# Corporate and investor stakeholder engagement

## FIRNS: Developing a source to sea, nature finance model

April 2024

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## Introduction

The FIRNS Source to Sea Fund project, commissioned by Fisheries Management Scotland and conducted by Finance Earth, with support from Howell Marine Consulting (HMC), investigated potential next steps for the Scottish Marine Environmental Enhancement Fund (SMEEF) with reference to nature finance options, combined with an assessment to establish a similar fund for river catchment restoration projects. The approach used by SMEEF was analysed with the aim to assess the opportunity to establish a Source to Sea funding model, through separate funds (SMEEF and a river fund) or as a one single combined fund. Using the SMEEF model as a starting point, a range of options for a funding model that covered from Source to Sea were developed and assessed. These are presented in the FIRNS: Developing a Scottish Source to Sea, nature finance model Final Report.

This report presents the key findings from interviews and engagement conducted by Finance Earth with existing corporate contributors to SMEEF and investors active in the natural capital space. The learnings and findings informed the development of the three funding model options discussed at the workshop and presented in the Final Report. In addition to this, the Final Report draws on Finance Earth's experience from developing other related nature finance initiatives such as the Greater Manchester Environmental Fund (GMEF) and the development of the UK Native Impact Strategy, a joint venture between Finance Earth and Federated Hermes that has secured £30m first loss capital from Defra.

**This summary report should be read in combination with HMC's Source to Sea - Stakeholder Engagement Report.**

## Stakeholder Engagement Approach

In late January and early February 2024, Finance Earth conducted four on-line meetings with companies from the offshore wind and renewable energy sector. Two meetings were held with regulated businesses and two were conducted with un-regulated business, providing a difference in perspective regarding regulatory considerations. In addition to these meetings, Finance Earth met with three financial institutions that were known to operate in Scotland, with an interest in both nature restoration and natural capital opportunities. The individuals interviewed were from the asset management and investment functions and as a result the interviews focused on the opportunity for repayable capital and the engagement with ecosystem sales to generate a positive financial return.

Finance Earth's objective was to capture the corporates views on:

- experience and understanding of SMEEF;
- requirements for additional services (demand);
- preferred model for a 'Source to Sea' fund and options for engagement (i.e., CSR donations, outcomes buyer, investor);
- requirements for collective funding or targeted contributions;

- monitoring and reporting requirements;
- investment requirements and opportunities (where appropriate); and
- community engagement and benefit requirements (where appropriate).

Finance Earth conducted the online meetings in a semi-structured way, presenting SMEEF, the project and the key objectives of the interview, while also allowing the interviewee to raise points or discuss issues in more detail when required. During all the calls, Finance Earth presented the Source to Sea project as a FIRNS-backed engagement, introduced SMEEF and the opportunity to establish a river catchment fund to create a Source to Sea funding model. Finance Earth presented a range of indicative projects from river restoration to saltmarsh habitats and seabed restoration that could be covered by a funding model that financed projects from Source to Sea. Finance Earth also presented a selection of different engagement and/or funding options through which corporate partners could support nature restoration with SMEEF or Source to Sea. These ranged from donations or philanthropic engagements to outcome-based funding and repayable finance focused on the potential to generate positive financial returns from ecosystem service sales (such as biodiversity and carbon).

In total Finance Earth conducted nine interviews, which included representatives from the following:

- **Energy Companies:** Copenhagen Offshore Partners, Orsted, SP Energy Networks, SSE Distribution
- **Investors:** Abrdn, Aviva Investors, River Global
- **Other:** NatureScot, One Planet Consulting
- Finance Earth also attended a selection of stakeholder interviews that HMC led to help build a broader understanding of SMEEF and requirement from project partners / stakeholders.

# Key Findings

## Experience and understanding of SMEEF

Stakeholders recognised SMEEF as an effective funding model with a strong brand that was able to bring key stakeholders together. Experiences of engaging with SMEEF had been positive and interviewees highlighted SMEEF as an important strategic partnership, enabling them to achieve operational benefits beyond a pure CSR/donation partnership (e.g. engaging with the ongoing development of compensation approaches).

