FINANCE FOR BIODIVERSITY Initiative

February 2021

The Dasgupta Review: What it Means for the Global Financial System

A Response by Finance for Biodiversity (F4B)

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About this note

This note compares the Dasgupta Review's recommendations with F4B's framework on aligning Global Finance with Nature's Needs, and makes detailed policy recommendations.

Comments are welcomed. Please direct these to:

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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.

F4B is funded by the MAVA Foundation, which has a mission to conserve biodiversity for the benefit of people and nature

1. Introduction

The Finance for Biodiversity Initiative has been considering the question of how to align Global Finance with Nature's Needs and has distilled the conclusions of much consultation and deliberation into the following six element framework. This note compares the Dasgupta Review's recommendations with this framework and makes detailed policy recommendations.

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.

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.

2. The Dasgupta Review's Findings

Finance for Biodiversity (F4B) warmly welcomes the Dasgupta Review on the Economics of Biodiversity for having set out the arguments for action on biodiversity and having stated that there is 'a need to identify and reduce financial flows that directly harm and deplete natural assets'. We offer the following observations on the reform of the financial system needed to address the crisis in nature:

- The proportion of finance devoted to conservation and restoration should increase, for example, in Protected Areas and through Overseas Development Assistance.

- 'Central banks and financial supervisors can assess the systemic extent of Nature-related financial risks.'

- 'A set of global standards is required, underpinned by data.'

- 'Businesses and financial institutions could … be obliged to integrate Nature-related considerations within their objectives. The idea ultimately is to have them assess and disclose their use of natural capital.'

- 'Financial regulators and supervisors can play a key role in the necessary shift by changing their own assessment horizons and using their regulatory powers.'

Having identified some of the elements needed, the report sets up the question of what a comprehensive financial system response to the crisis would look like, and the details of the solutions that should or could be deployed.

3. The coordinating and guiding role of governments

In clearly setting out the need for a transition to reduce financial flows that harm and deplete natural assets and, conversely, increasing financial flows to conserve and restore natural assets, the Dasgupta Review describes the extent of this change as no less in ambition than the post-Second World War Marshall Plan in Europe.

Faced with this disruptive but essential transition, participants in the financial system now need governments to confirm the ambition and set out the changes that it will involve, and their timeframe, so that all parties can prepare and adapt with greater certainty. If the example of climate change offers useful pointers, Governments should set a collective ambition for a **Nature**

Positive Transition in the global economy as a necessary complement to the Net Zero goal for carbon emissions. This would pre-dispose both non-financial and financial corporations to make commitments to a Nature Positive Transition or similar objective, just as over 1,500 firms have already made commitments to Net Zero carbon emissions. These commitments by governments have triggered a great deal of innovation in law, regulation, culture, institutions, technology and policy. Framed by a collective commitment to a Nature Positive Transition, the same can be expected as a response to the nature crisis.

The managers and owners of financial corporations will need governments to lay out strategies and timelines, and to provide the leadership, and the legislative and regulatory basis within which the transition to a nature positive financial system can take place.

4. Implementing the Dasgupta Review's recommendations

The Dasgupta Review clearly states the need to **align public finance with nature.** Governments and public agencies can transparently align all public finance to biodiversity-related policies, goals and commitments through two key actions. First, as the Review clearly recommends, by eliminating or reforming all nature-harming subsidies and taxes and by developing and scaling up incentives for biodiversity restoration. Second, through public procurement, investment and financial instrument design, and additional to the Review's recommendations, through the design of sovereign debt arrangements and through the market activities of central banks.

4.1. Public procurement and finance

The Dasgupta Review places at the top of its recommendations the **removal of subsidies** which cause material harm to biodiversity and nature. The complement to this is for public procurement officers to require **vendors to disclose biodiversity and nature impacts** along the entire procurement value chain. In matters as important as this, finance ministries including HM Treasury should publish annual reports on the progress they are making to **realign the fiscal regime to become nature positive**, including through taxes, subsidies, quantitative easing, foreign sovereign debt purchases and restructurings.

