



# Biodiversity risk in the finance sector

**Ben Jobson**, Programme Officer, IBAT Alliance

**Olivia White**, IBAT consultant and ESG adviser

**Guilia Guidi**, IBAT consultant and ESG adviser



**Biodiversity is a critical risk factor across the world and underpins many of the United Nations Sustainable Development Goals (SDGs). This white paper explains how biodiversity fits into sustainable finance for both banks and investors. We highlight the new demands that private sector corporations will need to consider. These demands are significant as biodiversity loss holds an existential risk for the world and is a clear focus of SDGs 14 and 15 - Life below Water and Life on Land. Integrating biodiversity concerns into lending and investment decisions requires some effort. However, data are available through tools, such as the Integrated Biodiversity Assessment Tool (IBAT), which financial institutions can use to inform their biodiversity risk management processes.**

Biodiversity is the fundamental infrastructure supporting life on earth but is rapidly diminishing. Declines are occurring at rates unprecedented in human history, with an estimated one million species at risk of extinction due to human activity (IPBES, 2019). The World Economic Forum continues to list biodiversity loss as one of the top five global risks in terms of impact and likelihood. As such, the private sector - including the finance sector - is increasingly expected to incorporate biodiversity protection into decision making and to evolve business models which protect and restore ecosystems and the services they provide. This expectation will continue to grow as the connection between systemic biodiversity loss and climate change becomes more apparent to society, with ecosystem deterioration reducing both the ability to store carbon and lowering the planet's resilience to climate change impacts like flooding. In addition to managing biodiversity-related risk, opportunities linked to nature-based conservation finance also highlight the prominent role that the finance sector has a to play in protecting nature and ecosystem services.

## **Biodiversity risk for the financial services sector will continue to grow**

Biodiversity conservation has risen rapidly up the environmental and political agenda. Whilst not conclusive, some evidence suggests that the loss of habitat and illegal wildlife trade could lead to an increase in animal-borne diseases (such as Covid-19) jeopardising human health and raising important questions about biodiversity loss and the future resilience of interconnected supply chains in the global economy. There is growing emphasis on the role of the private sector in reducing nature loss, with some organisations calling for a 'Paris Climate Agreement equivalent' outlining a new globally binding biodiversity agreement to halt the decline of biodiversity. Transformational change will be required across business to address ongoing declines alongside reporting and tracking mechanisms to assess change.

## **The expectations on the private sector - including financial services - to protect biodiversity are likely to increase**

- The Convention on Biological Diversity's Fifth Global Biodiversity Outlook reported that we have failed to meet, in full, any of the 20 'Aichi' Targets. These were adopted by governments a decade ago at the tenth meeting of the Conference of the Parties to the Convention on Biological Diversity, 18-29 October 2010 - Nagoya, Aichi Prefecture, Japan. As we enter a new decade, the Conference of the Parties for the Convention on Biological Diversity will set new ambitious global biodiversity targets. Private sector involvement will be crucial to developing solutions to help meet these new targets and there will likely be a push to mainstream biodiversity considerations across the business and finance sectors.
- The EU Sustainable Finance Taxonomy includes the 'protection and restoration of biodiversity and ecosystems' (European Commission, 2020) and will be critical for integrating sustainability considerations into the capital markets and re-orienting capital flows towards

sustainable growth. Under the proposed taxonomy regulation, for an activity to be classified as 'sustainable' it must "do no significant harm" to several environmental objectives including "protection of healthy ecosystems". The taxonomy will provide investors, pension funds and private equity firms with a common definition of what is green and what is not in order to channel more capital into sustainable businesses and prevent green washing.

