FINANCE FOR BIODIVERSITY Initiative

Aligning Global Finance with Nature’s Needs

A Framework for Systemic Change

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About this Paper

Aligning Global Finance with Nature's Needs: A Framework for Systemic Change is the second white paper released by Finance for Biodiversity (F4B). It builds on our first white paper, *Towards a Common Framework at the Nexus of Financing and Biodiversity*, released in April 2020. These and other publications can be downloaded at https://bit.ly/3dJfzYj.

Aligning Global Finance with Nature's Needs: A Framework for Systemic Change is based on the learning from F4B's portfolio of activities. It has been prepared by Robin Smale and Simon Zadek, along with team members including Charlie Dixon, Jeremy Eppel, Jason Eis, Liz Gallagher, Mark Halle, Rupesh Madlani, Nathalie Nathe and Philippa Wisbey. Many thanks to the many individuals who provided valuable feedback and insights throughout the preparation of this paper.

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About Finance for Biodiversity

Finance for Biodiversity (F4B) aims to increase the materiality of biodiversity in financial decision-making, and so better align global finance with nature conservation and restoration. F4B is advancing five workstreams that create and amplify the feedback signals that increase the value of biodiversity in private and public financing decisions:

- Market efficiency and innovation
- Biodiversity-related liability
- Bridging biodiversity policy and financial rules and behaviour
- Citizen engagement and public campaigns
- Responses to the COVID crisis

For more information, visit www.f4b-initiative.net.

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Executive Summary

Today's global financial system is funding the destruction of the natural world. This undermines long-term human well-being and economic prosperity, and eventually will make our planet uninhabitable. Change is needed to ensure that the planet's biodiversity is no longer the loser, and can support sustainable development.

Growing efforts to improve biodiversity-related financial risk analysis and disclosure are to be welcomed, but alone will be too little, too late. Today's misalignment reflects broader weaknesses and failures in the global economy, including the design of global finance, both private and public. Bolder, systemic solutions are needed that provide the feedback signals that will be make biodiversity material to financial decision-making.

Systemic solutions require the transformation of financial markets and public finance, rules established through law, regulations and standards, and norms and therefore the behaviour of citizens and institutions. There is no one 'silver bullet' that can deliver such solutions, and we cannot rely on broad, long-term policy and business commitments alone to catalyse the changes needed.

Interventions that can drive more rapid, systemic change are, however, possible. *Finance for Biodiversity* has distilled the insights, experience and expertise of many working at the nexus of finance and biodiversity into a framework for action in aligning finance and biodiversity. The framework is made up of six core elements, along with specific recommendations that we believe exemplify how to ambitiously advance each element in practice. Each element seeks to overcome the current weakness or outright absence of feedback signals needed to drive financial decision-making to value biodiversity.

Finance for Biodiversity considers that implementing the framework effectively would result in global financial flows being consistent with the protection and restoration of biodiversity. Without these changes, the financial system will remain a keystone part of the problem.

Time for Change

The species extinction rate over the last 50 years has reached 1,000 times its background rate. Species abundance, ecosystem integrity and genetic diversity have all been driven downwards by land-use change, over-exploitation, climate change and pollution.

A radical reduction in pressure on biodiversity can only be brought about by systemic change in the production and consumption of goods and services that impact on the natural environment. This can take place only if the lifeblood and guiding force of the global economy – finance (both private and public) – is aligned with nature's needs, and so with our needs from nature.

Biodiversity is deemed by financial decision-makers to be largely immaterial. The basis on which private and public actors invest, notably in biodiversity-intensive sectors such as mining, agriculture, forestry and fisheries, systematically under-prices access to, depletion of, and economic value created from ecosystem services. Such under-pricing is fundamental to how much of the modern economy, private and public, works. Cheap food, fast fashion apparel, disposable consumer goods and extensive waste exemplify 'business as usual' economic activities that depend on under-pricing, depleting and destroying biodiversity.

Citizens are both complicit in and ultimately victims of this systemic failure. As consumers, taxpayers, voters and investors, they largely choose to turn a collective blind eye, whether through lack of information or because they are too far removed or disempowered from the use of their own money. Governments rarely seek to overcome such short-term, myopic behaviour, preferring to sustain tax, subsidies and procurement regimes that damage biodiversity and the long-term interests of those they represent. Private intermediaries of citizens' finance too often also 'go with the flow', choosing to satisfy, at best, their clients' narrower, shorter-term interests.