Governments are themselves large investors in assets. As Professor Dasgupta points out, they should **rebalance their public asset portfolios to a Nature Positive Transition**, from nature-harming to nature-enhancing investments. For example, the Bank of England should divest from holding assets which cause material harm to biodiversity and nature so that its portfolio becomes nature positive within a defined and limited timescale.

Governments can take effective action to stem the flow of private money to nature depleting activities by **recognising financial services as part of the supply chain**. The UK Government should use legislative opportunities such as the Financial Services Bill and the Environment Bill to introduce a Duty of Care on financial institutions so that they may not finance activities that cause loss and degradation of key ecosystems, such as tropical forests.

A hugely important opportunity, rightly emphasised by the Review, concerns the **mandates which donor governments give to development finance institutions** (DFIs). The DFIs that responsible governments sponsor should insist on lending policies that are at least 'equivalent' to national and international biodiversity and nature policies. They should encourage other sponsors to do the same, for example, by forming a club of like-minded sponsors. All DFIs should routinely measure and publicly disclose the biodiversity and nature risk and impacts of their funds. At present, none of them undertake such stress testing and impact disclosure of their balance sheets. The UK Government should start by requiring the DFIs to which it is a donor to do so as a condition of future funding.

4.2. Financial Services Regulation

The Review also makes clear the need for transparency, achieved through **financial disclosure**. Professor Dasgupta exhorts financial supervisors and regulators to use their regulatory powers. First, supervisors can require financial institutions (banks, pension funds and insurers) to disclose material risks, both from dependency and transition, and foreseeable trends and impacts of their investments on biodiversity and nature, and to publish their policies on the management of these risks. This will protect system stability. As the Review says, they will have to look to longer assessment horizons and anticipate the inevitable policy response which imposes transition risk on financial institutions.

In order to make **financial disclosure** possible, there will have to be a flow of information between corporates and the financiers. The corporations in which financial institutions invest will have to share data on the locations and nature of their activities so that the nature and biodiversity risk of their activities can be assessed by financial institutions. This will allow financial institutions to carry out their new disclosure duties.

The Review remarks on the need for global standards. It is clear that a proliferation of standards would be costly and undesirable. Thus, reporting requirements in the UK and elsewhere should align, where appropriate, with those imposed under the EU Non-Financial Reporting Directive (NRFD) and the EU Taxonomy, in order to avoid proliferation of reporting standards, and the **international associations of supervisory bodies should cooperate to develop global standards**.

With these foundations for disclosure in place, the Taskforce for Nature-related Financial Disclosure will be able to and should **expand to report on biodiversity and nature impacts**, as well as risks. This will allow it to cover transition as well as dependency risks. It will also make sense to extend the UN Sustainable Stock Exchanges Initiative on global climate related disclosures to include a **task team** on nature related financial disclosures, to ensure integration, collaboration and feedback on TNFD.

Turning to other aspects of the 'key role' that Professor Dasgupta identifies for financial regulators and supervisors, those authorities should now take steps to adapt the climate playbook, in which insurance supervisors began by sending **questionnaires** to insurers to ask about their climate risk exposure. They and their fellow banking and pension supervisors should now do the same on biodiversity and nature-related risk. This will raise awareness of forthcoming nature compliance requirements, such as **stress testing**, at board level.

Given the Marshall Plan scale of Professor Dasgupta's ambition, the UK Treasury should now convene the Bank of England and the supervisory authorities as part of a new Treasury **Biodiversity Working Group**. This should join up all relevant policy work within government and within financial supervision, while allowing the supervisors to continue their role at arm's length.

One of the successes of the Marshall Plan was its ability to align many players behind its objectives. The same is needed here to respond effectively to the scale of the global nature crisis. Financial regulators, through their licensing regimes, can make 'equivalent' their policies with national and international biodiversity policies. They can also require their regulated entities to **compare and publish** performance against national and international policies. Central banks should, like the other financial institutions, be expected to show that their **balance sheet activities are 'equivalent'** to national and international policies on climate, nature and biodiversity.