Corporate partners and investors interviewed recognised that SMEEF was underpinned by a robust governance process and welcomed the role that NatureScot has in the management and development of the fund. A handful of corporates noted that the creation of a Source to Sea fund outside of NatureScot could impact confidence and might deter additional funding commitment unless the governance structure enabled NatureScot to restrict the activities of the fund to those in line with key objectives.

## Opportunities

In general, there was appetite for, and interest in, corporates making contributions to SMEEF or a Source to Sea fund that were larger than those previously made, provided projects and outcomes aligned with an organisation's strategic priorities. Interviews with existing contributors to SMEEF also flagged a role that SMEEF, or Source to Sea could play in developing projects to build capacity in the market, especially where this could lead to projects that assisted the delivery of regulatory requirements. This view was shared by one of the investors that recognised the value that SMEEF or a Source to Sea fund could add in terms of enabling project development and capacity development.

One interviewee questioned if a revised funding model could play a role in linking opportunities under new regulatory commitments and whether SMEEF or a Source to Sea Fund could act in partnership with a Scottish Marine Recovery Fund. In this scenario offshore partners could contribute funds to a single fund or source that invested in projects such as biodiversity mitigation which supported the delivery of regulatory requirements.

*These findings correlated closely to the stakeholder engagement conducted by HMC, as documented in the Source to Sea Stakeholder Engagement Report.*

## Funding for specific areas of corporate interest

SMEEF is recognised as a fund that pools contributions from private and public partners, directing capital to projects that have the greatest impact. However, two energy companies noted increased interest in funding specific initiatives that aligned with a corporate's strategic objectives and suggested greater visibility for contributions made through SMEEF. These interviewees also noted that a fund would need to facilitate contributions to specific areas to retain or increase corporate commitments going forward.

*SMEEF does currently have the flexibility to allocate capital to initiatives via focused pots or buckets that align with SMEEF restoration objectives, two such areas currently in development through SMEEF are seabird resilience and seabed restoration pots.*

## Multi-year funding

A couple of the interviewees noted that projects rarely operate on a short time-frame and may therefore need multiple years of funding to deliver restoration and before meaningful outcomes and measurement can take place. To meet the project requirements longer term support, the energy companies interviewed recognised the need to provide multi-year commitments to SMEEF or a Source to Sea fund. One interviewee noted that SMEEF was already engaging with a consortium of off-shore energy companies to commit up to five years of contributions, with the intention that this could provide cross-year funding to projects with a seabird resilience focus. This multi-year model would provide a framework for ensuring longer-term corporate engagement and the interviewee advised that any further funding models for Source to Sea should consider similar arrangement.

## Investment size and return targets

The financial institutions recognised SMEEF's brand and understood that SMEEF provided capital to projects on a non-repayable basis, acting as an aggregator of contributions from the private and public sector. The individuals interviewed were from the asset management and investment functions and as a result the interviews focused on repayable capital and the opportunity for a Source to Sea fund to engage with ecosystem sales to generate a positive financial return. Two of the interviewees expressed interest in supporting the development of a fund that targeted positive financial returns for investors, but the opportunity would have to be of sufficient scale to take on further consideration. Where the fund strategy and focus did not target a positive financial return, the investors noted that this would not be of interest given their investment focus and as such, voluntary contributions to SMEEF or a Source to Sea fund would be unlikely unless provided by the respective businesses ESG / CSR functions. The interviewees were not responsible for corporate ESG / CSR decisions.

One interviewee that was targeting to raise a natural capital focused investment strategy in 2024, implied that Source to Sea could complement the proposed natural capital investment strategy, with an indicative allocation of 2% - 5% of the natural capital fund's net asset value (if the natural capital fund was £100m, the investment into new fund such as Source to Sea would be up to £5m of private investor capital).