More recently, much has been said, and some actions taken, in advancing a sustainable financial system – that is, one that delivers finance aligned to sustainable development. Climate change, and the associated dangers and risks, has been the trigger for many of these developments. Leading figures from the policy, regulatory and private financial communities have argued for the need for a 'reset' in how global finance works, from the metrics it uses to the design of tools, standards and governing arrangements. As a result, finance is becoming more responsive to such climate risks, although much still remains to be done.

Such developments demonstrate that it is entirely possible to shift the financial system to take account of what are currently problematic externalities, but that it needs change by many actors at multiple levels that in turn requires them to improve their understanding of their roles as well as retool their capabilities. Fortunately, global finance is in any case in flux, not least from the combined impacts of the Great Financial Crisis and the current COVID crisis, and the disruptive influences of digitalisation and broader geopolitical shifts. In already being subject to such transformations and building on the experience gained at the nexus of climate and finance, introducing new, critical variables such as biodiversity, becomes easier, or at least less difficult.

Systemic change is not a matter of designing and executing according to a fixed blueprint. Complex, dynamic systems and associated uncertainties require more nudges, more experimentation and more iterative steps linked to rapid learning. Understanding that we need to transition along uncertain pathways should not, however, become an excuse for degenerating into small-scale pilots and incremental ambitions in practice.

Nuanced nudging and ambitious action need to go hand in hand in changing processes, capabilities and expertise, and in introducing new liabilities, incentives, controls, standards and flows of data. Offered here is a way of finessing these needs by implementing a framework for action that can deliver the systemic change needed in the alignment of global finance with nature's needs, and so with our needs from nature.

The Framework for Aligning Global Finance with Nature's Needs is made up of six, core elements. These elements, individually and taken together, seek to:

- Introduce absent, and/or improve on existing, weak feedback signals that significantly increase the materiality of biodiversity in private and public financial decision-making.
- Make financing that results in net biodiversity loss less attractive, and financing that results in no net loss or net positive biodiversity outcomes more attractive.
- Advance and align the narrower 'financial risk' lens of traditional, private financial intermediaries, and the broader 'impact' lens that concerns policy and a growing community of private financing actors.

Each element can be advanced individually and make a significant difference. Taken together, however, they would take us a long way forward in aligning global finance with nature's needs.

There are many possible routes for implementing each element, and learning over time will help us understand which are most effective. That said, we have provided for each element two routes that we consider as exemplifying what is possible in advancing ambitious action.

Framework for Aligning Global Finance with Nature's Needs

1. **Advance Citizens' Biodiversity Choices**: financial institutions should take account of citizens' individual and collective biodiversity-related rights and preferences in their financing decisions.
   - Financial institutions inform and empower citizens to make biodiversity-related choices, as savers, lenders, insurers, consumers, voters and taxpayers.
   - Regulators require financial institutions to adopt compliance processes to respect the heritage rights of indigenous communities to biodiversity stewardship and use, and to respect their traditional livelihoods.
2. **Disclose Impacts on Biodiversity**: financial institutions should publicly disclose actual and expected biodiversity impacts and associated risks.
   - Financial institutions make the data and assumptions underlying reported impacts and risks publicly available, to enable effective citizen and shareholder action, and to facilitate the setting of effective standards, policies and regulation.
   - Regulators require financial institutions regularly and publicly to report the biodiversity impact of their entire balance sheets, and to stress-test expected biodiversity risk.
3. **Create Liability for Biodiversity**: legal systems should make financial institutions liable for biodiversity impacts.
   - Legislators extend liability for biodiversity damage caused by companies to their banks and other financing institutions.
   - Regulators require financial institutions and corporates to establish biodiversity protection as a public fiduciary responsibility of company directors in their corporate governance.
4. **Align Public Finance with Biodiversity**: governments and public agencies should transparently align all public finance to biodiversity-related policies, goals and commitments.
   - Governments eliminate or reform all biodiversity-negative subsidies and taxes and develop and scale up incentives for biodiversity restoration.
   - procurement, investments and financial instrument design, sovereign debt arrangements and monetary practices.

Framework for Aligning Global Finance with Nature's Needs (cont.)