The Dasgupta Review notes with concern that financial institutions very rarely have policies on nature risk and impact. Supervisory authorities should require domiciled financial institutions to develop **policies and strategies** which prepare them for the nature positive transition. For pension funds, this will include policies on biodiversity and nature in their **Statements of Investment Principles**, statements which embody the preferences of pension fund holders, after they have been consulted. Supervisors may then test those statements for policy equivalence.

There are further opportunities for alignment in trade finance, where banks issue of letters of credit, and can require warrants that the goods have been produced without breach of national biodiversity and nature laws.

5. Further Actions

The Dasgupta Review has identified many of the elements which the Finance for Biodiversity Initiative has set out as necessary in its Framework for reform of the financial system. However, it has missed out some of the elements which would make the prescription sufficient. In particular, it has not linked choices for citizens explicitly to finance and the extension of liability for nature damage to financiers.

Financial institutions should take account of citizens' individual and collective biodiversity-related rights and preferences in their financing decisions. Financial institutions should inform and empower citizens to make biodiversity-related choices, as savers, lenders, insurers, consumers, voters and taxpayers. In addition, regulators should 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.

At present, most legal systems insulate investors from the liabilities associated with the damage caused by the use of proceeds. This has allowed investors to continue to pour capital into nature depleting activities without accountability or penalty. Legal systems, including in the UK, should make financial institutions liable for biodiversity impacts, treating them as a core party to the supply chain, as they are economically and through the control they exert over management. They can do this by extending liability for nature and biodiversity damage caused by companies to their banks and other financing institutions. A reasonable reaction to this liability would be for regulators to require financial institutions and corporates to establish nature and biodiversity protection as a public fiduciary responsibility of their company directors.

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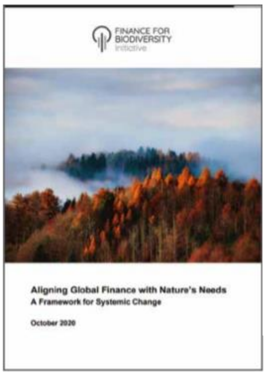

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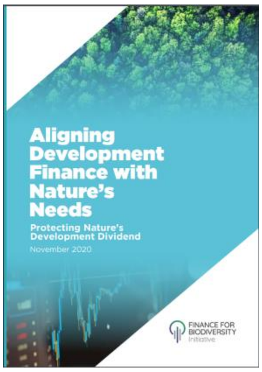

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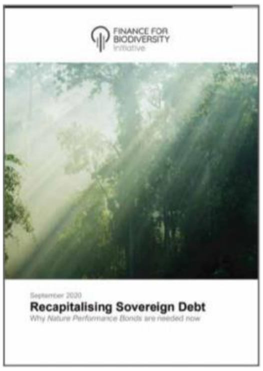

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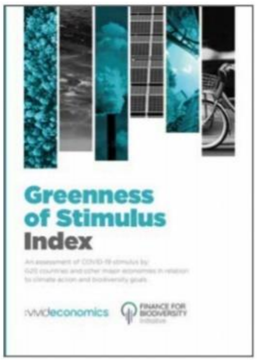

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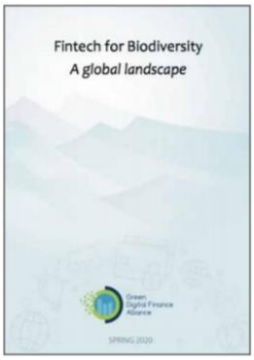

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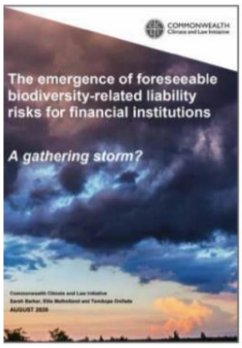

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