- Signatories to the 2019 UN Principles for Responsible Banking (comprising 130 banks representing more than US\$147 trn in assets) will continue to implement their commitments to set targets and report publicly on their progress to meet the Sustainable Development Goals (several of which are directly and indirectly related to biodiversity) and the Paris Climate goals.
- The OECD Due Diligence for Responsible Corporate Lending and Securities Underwriting (OECD, 2019) guides banks on their due diligence processes beyond asset-specific finance to better understand and manage their social and environmental – including climate and biodiversity – impacts of their corporate lending and underwriting portfolios. This guidance introduces the importance of using the appropriate tools to gather information and perform a meaningful due diligence.
- The 2019 Equator Principles 4 (adopted by 110 financial institutions in 38 countries) is underpinned by the recently updated International Finance Corporation (IFC) Performance Standard 6 Guidance Note on Biodiversity Conservation and reflects specific conservation requirements for financial institutions working in certain areas with high biodiversity value. Equator Principles 4 also encourages banks' clients to share their data and contribute to global data sets for biodiversity using the Global Biodiversity Information Facility (GBIF). GBIF is an international network and research infrastructure funded by the world's governments and provides open-access information about life on Earth.
- The UK government's independent global review on the Economics of Biodiversity (The Dasgupta Review) is set to report ahead of the 15th meeting of the Conference of the Parties to the Convention on Biological Diversity in China. This is expected to shape the economic and finance policy response to biodiversity loss and demonstrate the cost effectiveness of decisive action for biodiversity.
- A new Task Force on Nature related Financial Disclosures (TNFD) will be launched in 2021 to explore how best to integrate nature-related financial considerations into risk analysis and decision making by financial institutions. The TNFD aims to redirect flows of finance at scale towards nature-positive activities. The TNFD is a timely follow-up to the already active Task Force on Climate-related Financial Disclosures (TCFD).

### **How can financial institutions be affected by biodiversity risk?**

Biodiversity can be impacted by client operations, which need access to, or convert, areas of biodiversity value in a range of industrial sectors, such as agriculture, extractives, forestry, consumer goods and infrastructure.

The provision of financial services to clients whose operations degrade – or may be viewed to degrade – areas of high biodiversity value can lead to both reputational and credit risk for banks and investors. This includes both direct impacts (which arise as a direct result of a project's footprint) and indirect impacts (which are often beyond the project's boundaries and can be harder to predict). Significant delays, imposed on projects that breach laws, or need to implement complex mitigation measures, can be avoided through effective early project screening.

The reputational risk is particularly acute where client activity corresponds with a high profile UNESCO World Heritage Site or protected area, or involves 'iconic species' or Critical Habitats for endangered species or species used by indigenous peoples for subsistence. Such cases can result in high profile 'follow the money' activist campaigns targeting investors, which can be time consuming to manage, and result in long-term reputational damage.

#### **Box 1: Key indicators of high biodiversity value**

- Nationally or regionally designated protected areas
- Internationally recognised sensitive areas, such as:
  - UNESCO Natural World Heritage Sites
  - UNESCO Man and the Biosphere Reserves
  - Key Biodiversity Areas
  - wetlands designated under the Convention on Wetlands of International Importance (the Ramsar Convention).
- The habitat of:
  - threatened species ie the 'Critically Endangered', 'Endangered' and 'Vulnerable' categories of the IUCN Red List of Threatened Species
  - endemic or range-restricted species
  - migratory and/or congregatory species
  - highly threatened and/or unique ecosystems
  - climate threatened species and ecosystems
  - key evolutionary processes
  - species of stakeholder concern.

### **Opportunities from understanding biodiversity risk**

Whilst the risk from biodiversity is increasing, there are also a number of opportunities that emerge. Understanding biodiversity risk can allow financial institutions to reduce operational, regulatory and reputational risks. They can also reduce transition risks at the same time as being recognised as early adopters of progressive policies. Opportunities exist from increasing the resilience of assets to natural disasters and liability from high-risk events, such as pollution. There can also be greater access to finance through understanding the biodiversity risk of clients and their respective market, credit and reputational risks.

### **Screening for biodiversity risk**

Financial institutions need to better understand whether their clients operate in, or plan to operate in, areas of high biodiversity value. Given the interrelationship between people and nature (particularly indigenous peoples), development in areas of high biodiversity value can potentially result in communities being adversely affected and lead to social conflict, hence raising not only the ecological impacts of a development but also the materiality of the reputational risk of a transaction. Although numerous biodiversity designations exist, some of the key (although not exhaustive) indicators of high biodiversity value may include those shown in Box 1 and these are useful during the diligence screening process.