5. **Align Private Finance with Public Policy**: financial institutions should ensure that their activities are consistent with biodiversity-related public policies, goals and commitments.
    - Financial institutions align their financing with biodiversity-related public policies and international commitments – for example, through assurance of net gain of biodiversity and ecosystem services.
    - Regulators require financial institutions to align their financial practices, including the design of financial instruments, offers and services, with the biodiversity-related public policies and biodiversity-related international public policy commitments in jurisdictions where they operate.
6. **Integrate Biodiversity into Financial Governance**: institutions governing global finance should ensure that financial institutions effectively steward biodiversity.
    - Governance arrangements, including mandates, instruments, and the basis on which governing bodies are held to account, should be demonstrably responsible, capable and effective in stewarding the impact of finance on biodiversity.
    - Financial governance institutions, including financial regulators and monetary authorities, standards setters, and those with fiduciary responsibilities for financial assets, should publicly explain the past and likely impacts of their decisions and actions on biodiversity.

Notes on the Framework

Advance Citizens' Biodiversity Choices

Citizens are the ultimate owners of the world's financial assets, as well as being members of the families, communities and nations that live within and depend upon nature and biodiversity. They should have rights, information and mechanisms to make decisions on how their money is deployed, as savers, investors, those insured, consumers, taxpayers and voters. Financial institutions should enable this, and financial regulators should ensure sufficient compliance processes.

Citizens as savers and investors will often be interested in off-the-shelf investment products and traditional asset class criteria. However, they are also interested in investing for better social, economic and environmental outcomes. Consumer spending is increasingly informed by a wide range of non-price considerations, including the impact of production and use on nature and climate. It is increasingly recognised that our society, economy and planet are intertwined, as highlighted by a COVID pandemic linked to human encroachment on the natural world.

Citizens in some instances already have rights to be informed about how their money is being used, such as under European pensions legislation which legally requires them to be consulted. Regulators should enable similar, wider scrutiny by taxpayers of public finance, including public procurement, and the less visible but highly significant public acquisition by central banks of corporate bonds. Most recently, civil society organisations have probed the potential impact on the natural world of the massive pandemic-related public stimulus funds, demonstrating public appetite for such scrutiny.

Indigenous peoples, meanwhile, count biodiversity and nature as part of their heritage and wealth, and have proven themselves capable stewards. Governments should grant them rights to play an active role in managing this wealth. The licensing of a financial institution should prevent it from exploiting irreplaceable natural heritage, the cumulative consequences of which could amount to ethnocide or cultural genocide.

Calls for a more citizen-centric finance align well with technological advances. Digitalisation can be a game-changer in empowering citizens in financial decision-making. Crowd-funding, peer-to-peer lending and robo-investors are examples of emerging mechanisms for enabling savers and investors to choose how their money is used. Radical increases in accountability can be secured through digitalised transparency, with significant advances made in the sphere of public spending.

Disclose Impacts on Biodiversity

For the financial system to function efficiently and be accountable to the ultimate asset owners and intended beneficiaries, it needs good quality, standardised information which can be cost-efficiently accessed and used and effectively communicate. This is true for traditional private intermediaries focused on measuring and valuing risks and opportunities. It is also true for those focussing on broader measures of biodiversity impacts.

Developing effective risk and impact measurement and reporting tools and standards is the starting point for much mainstream work at the nexus of finance and biodiversity. The newly established Informal Working Group (IWG) is taking forward the design phase of the Task Force for Nature Related Financial Disclosure (TNFD). Whilst drawing on the experience of the Task Force on Climate Related Financial Disclosure (TCFD), the IWG is considering a broader scope that takes account of opportunities, dependencies and nature impacts as well as financial risks, involving policy-makers, development finance institutions and financial regulators.

It is possible to anticipate future liabilities consistent with long-term public policy targets and action. Long-term investors would build these risks into their investment management strategies. Otherwise, risk-based metrics for investors are ‘lagging’, capturing at best what is already material. It is essential to close the circle, where long-term liabilities for damage drive current financing decisions that enhance biodiversity. Metrics can play a role in changing the financial system only if they are part of a process of creating, rather than merely seeking to demonstrate, materiality.

Biodiversity as a new dimension to financial asset management, new data reporting obligations, and new methods and data infrastructure to support that reporting, will be necessary. Financial institutions should be required to publicly disclose actual and expected biodiversity impacts and associated risks, thus enabling effective citizen and shareholder action. Furthermore, the prudential system, which ensures that financial institutions carry enough capital to maintain liquidity and solvency, should require these institutions regularly to assess and publicly report biodiversity impacts, and stress-test the biodiversity risks of their entire balance sheets.