At present there is a low level of investor confidence in projects generating sufficient financial returns and it was unclear from the engagement with investors whether a fund that focused on voluntary contributions or a fund that targeted a financial return was the best option. One interviewee suggested a potential fund structure for a Source to Sea concept that combined the delivery of ecosystem services outcomes with long-term agreements secured with infrastructure and utility companies. Under this structure private repayable capital could be committed up front to enable project delivery with targeted outcomes (such as biodiversity or carbon), with security over capital repayment provided by the long-term agreements (~10 year) with the utility or infrastructure providers linked to the delivery of outcomes. The interviewee stated that this would be a lower-risk and more attractive investment opportunity than providing investment capital to a fund which aimed to generate returns from the sale of ecosystem services, given the low level of confidence in the ability of projects to deliver a finance return. A funding model structured with a long-term agreement from a utility or infrastructure providers could unlock significant capital from the private market and from raising opportunities from investors that have significant demand for project pipeline opportunities.

## Geographic focus

Those interviewees that noted an increasing requirement for contributions aligned with specific initiatives (such as BNG or seabed/seagrass restoration) also noted a need for funding to be geographically focused, in their areas of operation. For the two regulated energy companies, projects would need to be within the specific distribution license areas and for the unregulated energy companies the consideration was linked to a project's proximity to operations (where possible). Interviewees had differing views on geography depending on their respective priorities, and one noted that in the past their organisations had funded terrestrial projects that overlapped, but are not entirely located within, licence areas.

Similarly, offshore wind developers are interested in projects within their respective regions of activity, such as habitat restoration on coastlines adjacent to the marine environments where wind farm development has an impact on local ecosystems. While some noted this could lead to difficulties in sourcing suitable projects, there appeared limited interest in supporting projects that were not within their region of operation (for instance, on a different area of coastline within Scotland).

## Regulatory constraints

In addition to the geographic constraints noted above, regulated energy distributors face specific requirements that would shape any contributions to a funding model and the monitoring requirements. Under Ofgem regulation, energy distributors can set aside allocations to fund environmental projects, for instance to deliver a biodiversity uplift or seabed restoration for seagrass. However, this funding could be clawed back by the regulator if it is not deployed or does not meet the objectives required by the regulator. A  regulation time-windows of five years should allow sufficient time to deploy and commit capital, but a fund that accepts contributions from a regulated pot of money, such as biodiversity enhancement from Ofgem, may need to consider how funds are returned in the event that the outcome is not delivered or capital has not been invested in projects by the end of the specific window (~5yrs for Ofgem).

## Monitoring requirements

SMEEF currently employees an aggregated, high-level approach to reporting at the fund level (see SMEEF Impact Report 2023 and HMC's findings in the FIRNS Stakeholder Engagement Report). This approach currently suits corporates where reporting requirements are not significant, but both energy companies and investors stated that higher levels of contributions, funding or investment would require greater reporting, with an increased focus on project level reporting such the total area of habitat restored annually, the number of carbon credits from a project or the biodiversity uplift forecast from a habitat management plan.

Irrespective of the structure, where a fund and underlying investee projects are engaged in ecosystem service markets seeking to sell ecosystem service opportunities to private investors, monitoring and reporting requirements will be significantly higher than SMEEF's current approach. This is attributed to the fact that private investors require regular and detailed updates on how the fund is deploying capital in line with investment criteria and how it is performing financially, in terms of impact and project level reporting. Projects funded by the structure would undergo detailed monitoring, reporting and verification (MRV) of actions to ensure compliance with regulated codes such as carbon markets and biodiversity. To this extent, were a fund to engage in ecosystem service markets, many of the interviews recognised that the burden of monitoring and reporting would be significant for the management team and underlying projects. One interviewee questioned if the Source to Sea funding model could take on a role of providing additional support to projects through contributions that fund monitoring, deliver training, build knowledge, or provide advice to project partners.

