ESG VIEWPOINT

Banking on biodiversity: findings and good practices from our engagement with global banks

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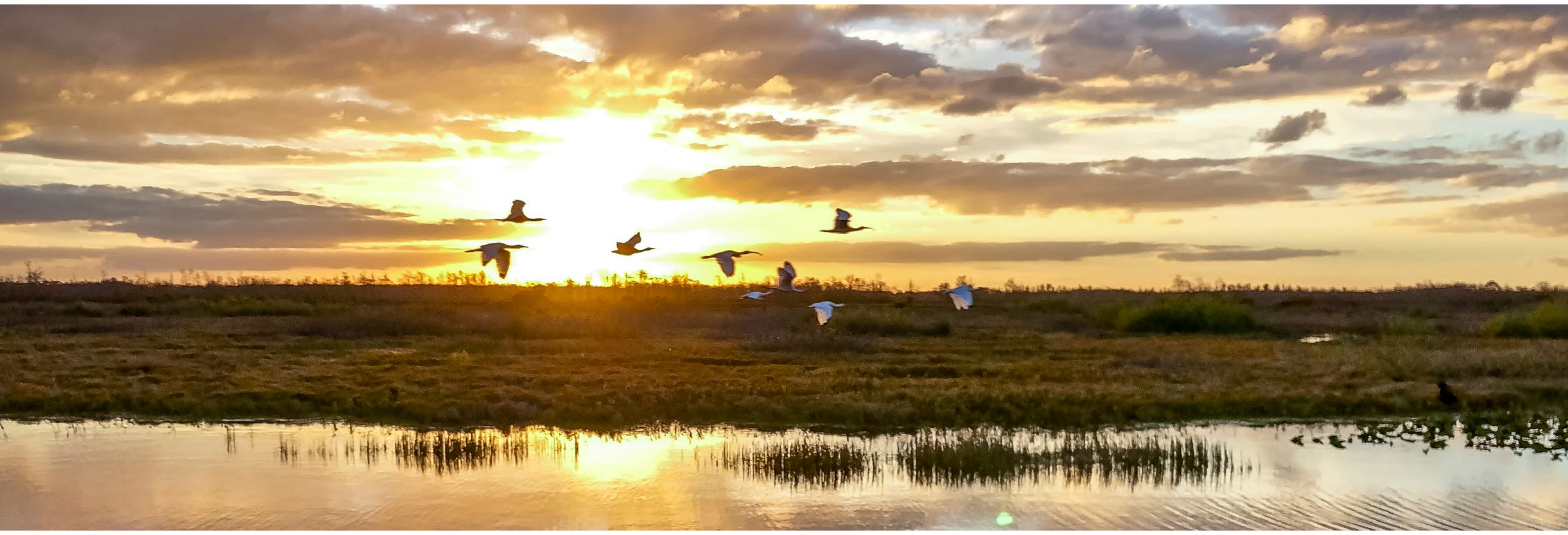
At a glance

- Biodiversity loss continues apace and with it comes increased systemic risks to the world economy. COP15 concluded with a global agreement to halt and reverse biodiversity loss.
- Given their exposure to a range of economic sectors, banks need to account for biodiversity impacts across their operations. We've found however, that many need to improve their approach.
- We have developed a list of best practices following our engagement with the banking sector, including a robust approach to governance, a clear approach to evaluation and disclosure, and target setting.
- We have shared our best practices with several global banks and will seek further detailed engagement conversations with them to discuss biodiversity, along with other material ESG issues.

Engagement and voting efforts as well as expectations outlined in this Viewpoint reflect the assets of a group of legal entities whose parent company is Columbia Threadneedle Investments UK International Limited and that formerly traded as BMO Global Asset Management EMEA. These entities are now part of Columbia Threadneedle Investments which is the asset management business of Ameriprise Financial, Inc.



Introduction

Biodiversity loss – why it is material and relevant for banks

Biodiversity is the variability of living organisms, including diversity within and between species. This biodiversity, together with water and soil, forms the ecosystems and the services these provide, which underpins the economy and sustains life on earth. These ecosystem services include climate, soil fertility and air quality regulation, water storage and filtration, pest and disease control, among other services. However, global wildlife populations have plummeted by 69% on average since 1970[1], painting a sobering picture on the current state of nature and biodiversity.

As biodiversity loss continues and awareness of the implications grows, companies will increasingly face a range of potential risks[2]. The World Economic Forum have also estimated that over half of the world's total GDP is dependent on nature and the associated ecosystem services it provides[3], representing a potential systemic risk to the global economy.