Despite the frequent calls for better data, well established data-rich tools already exist for the private sector to start assessing their biodiversity risk. During the diligence and investment decision process, the Integrated Biodiversity Assessment Tool (IBAT) provides a rapid, easy and desk-based solution to help identify whether client operations may impact areas of high biodiversity value. Its global database is comprised of the most up-to-date and authoritative scientific datasets on The IUCN Red List of Threatened Species, the World Database on Protected Areas, and the World Database of Key Biodiversity Areas. This information better enables both business lines and risk managers to understand how transactions and their clients' activity may affect critical biodiversity and provide a trigger for enhanced diligence. IBAT is not designed to assess company impact or dependence on ecosystem services, though it will flag critical biodiversity, which is likely to underpin ecosystem services, and should be factored into diligence processes.

Whilst the IBAT tool is not designed to prescribe mitigation measures (or define an acceptable level of risk), it can support the identification of potential conflicts with biodiversity at a given site, and through interpretation of these results, financiers can make better informed decisions about how to avoid biodiversity loss. IBAT does not pre-empt community dependency on biodiversity or ecosystem services but rather identifies important species and ecosystem features to consider during a transaction.

### **Considerations for transactions involving higher risk biodiversity locations**

The appropriate corporate management of biodiversity impact is a complex topic and – depending on the transaction and/or life cycle of the asset in question – can be even more challenging for investors to manage. Where a client's current or planned operations correspond with an area of high biodiversity value, investors may wish to consider focusing due diligence topics to understand better the client's commitment and capacity to manage biodiversity (Box 2).

#### **Box 2: Biodiversity due diligence questions**

- Has an Environmental Impact Assessment (EIA) been conducted, which included appropriate biodiversity baseline surveys undertaken across seasons and with appropriate scope?
- Has the client applied the mitigation hierarchy (ie avoid, minimise, restore and potentially offset biodiversity impacts)?
- Could the project or asset (directly or indirectly) adversely impact endangered or Critically Endangered species, indigenous communities and/or legally protected and/or internationally recognised areas for the persistence of biodiversity?
- Is there a 'biodiversity action plan' or 'biodiversity management plan' in place, which details a set of actions that will lead to biodiversity enhancement?
- Has the EIA included a 'Critical Habitat' assessment?
- Within the client's organisational structure, is there appropriate knowledge and capacity (both at corporate and site level) to effectively implement biodiversity management arrangements?
- Did relevant subject matter experts or organisations participate in the identification and mitigation of biodiversity impacts?
- Will unavoidable impacts to biodiversity affect local communities or indigenous peoples, and if so, is there a management plan in place to address these?
- Has the project/ asset or client been the subject of civil society/non-governmental organisation (NGO) opposition? And if so, how have these concerns been addressed?

These diligence questions are neither all-encompassing nor intended to be a 'check list' for transactions, which fall under the Equator Principles and trigger the application of IFC Performance Standard 6 (PS6) on Biodiversity and Sustainable Management of Living Natural Resources. IFC's Performance Standards define IFC clients' responsibilities for managing their environmental and social risks and are also widely used as best practice elsewhere in the finance sector. Application of PS6 is highly site-specific, depending on the species, ecosystems, quality of baseline data and existing biodiversity management. Fulfilling the requirements of PS6 is a significant undertaking, hence alignment is best initiated at the very start of project planning and integrated with the development of an Environmental Impact Assessment.

#### Cost-effectiveness of biodiversity conservation

It has already been demonstrated that the financial cost of losing ecosystems and their associated services is far greater than the costs required to support global biodiversity conservation. The total costs of investing in biodiversity are far lower than the value of the goods and services that biodiversity provides – equal to 1% to 4% of the estimated net value of ecosystem services that are lost each year (estimated at \$2 to \$6.6 trillion) and equal to just 20% of annual spending on the soft drinks industry (McCarthy et al, 2012)! Furthermore, the moderate costs of updating and maintaining the biodiversity data required to inform sustainable economic development globally are only estimated at US\$6.2–6.7 million (Juffe-Bignoli et al, 2016).