The engagement with energy companies highlighted divergence in how different parties are undertaking engagement with nature restoration and ecosystem services. One company had elected to take a more direct role in project management where ecosystem service opportunities were available, ensuring that the project aligned to both internal standards and global protocols (Verra / Gold Standard). Meanwhile others noted a growing requirement for project monitoring and reporting to align with requirements under Taskforce for Nature Related Disclosure (TNFD) and Science Based Targets Network (SBTN). One interviewee noted that regulated pots of capital such as a biodiversity enhancement fund from Ofgem introduced reporting requirements that may differ to what a fund such as SMEEF provides at a fund level (aggregated across projects). In this example, Ofgem required reporting at the end of the regulated window (2026) with each project providing a habitat management plan and a BNG assessment (through an approved metric) with the enhancement value. The reporting requirement is project specific and could place additional complexity on a river catchment fund if it was to accept contributions from ring-fenced regulated pots of money.

Several stakeholders, both energy companies and investors, mentioned the development of in-house criteria or approaches for monitoring. For instance, several interviewees noted that they were investigating the potential to use the Defra metric for Biodiversity Net Gain (BNG) as the basis to measure biodiversity uplift but there was no mention of marine compensation measurement during the interviews. One interviewee noted that 'projects need to set out what they will achieve and how they will monitor it,' which would combine into a fund level report. They questioned if the fund would set a standardised reporting framework, or clear KPIs that could be more practical and make investment in the fund more attractive.

Proposed metrics to develop and report on for a river catchment funding model or Source to Sea fund included:

- Length of riverbank restored or area of coastal / marine habitat (acres of seabed);
- Biodiversity unit uplift;
- Carbon benefits (sequestration/abatement);

- Water quality improvements / nutrient credits; and
- Coastal erosion risk reduction or flood risk reduction, e.g. reduced risk of a 1 in 50-year flooding event in percentage terms or using an output as a proxy for an outcome such as litres of water stored temporarily.

## Community considerations

*Leah Reinfranck, Fisheries Management Scotland, concurrently conducted a project 'How a "Source to Sea" fund could benefit both ecosystems and communities'; these findings were shared at the workshop in Edinburgh (Monday 11th March 2024).*

During several of the energy and investor interviews Finance Earth included questions on community opportunities / outcomes and worked in partnership with another FIRNS project focused on Community Benefits to understand the interviewees' stance on engagement and benefits.

Corporates and investors interviewed aligned on the need for more detailed reporting on community outcomes (where possible), especially given increasing regulatory pressure to demonstrate community benefit and uplift. As with other monitoring requirements, certain corporates have already developed their own internal KPIs for assessing community benefit, against which projects report. However, most of the interviewees were open to additional reporting through a fund or model if it could align with corporate requirements. Between the investors one company a difference in the levels of community engagement currently undertaken was noted and where the most advanced practices were closely linked to the existing ownership of natural capital assets / projects, while the investor targeting investment going forward had to confirm community engagement practices. The more advanced of the interviewees had created a specialist social value team in-house to manage natural capital assets that had been bought within a wider investment strategy. The social value team administered community engagement for the business, adhering to set of in-house best practices.

Certain stakeholders were unclear or uncertain about how best to measure community benefits beyond simply reporting on the proportion of funding that goes to communities. This approach does not fully capture the benefits to communities and a funding model may need to consider whether a standardised approach to reporting on community benefits is desirable. Such an approach may require the measurement, monitoring, and reporting (and preferably independent verification) of a range of financial and non-financial benefits (including community benefit), with a recognition that not all projects will deliver all the possible benefits as measured by the standardised approach.

One interviewee noted the role the funding model could play in supporting community upskilling, providing examples of nature restoration projects that included training residents to deliver restoration works, given the lack of skilled delivery labour. During the conversation the interviewee noted that they conducted community engagement on all owned / acquired natural capital projects given the reputational risks of the emergent natural capital asset class, and that they wanted to incorporate the views of local groups in project design. Additionally, some interviewees noted interest in projects that delivered a proportion of revenues to local communities, but questioned how this could be achieved in a funding model such as SMEEF where projects were not generating income from ecosystem services or other opportunities (e.g. ecosystem tourism).