This is the particularly the case for banks, who have wide and diverse exposure across a range of economic sectors, as well as more direct exposure to some higher biodiversity impact and dependency sectors, such as agriculture. It is positive to see that banks globally are already recognising these potential risks and calling for greater biodiversity protection. In October 2021, over 50 banks signed a declaration, coordinated by the China Banking Association, supporting biodiversity conservation, and seeking to strengthen biodiversity risk management and disclosures[4].

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Governments made progress at COP15

Engaging with banks on biodiversity – our findings

Best practice for banks and biodiversity

Why banks need to act and what next

1 WWF (October 2022) Living Planet Report 2022
2 Columbia Threadneedle Investments (October 2022) Nature and biodiversity loss: how is it relevant to portfolios?
3 World Economic Forum (January 2020) Nature risk rising: why the crisis engulfing nature matters for business and the economy.
4 Common Declaration of Banking Financial Institutions Supporting Biodiversity Conservation http://finance.people.com.cn/n1/2021/1015/c1004-32254983.html

The response from regulators and governments

Central banks are also increasingly recognising the potential systemic risks posed by nature and biodiversity loss. The Network for Greening the Financial System, a group of global central banks and financial supervisors with over 100 members, has released several reports examining the implications of biodiversity loss for financial stability.

In March 2022, they released a position statement recognising that while governments bear primary responsibility for addressing biodiversity loss, it could also have 'significant macroeconomic implications, and that failure to account for, mitigate, and adapt to these implications is a source of risks for individual financial institutions as well as for financial stability'[5].

In a speech at the end of September, a member of the Executive Board of the European Central Bank (ECB), highlighted that addressing nature-related risks is considered part of the ECB's mandate, and emphasised that central banks must move from principles into practice in relation to their supervisory frameworks on biodiversity and broader environmental risks[6]. This hints at upcoming biodiversity-related regulation, with similar sentiment being echoed by other prudential regulators globally[7].

Beyond this, governments are also starting to take note. In December, the second part of COP15 concluded with agreement on a historic new post-2020 Kunming-Montreal Global Biodiversity Framework[8]. The agreement seeks to halt and reverse biodiversity loss, with a number of high-level goals, including to maintain and enhance the resilience of natural ecosystems and to halt human-induced extinction of known threatened species. The agreement also includes ambitious targets to ensure at least 30% of terrestrial, inland water, and coastal and marine areas are protected by 2030.

Following on from the focus of the first part of COP15 in Kunming in 2021, which placed a significant emphasise on the role of finance, the adopted agreement includes a goal of closing the biodiversity finance gap of US$700 billion dollars per year and to align financial flows with the post-2020 Global Biodiversity Framework. This could have a similar galvanising effect as Article 2.1c of the Paris Agreement, which called for financial flows to be consistent with a pathway towards low greenhouse gas emissions. It also includes several other relevant targets for financial institutions, including a target for large transnational companies and financial institutions to regularly monitor, assess and disclose their risks, dependencies and impacts on biodiversity in order to reduce negative impacts and biodiversity-related risks.

Agreement was reached at COP15 to halt and reverse biodiversity loss

[5] Network for Greening the Financial System (March 2022) Statement on nature-related risks

[6] European Central Bank (29th September 2022) Keynote speech by Frank Elderson, Member of the Executive Board of the ECB and Vice-Chair of the Supervisory Board of the ECB

[7] Bank Negara Malaysia (March 2022) An exploration of nature-related financial risks in Malaysia and Banque de France (October 2022) Central banking in the Anthropocene: How to re-embed our economic and financial systems within planetary boundaries?

[8] Kunming-Montreal Global biodiversity framework https://www.cbd.int/doc/c/e6d3/cd1d/daf663719a03902a9b116c34/cop-15-l-25-en.pdf

How we assess and engage on biodiversity-related risks

As highlighted in our Biodiversity Best Practices and Engagement Approach[9], we have conducted a heatmap assessment of our equity and corporate fixed income investments to understand our sector exposure to biodiversity impacts and dependencies on ecosystem services. This has helped us to prioritise sectors to focus our engagement activities on, as well as to define objectives for these engagements. More insights into this engagement can be found in this **Approach document**. We have engaged companies across a range of sectors including the materials, extractives, consumer staples, and transportations sectors[10]. We are also one of eleven lead investors involved in launching the collaborative engagement initiative Nature Action 100[11].

Recognising the unique role that banks play in the global economy, and the potential systemic risks posed by biodiversity loss detailed above, we have also engaged with 15 banks where biodiversity has been discussed over the past year and a half.