#### Transformational change

There are plenty of challenges associated with creating a nature-positive economic system, such as redirecting perverse subsidies in agriculture, forestry and fisheries, which are currently 3.5x to 6.4x higher than the annual public and private funding supporting biodiversity conservation. A recent report (Deutza et al, 2020) estimates that global subsidies favouring activities that have detrimental effects on the environment reached US\$451bn for agriculture (for example subsidies supporting monocultures or excessive fertiliser application), US\$55bn for forestry and US\$36bn for fisheries in 2019. However, the actions required to implement transformative change are economically feasible and strongly tied to broader sustainability goals and the SDGs, as demonstrated in the technical note: Biodiversity and the 2030 Agenda for Sustainable Development (Convention on Biological Diversity, 2016). Reassuringly, there is still an opportunity to see positive biodiversity trends by 2050 by tackling the drivers of land use change, restoring degraded lands and increased habitat conservation (Leclère et al., 2020).

#### About the Authors



**Ben Jobson** is Programme Officer at the Integrated Biodiversity Assessment Tool (IBAT), where he works to support IBAT clients and subscribers in their use of the tool, as well as progressing IBAT business development.

Ben holds a master's degree in Conservation Science from Imperial College London and has experience working with the BirdLife International Science Team to support the sustainable deployment of renewable energies.



**Olivia White** has over 15 years' experience in environmental and social management and has recently left her role as an Executive Director in the Global Environmental and Social Risk Management team at JP Morgan Chase. Her role included supporting

commercial teams to ensure client transactions met the firm's environmental and social risk standards, and designing and implementing environmental and social risk policies and diligence frameworks (including those to restrict financial services for activities in sensitive biodiversity areas). Olivia has deep experience of environmental risk in the oil and gas sector, including hydraulic fracturing of shale, oil sands and midstream activities. She is on the Stakeholder Panel for the update to the IPIECA/OGP/API Sustainability Reporting Guidance. Olivia has site-based exposure to operational environmental issues and familiarity with best practice frameworks, standards and assessment tools for corporate environmental and social risk management across numerous sectors and geographies. Olivia previously provided sustainability consulting services at PwC (where she was a contributing author to *The Economics of Ecosystems & Biodiversity*), Standard Chartered and Mouchel Consulting. Olivia holds a master's Degree in Environmental Technology from Imperial College London.



**Giulia Guidi** is a senior expert on Environmental Social and Governance (ESG) risk management with a deep and extended knowledge of the ESG trends for the financial sector. After ten years at JP Morgan Chase, where she was responsible for the firm's

policy implementation, she is now working independently to advance the ESG agenda for a diverse range of clients. She is the head of ESG team for an investment manager that focuses on renewable energy, where biodiversity is one of the group's sustainability pillars, and in the last three years she has been advising an oil and gas trader, a development bank, a European investment bank, the Dutch Banking Association, a large Italian pension fund and insurance company, academia, media and NGOs. In 2018 she worked with WWF UK on the Saving our Shared Heritage campaign, engaging with global investment banks, institutional investors and insurers on their UNESCO World Heritage Sites policies and practices. This involved engagement with IBAT.

## Further information

### IBAT Alliance

e: [ibat@ibat-alliance.org](mailto:ibat@ibat-alliance.org)

w: [www.ibat-alliance.org](http://www.ibat-alliance.org)

The IBAT Alliance is formed of four partners:

- BirdLife International ([www.birdlife.org](http://www.birdlife.org))
- International Union for Conservation of Nature (IUCN) ([www.iucn.org](http://www.iucn.org))
- United Nations Environment Programme – World Conservation Monitoring Centre ([www.unep-wcmc.org](http://www.unep-wcmc.org))
- Conservation International ([www.conservation.org](http://www.conservation.org))

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