada that offer stormwater credits to homeowners for certain activities, but these are typically one-offs. As these offer individual rewards for specific actions, they are not poised for a larger scale market.

- **Voluntary and Regulatory Carbon Credits and Offsets** – Several design features of the policy that underlies the California carbon market have influenced its longevity and success in reducing emissions. A moving price floor ($10/tonne and increasing five percent annually plus inflation) has led to stability and investor confidence when carbon prices globally are fluctuating. Rules that allow carbon credit generation from avoided conversion on private lands have also enabled tribal and Indigenous communities to generate revenue from conservation activities.

- **Wetland Mitigation Banking Expansion** – Wetland and other types of habitat mitigation takes place when a development must compensate for the impact on local ecosystems by restoring or conserving equivalent lands elsewhere. Mitigation banking is when project developers ("proponents") can proactively protect and restore lands, "banking" them with the expectation that there will be a future demand for the mitigation credit that these activities generated. Wetland mitigation banking was always included in the U.S.'s *Clean Water Act*, but a rule change in 2008 allowed it to scale dramatically by allowing third-party investors (i.e. non-proponents) to participate and create banks in advance of projects. In other words, even in the absence of a development project requiring mitigation measures, proactive restoration activities incentivized more cost-effective landscape-level activity in anticipation of future development.

Canadian Policy Gaps

While there are many novel policy and programming opportunities to catalyze further investment in nature in Canada, some of the existing uncertainty from the current regulatory environment is keeping investors at bay.

Generating Credits and Offsets from Unmanaged Public Lands

Most of Canada's forests are on public lands. These forests are considered "managed" if they have plans that define management activities including commercial forestry. Much of Canada's intact forest and wild ecosystems are "unmanaged", meaning they do not contain commercial resource tenures. Where management plans are not present to define the extent of forestry or other types of activities that impact the landscape – demonstrating that degradation is avoided (for example, the extent of forestry reduced) – generating offsets or credits is not possible. This limits a major potential revenue stream for communities seeking economic opportunities from conservation.

Peatlands and Carbon Sinks

The existing policy gaps in carbon accounting for peatlands and carbon sinks pose a significant challenge to the protection and conservation of these landscapes. Canada's reporting commitments under the *Paris Agreement* do not include many relevant carbon fluxes, especially from peatlands, which are concentrated in the Boreal Forest and in northern Canada. Creating a holistic carbon accounting system would provide a more accurate picture of how development activities influence carbon sequestration, potentially opening up new opportunities for carbon credit generation.

Species and Habitat Mitigation Banking

As outlined above, the U.S.'s regulatory system allows for landscape-scale protection prior to degradation taking place, enabling multiple development projects per site and third-party participation. This has created an actual market; as compared to in Canada, where mitigation banking can only take place on federal lands and is especially limited in provinces, and only one development project can be mitigated on any site. Biodiversity offsets in Canada are also limited to industrial and development proponents (i.e. no third-party participation), constraining the potential for external investment and scaling.

Canada's Federal Carbon Offset Regulations Are Under Development

To date, Canada has released one carbon offset protocol for nature-based contexts: for Improved Forest Management on Private Land. Regulated markets provide increased certainty and often improved carbon prices, though private lands make up a small percentage of Canada's forests. Moreover, even once there is a protocol for improved forest management on public lands, it will only apply in "managed" regions and not in areas where commercial forestry is less common, such as in the vast Northern landscapes where stewardship of intact natural systems could be incentivized and rewarded.

Enabling Considerations

Policy pathways — in the public and private sector — can provide clarity and the necessary underlying data to support the scaling of conservation finance activities in Canada.

Empowering Indigenous Leadership

Honouring commitments to the United Nations Declaration on the Rights of Indigenous People, and respecting and upholding rights and title, is a necessary foundation for conservation finance in Canada. This also enhances clarity and confidence for investors and enables funding to flow to conservation, which is particularly relevant for Indigenous communities leading the conservation and stewardship of their lands and waters.

Natural Capital Accounting

Updating accounting guidelines of the Public Sector Accounting Board to include natural assets as tangible capital assets helps to quantify the environmental and economic benefits derived from nature. This helps demonstrate the value to society and enables policies to be designed to incentivize investment, attracting the private sector. British Columbia is a leader in incorporating natural assets into its accounting practices.

Tax Innovation

From a regulatory standpoint, tax incentives can play a dual role in both encouraging investment and distributing risk. A favourable tax environment is an enabling factor for several conservation finance instruments, including easements and impact investing incentives. Further, tax innovation or relief measures have the potential to reduce barriers to entry, while favorable taxation can provide the needed financial incentive required to attract landowners and investors.

New Investment Standards

Quarterly reporting will always be a limiting factor for nature-based investment strategies since it takes considerable time for ecological benefits and impacts to accrue and be measured. It is important that senior management demonstrates leadership by recognizing the value of returns beyond the quarterly cycle and acknowledging that other types of non-financial returns are of value and interest to investors. The emergence of bond evaluators equipped to deal with environmental projects, specifically ecological projects, will also help attract investors and provide confidence to those less familiar with the nuances of the space. Likewise, attaching bond ratings and other types of risk assessments on conservation finance instruments will contribute to investor confidence and interest.

As the volume of investment opportunities that meets stringent sustainability criteria increases, value-based investors will be seeking more diverse opportunities in the realm of nature-focused investments. Developing standards and a taxonomy to address this demand will help facilitate overall market growth.

Nature-Related Financial Disclosures

Reporting requirements for greenhouse gas-linked emissions and other environmental and social impacts are on the rise. Notably, the *Task Force on Nature-Related Financial Disclosures* is a UN-led initiative, modeled after the *Task Force on Climate Related Financial Disclosures*, has produced a framework for evaluating operational and supply chain impact on biodiversity and ecosystems.

New reporting and accounting standards for nature are emerging on several fronts. Initiatives such as the Partnership for Biodiversity Accounting Financials and the inclusion of natural assets in Canada’s Public Sector Accounting Board are a sign of this trend. It is likely these activities will increase demand for Environmental, Social, and Governance (ESG) funds screened for biodiversity, as well as direct investments in nature-related activities.

Knowledge Sharing and Agenda Setting

Collaboration between relevant partners and involved parties is essential to produce a common language for conservation finance. Collaboration will also help develop an understanding of impact metrics, key ecosystem valuation tools, and how international examples apply to the Canadian context.

The Nature Investment Hub is driving a fivefold increase in investments in nature in Canada, to realize environmental, social, and economic benefits locally and nationally. This collaboration between public, private, philanthropic, and Indigenous leaders champions a new conservation finance agenda for Canada. The Nature Investment Hub is a Solution Space of The Natural Step Canada in partnership with the Smart Prosperity Institute, whose shared vision is a strong and inclusive economy that thrives within nature's limits.