We have worked to understand our sector exposure to biodiversity impacts and dependencies

What we found

Governance

Few of the banks that we engaged with had dedicated board oversight and accountability specifically related to biodiversity. For the most part they highlighted that biodiversity was one of the many aspects that form part of the broader environmental and social (E&S) risk reporting from management to the board. We note an emerging trend of some banks hiring or appointing dedicated resources tasked to lead on biodiversity and nature.

Strategy

While all banks we engaged with had developed a sustainable finance strategy, few appeared to have developed specific policies or strategies to manage biodiversity-related risks and opportunities. Some have started to provide high-level narrative-based biodiversity-related disclosures, either within their sustainability reports, as part of their climate strategies, or in standalone statements. No banks engaged appeared to have systematically identified risks and opportunities related to biodiversity across their operations and financing. Some of the banks are beginning to explore biodiversity-related opportunities, for example through conservation finance and other blended financing mechanisms that seek to mobilize private capital to address biodiversity loss and bridge the biodiversity funding gap.

Risk management

With regards to the management of biodiversity-related risks, several banks have highlighted that they are piloting the use of the ENCORE[12] tool to conduct a qualitative assessment of their lending portfolio for biodiversity impacts and dependencies. Others are using input-output models to conduct biodiversity footprinting to better understand the impacts of their lending portfolios on biodiversity. Both are positive first steps. Beyond this, in general banks highlighted that biodiversity is included as one of the issues that is assessed within their E&S due diligence, however in many cases disclosures on the process for conducting this due diligence and any biodiversity-specific metrics assessed remain limited. There is an emerging practice of banks referring to their client engagement on the topic, this is disclosed alongside the information they provide on their engagement regarding clients' climate transition plans.

Few banks have developed specific biodiversity policies or strategies

[9] Columbia Threadneedle Investment ESG Viewpoint Biodiversity best practice and engagement approach

[10] More information on this engagement and some of the outcomes for specific sectors can be found in our ESG Viewpoint Engaging companies on biodiversity.

[11] Nature Action 100

[12] Exploring Natural Capital Opportunities, Risks and Exposure (ENCORE) is a tool developed by the Natural Capital Finance Alliance and UNEP-WCMC to help corporates and financial institutions to better understand, assess and integrate natural capital risks into their activities based on their dependencies and impacts on nature.

Geography and sector-specific policies

In some cases, banks have geography and sector-specific policies in place related to biodiversity risks. Lending policies for the forestry and palm oil sectors are the most common sectoral policies. Given that banks do not seem to have conducted systematic assessments of the biodiversity impacts and dependencies in their portfolios, it is not clear why banks have chosen these sectors to focus on, compared to other potentially high biodiversity risk sectors. Other common policies relate to avoiding financing of companies operating in UNESCO World Heritage Sites and RAMSAR wetlands, as well as policies prohibiting financing of illegal activities, such as illegal logging or the illegal wildlife trade.

While these policies are important steps, the level of detail provided varies significantly making it difficult as investors to understand how these policies are implemented. It can often be unclear which clients these policies apply to, for example whether they apply to only new clients or also existing clients, and which specific industries and sub-industries are in scope. For forestry and agricultural commodities, banks often rely on third-party certifications to verify adherence with their financing criteria, but wording differs substantially between banks requiring adherence to stated criteria or simply encouraging adherence. Additionally, where banks have agricultural commodity policies in place, in many cases these relate to palm oil production or value chains, and timber, pulp and paper, while failing to include other commodities (such as cattle, soybeans, rubber, and cocoa) whose production also has impacts on biodiversity.

None of the banks we engaged with disclosed any specific metrics that they use to assess biodiversity risks, with only a few setting broad targets to prevent further loss and contribute to a net gain of biodiversity by 2030. A more common approach was membership of the Taskforce on Nature-related Financial Disclosures (TNFD)[13] Forum to build capacity and understanding on this issue, while some banks are members of the Taskforce itself.

Overall, the current practices of the banks we engaged with reflects a range of factors, including the uncertainty they face given the nascency of the issue and the understanding of its relevance, the growth in different initiatives and continued development of methodologies to assess and disclose biodiversity-related information, as well as the limited availability of underlying data. Some banks also expressed capacity constraints, given the changing regulatory environment on ESG disclosures and climate risk management, deciding to focus their initial efforts on climate risk management.

In response to this mixed picture, we have developed our thinking on best practice on this issue for the sector, which we will promote through our engagement.

We have developed a biodiversity best practice for the banking sector

[13] The Taskforce on Nature-related Financial Disclosures (TNFD) is an industry-led taskforce working to develop and deliver a risk management and disclosure framework for organisations to report and act on evolving nature-related risks.