Building and ensuring effective access and use of relevant data will underpin success in effective disclosure. Biodiversity data will often come from public sources, and requires taxonomies and standards and enabling data platforms to ensure appropriate, cost-effective, timely availability and use. Securing the broadest possible access to relevant biodiversity data will help to enable policy makers, regulators and the public to hold financial institutions to account for the biodiversity impacts of what they finance.

Create Liability for Biodiversity

The materiality of biodiversity impacts depends in part on associated liabilities. Liabilities might arise through the application of the rule of law and relevant regulations and standards. Moreover, future possible liabilities may be a relevant driver of materiality, notably in jurisdictions that tend to favour intense, extended litigation. Liability may be direct, a matter of breaking rules concerning biodiversity, or indirect, such as where biodiversity loss is linked to illicit financial flows and other criminal activities.

There is no compelling logic, in practice or theory, to support the restriction of liability to the businesses that directly cause biodiversity loss. Their sponsors – notably their financiers – need to be jointly culpable. Limited liability may constrain the risk to arm's-length shareholders, and of course all financiers face the risks of financial loss due to the failure of business that they finance. Beyond that, however, is the matter of liability, particularly for those providing loans and debt.

Extending liability to the providers of finance is an important route for crystallising material risks on the balance sheets of financial institutions of the biodiversity loss resulting from the activities that they finance. Without this, financial institutions may continue to finance profitable businesses (and governments) in the knowledge that they are destroying biodiversity, illegally or otherwise. There are widely accepted precedents for such extended liability. Banks today can be held legally liable for providing financial services to international organised crime gangs, assisting enemy governments, corrupting governments, and complicity in bribery.

This approach must be applied to liability for biodiversity-related damage, which would establish the right economic signals to ensure that financial institutions take biodiversity more fully into account. Extended environmental lender liability has been shown to work. Brazil's National Environmental Policy Law, together with jurisprudence from the Superior Court of Justice and the higher courts of the Brazilian States, creates clear rules and precedents, making it incumbent on lenders not to lend to projects that cause damage.

Enhanced liability of financiers can be established through many routes. Much has been done over recent years to expand the definitions and interpretations of fiduciary responsibility, in many instances to ensure that businesses take greater account of important, but possibly not financially material, social, economic and environmental matters. To date, these initiatives have not in the main been applied to financial institutions, let alone biodiversity. Such moves would be all the more effective if linked to an enhanced obligation to consult the asset owners and intended beneficiaries, and to extend such transparency and consultation obligations to savers and those taking out insurance.

Align Public Finance with Biodiversity

Public finance is almost always the largest single-originated flow of finance in any economy, averaging about 20% of GDP internationally. It therefore has major, direct impacts on biodiversity, as well as its indirect effects through its influence on the shape of every economy. Most governments have value-for-money procurement criteria, which in many instances include broader policy considerations. Moreover, growing numbers of governments are adopting 'green' criteria in financing decisions, which can protect biodiversity.

Public finance remains, however, decidedly un-green, and in only rare cases, often on the margin of funding, is it sensitive to impacts on nature. So-called 'blended finance', combining public and private finance to secure public interest outcomes, has an oft-ignored dark side: agricultural and fishing subsidies, which are often distributed through development financial institutions in the form of grants, technical assistance and concessional loans.

Green criteria have been widely debated, and at times applied in major public stimulus and recovery programmes in response to the COVID crisis. Yet most of these programmes are 'nature-negative', highlighted by the Green Stimulus Index produced by Vivid Economics as part of F4B. Central banks' bond-buying programmes, the second stimulus pillar of many major economies, have in the main declined to consider green, let alone nature-specific, criteria.

Governments must eliminate all biodiversity-negative subsidies and taxes. As the Conference on Biological Diversity (CBD) resource mobilisation report argues, it is essential to 'eliminate or reform incentives, including subsidies, that are harmful to biodiversity; develop and scale up disincentives for actions that are harmful to biodiversity; and develop and scale up incentives to encourage biodiversity-positive actions'.

Moreover, governments need to integrate biodiversity impact criteria into public procurement, public investments, sovereign debt arrangements, and monetary practices such as asset purchases within quantitative easing programmes. And public financial institutions, central banks, regulators, public services and finance ministries must all align their policies and practices with biodiversity-related public policies and biodiversity-related international public policy commitments.