A further challenge noted was the difficulty for coastal or marine projects funded by offshore developers to define a community benefit when the project is offshore. This concept highlighted that having community consideration in a funding model can be good practice, but if generating community benefits are mandatory, it could dissuade voluntary corporations if the community consideration impacted the restoration objectives that could align with corporate requirements.

## Summary

The corporate engagement conducted during this project highlighted that SMEEF has developed a strong brand and understanding of purpose in certain corporate sectors. Those interviewed continue to have interest in SMEEF and there is also interest in a river catchment and/or Source to Sea fund. However, the level of interest is subject to a clear definition of a fund(s) focus and strategy, and the ability to align with corporate monitoring and reporting requirements. All the investors that were interviewed stated that a fund would need to provide a positive financial return to attract repayable investor capital and that further engagement with SMEEF or a Source to Sea model would be more appropriate from an ESG / CSR perspective if no financial return was available.

An overview of the key opportunities and risks / challenges with establishing a Source to Sea fund, identified through interviews with stakeholders, is provided in Table 1.

**Table 1.** Overview of opportunities and recommendations associated with developing a fund as identified through stakeholder engagement.

| Opportunities |
|---|
| • Since inception SMEEF has developed a simple structure that aggregates donations from public and private sources and distributes grants to projects. This model is understood and respected by corporates, but further development could be required to maintain SMEEFs role with corporate contributors.<br>• Corporates recognise SMEEF's identity and marine / coastal targets, but there are potential risks to SMEEFs messaging and brand if river catchment opportunities are added to the fund.<br>• Corporates want to work with SMEEF and expressed an interest in a model focused on or including river catchment opportunities. However, adding a focus on river catchments to SMEEF may not suit existing contributors (offshore wind sector). |

- Corporates are interested in funding specific initiatives (seabird resilience / seabed restoration) through a fund. The opportunity to facilitate investment in projects that align with corporate initiatives could generate support for a fund.
- Corporates understand that projects need multi-year funding and expressed interest in setting up multi-year funding commitments with SMEEF.
- Investor demand exists for projects that can generate a positive financial return, but this requires engaging in ecosystem service markets and a different fund structure to SMEEF. This opportunity could attract significant private capital, increasing the investment into Scottish nature restoration.
- Any investment structure that engages with ecosystem service markets and attracts repayable private capital will require more detailed monitoring and reporting at the fund level and monitoring, reporting and verification at the project level.
- Geographic focus is important to contributors and is expected to align with a fund's ability to accommodate specialist interests that align with regulated activities or corporate requirements (such as seabed restoration in the North-East of Scotland and not the South West).
- SMEEF and/or Source to Sea could function as a partner to corporates seeking to deliver regulatory and policy driven requirements such as net gain and compensation.

Recommendations

- Stakeholder engagement was conducted with the asset management and investment teams of three investors, each of which focused on opportunities to generate a financial return through ecosystem service sales. Further engagement should focus on sustainability teams as ESG / CSR opportunities could create stronger demand for SMEEF and/or a Source to Sea model.
- Additional corporate engagement should be undertaken to understand strategic objectives and ensure a fund is able to align with key priorities to ensure a long-term future.
- SMEEF and/or Source to Sea should assess the opportunity to provide project development capital and build capacity in the market.
- Ensuring clarity over a funds focus and strategy through communications and branding will enable corporate partners to align with the focus of the fund over the long-term.
- SMEEF should continue to explore opportunities for multi-year funding (with private capital) and corporates recognise project requirements for >1 year of funds.
- Any fund or mechanism that engages with capital contributions linked to a regulated pot of money, such as Ofgem biodiversity enhancement, should assess the risk of claw back and reporting requirements.

The learnings and findings from the stakeholder engagement were used to evolve the fund model options and were assessed at the workshop. This information, combined with the Source to Sea - Stakeholder Engagement Report and Workshop Learnings Presentation contributed to the finding presented in the FIRNS Source to Sea Final Report.