Evolving best practices for banks

We have developed a list of preliminary good practices based on our interactions with banks, which are designed to encourage capacity building and familiarity with existing tools and methodologies. These are aligned with our corporate biodiversity best practice framework, and are broadly aligned with the key pillars of the TNFD disclosure framework.

Governance

Demonstrated robust and effective board oversight and governance of biodiversity-related risks and opportunities

This includes ensuring that regular E&S updates to senior management and the board include information on biodiversity risks and opportunities. As well as consideration of a dedicated resource to focus on assessing and managing biodiversity-related risks and opportunities.

Strategy

Disclosure of a clear biodiversity strategy or position

Develop a high-level biodiversity position statement describing your organisation's approach to the issue and the potential risks and opportunities to the business.

Evaluation and disclosure of biodiversity-related risks and opportunities

Consider evaluating and disclosing how biodiversity risks and opportunities have impacts across all aspects of the business, including lending, underwriting, advisory, project finance, and the actions taken to manage these.

Risk Management

Biodiversity-related risk and impact assessment

Provide increased disclosure on the broader E&S risk management approach, including how high E&S risk sectors have been identified, the process for conducting client E&S due diligence, and the extent to which biodiversity-related issues are included in this assessment.

Conduct a systematic assessment and screening of biodiversity impacts and dependencies within lending and underwriting activities, as well as an assessment of clients with significant operations in or supply chain links to high biodiversity risk geographies and regions (biodiversity hotspots).

Consider publicly disclosing the initial findings of the assessment of financing exposure to high biodiversity impact and dependency sectors, and biodiversity hotspots.

Develop robust policies and procedures to address biodiversity-related risks

Publicly disclose policies highlighting how they will seek to minimise biodiversity risks in these high impact and dependency sectors, and regions. Ensuring that these policies contain sufficient detail on the criteria which clients are expected and/or encouraged to meet, where possible, and how they will engage and support clients in meeting these.

Metrics and commitments

Ambition to be nature positive supported by targets

Consider announcing an ambition to reduce, reverse and restore all negative impacts on nature by 2030. Robust biodiversity ambitions should be supported by a series of targets covering short, medium and long-term timeframes, focused on the most pertinent impacts an organisation has on biodiversity.

Work collaboratively to build capacity to understand biodiversity-related risks and opportunities

Join the Taskforce on Nature-related Financial Disclosures Forum to build internal capacity and understanding on biodiversity and nature-related risks and opportunities.

Outlook

The outcomes of the Kunming-Montreal Global Biodiversity Framework will have implications for the private sector and financial institutions.

To keep in step with evolving regulation and increasing financial risk, companies will need to ensure they make full use of industry-led standards designed to support the assessment and disclosure of nature and biodiversity-related risks.

The Platform for Biodiversity Accounting Financials earlier this year published their standard to guide financial institutions with assessing the biodiversity impacts of their financing, and have highlighted that they will update this in 2023 to also include guidance on assessing the dependencies of their loan and investment portfolios on ecosystem services[14].

Meanwhile, the TNFD recently released the third draft version of their framework for disclosing nature-related risks and have provided additional guidance on how the current approach can be used by financial institutions to support their piloting and testing of the framework. The final framework and recommendations are due to be published in September 2023. We are members of the TNFD Forum and have provided detailed feedback on the previous draft versions. We share the widespread expectation that the TNFD framework will become adopted by regulators as mandatory for many issuers in the future.

With these standards and frameworks still evolving, in general banks have adopted a 'wait and see' approach. While this is understandable, it is at odds with the urgent need to address biodiversity loss and the associated risks, the momentum behind these industry-led standards, and growing noise and commitments from governments at COP15, central banks and regulators. Banks must start acting now to build internal understanding and capacity to support the assessment of biodiversity-related risks and opportunities, and to stay ahead of what will be a steep learning curve.

Next steps

We have shared the best practices outlined above with several global banks and will seek further detailed engagement conversations with them to discuss these issues, along with other material ESG issues.

Banks need to urgently address biodiversity loss and associated risks – we're committed to engaging on this topic

[14] The Platform for Biodiversity Accounting Financials seeks to provide financial institutions with practical guidance to standardise biodiversity impact and dependency assessments.

Get to know the author

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Tom joined our Responsible Investment team in 2022. He focuses on research and engagement in emerging markets, focusing on APAC financials and utilities. He previously worked at Impax Asset Management, where he was a Sustainability & ESG analyst, involved in company ESG research and engagement, and prior to that worked within the stewardship team at the Principles for Responsible Investment. He holds a Bachelors degree from the University of Bristol and a Masters from King's College London. He holds the CFA UK Investment Management Certificate.

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