Align Private Finance with Public Policy

Global finance cannot be expected to, and perhaps even should not, set ambitious biodiversity targets independently of relevant policy developments. By the same argument, it should play a productive role in enabling the transition to sustainable development by being aligned with the nature-related goals and targets set by governments. This is obviously true for public finance, but is equally critical for private finance.

Growing numbers of private financial institutions are voluntarily committing to align their financing practices with the Paris Agreement on climate, even though this is an agreement between states. Similarly, such institutions are increasingly complying with the Guiding Principles on Business and Human Rights which has established a framework for businesses to voluntarily adhere to state-addressed human rights.

Policymakers and financial regulators can and do take steps to ensure that financial markets are in lock-step with broader public policy goals. South Africa's financial community is required to advance the country's black economic empowerment objectives. The Bank of England required UK banks to agree to accelerate financing to small businesses as a condition for providing liquidity.

Private financial institutions should be required to ensure and demonstrate that they are aligned to the public goals and targets of wherever they operate, or possible of their primary domicile. For biodiversity, this would require them to periodically undertake and report on nature stress tests of their balance sheets, and to set out a future pathway for nature impacts to track to zero or positive. Although not the focus of this paper, the same should be required in demonstrating a track to zero carbon intensity of their balance sheets by 2050.

Compliance with this requirement could be advanced by policy measures. However, once biodiversity public policy goals are set, the compliance requirement could be secured by financial regulators, ultimately as a licensing condition. There are ample precedents for financial regulators advancing policy goals, explicitly or otherwise. The People's Bank of China, and other central banks, have in recent years advanced the cause and practice of green finance, mainly with explicit reference to national development goals.

Integrate Biodiversity into Financial Governance

The governance of global finance establishes the rules that shape what and how finance flows. How financial institutions consider risks and opportunities is significantly determined not only by the merits of the project or business but also by, for example, Basel III's risk weightings, stock exchange disclosure requirements, and the regulated basis on which assets are valued.

Yet financial governance is not, as sometimes portrayed, a systematic, integrated, independent affair. Rather, it is made up of a mosaic of policymakers, regulators and standard-setters across a set of intersecting, often-competing institutions and platforms, dominated by a small number of national actors, and largely enforced across governing institutions by club rules and peer pressure.

Prior to 2014, not one central bank considered climate change to be its business. By 2020, there was not one major central bank worldwide that did not speak of its forward-looking approach to climate change. This shift was effected in large part by exemplary leadership. Such leadership acted within their authority in addressing the risk climate change poses to financial stability. But in truth, they were as much driven by a conviction that central banks and financial regulators needed to play their part in addressing a global, existential challenge. Indeed, these leaders ensured that their progress would not be impeded by incumbent governance norms by inventing a new platform: the Network of Central Banks for Greening the Financial System.

As such, those governing global finance need to ensure the materiality of biodiversity in financing decisions. Central banks and financial regulators can advance this only by acting within their authority. Yet precedent shows that their mandates can and often are broadly interpreted. Indeed, the Group of Thirty, an international body of leading financiers, in a landmark report following the Great Financial Crisis, concluded that central banks should align with long-term public policy goals (while avoiding being responsive to shorter-term public policy measures). As financial regulators, then, such alignment would mean ensuring that licensed financial institutions align their behaviour and impacts with such long-term policy goals, and not only with the needs of robust risk pricing and financial stability.

Getting started would require financial regulators, monetary authorities and finance ministries to explain the actual and likely impacts of their decisions and actions on biodiversity. It is already good practice for such actors to analyse and report on actual and likely impacts of policies, regulations and standards. Indeed, such an approach is increasingly applied to climate-related impacts.

Concluding Remarks

There is an urgent need for systemic change at the nexus of global finance and biodiversity. It is not enough for an analysis, initiative or recommendation to claim to 'make a difference'. Many important initiatives are being taken in this area, but they are at best inadequate and always in danger of becoming a distraction. Any serious call for action needs to demonstrate how and when it will shift the system dynamics convincingly in the right direction.

Our proposed framework is a place to start in raising our collective ambition. This is not because it is obviously right, or easy to implement. Much can and must be learnt as we progress, and this will feed into improved iterations of a framework that provides a pathway to the ambitious changes needed. It will, however, encourage us all to situate our efforts within a wider context on what needs to be done. It allows us to articulate our findings, insights and proposals within a fuller, systemic view of what needs to be changed, and how.