REGULATING FINANCE FOR BIODIVERSIT

An Assessment for the Global Biodiversity Framework Executive Summary





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Executive Summary

Public and private financial flows directly contributing to global nature loss were estimated at US\$ 7 trillion in 2023, whereas only US\$ 200 billion was spent on conserving or restoring biodiversity (<u>UNEP, 2023</u>). Introducing regulations that eliminate financial flows driving deforestation and associated human rights violations must be a precondition for successful conservation interventions.

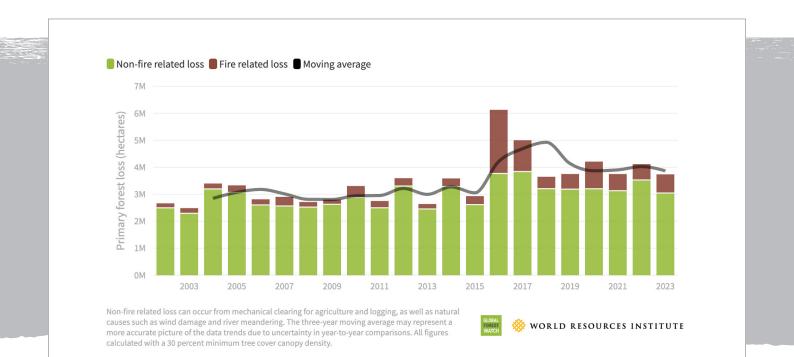
New research by the Forests & Finance Coalition examines the adequacy of financial sector regulations in five countries and regions — Indonesia, Brazil, China, the European Union and the United States — in relation to safeguards for biodiversity protection, with a focus on tropical forests. These jurisdictions are some of the most consequential for finance and investment, driving tropical biodiversity loss and rights violations worldwide and encompassing most financial flows reported in the latest Banking on Biodiversity Collapse report (Forests & Finance, 2024).

The Global Biodiversity Framework (GBF) is a landmark agreement reached at the United Nations Convention on Biological Diversity in 2022 and signed by 196 countries. The GBF aims to reverse biodiversity loss and restore nature, as defined by four goals for 2050 and 23 targets for 2030. This report assesses the strengths and gaps in current financial sector regulations against a selection of the 2030 GBF targets, with reference to deforestation cases.

The report finds that, despite some signs of positive financial sector reform in some jurisdictions, regulations are generally inadequate to prevent the financial sector from supporting exploitative resource extraction from tropical forest biomes. The report urges the adoption of robust outcome-oriented financial sector regulations and supervisory policies, along with clear sanctions regimes for non-compliance.

Although not directly addressed in this report, the underlying economic incentives that serve to lock in the global extractivist economy must also be addressed. Chief among these are issues such as unsustainable sovereign debt servicing, related economic conditionalities, and certain trade agreement provisions (<u>Dempsey, et al, 2024</u>). It is expected that overhauling financial sector regulation in direct support of achieving biodiversity-related public policy goals would also serve to support efforts on these wider structural challenges.

Tropical Primary Forest Loss, 2002-2023 (SOURCE: WORLD RESOURCES INSTITUTE)



COVER PHOTO: RAN

Deforestation and Rights Violations Continue Globally

All life on Earth depends on forests. From the water cycle, to clean air, to stabilising global temperatures, forests directly influence the well-being of the entire planet. What's more, tropical rainforests are some of the most biodiverse ecosystems on Earth, home to over half of the world's vertebrate species. For all life on Earth, it is critical to address the ongoing and interlinked crises of climate change, biodiversity loss and violence against communities related to resource extraction.

The rate of global tropical forest loss has remained dangerously high since 2018, with 3.7 million hectares wiped out in 2023 alone, releasing an estimated 2.4 gigatonnes of carbon dioxide into the atmosphere (<u>WRI, 2024</u>). If current trends continue, this would mean a tropical forest area the size of Guyana would be wiped out by 2030, emitting the equivalent of an additional 2.5 years of the entire US economy's carbon emissions.

Mining, agribusiness — including beef, palm, and soy — and logging for timber and paper, are major drivers of tropical deforestation and are sectors closely linked to the killing of land rights defenders around the world. When these activities expand into forests that are traditionally managed by Indigenous or local communities, a cascade of harm often follows. Land defenders on the frontlines are increasingly facing intimidation, violence and murder. It was reported that in 2023, 196 land defenders were murdered for attempting to protect their territories. Land defenders who are also Indigenous are disproportionately killed, making up over one-third of all documented lethal attacks since 2012 (Global Witness, 2024).

Instead of addressing its own harmful role in perpetuating the biodiversity crisis, the financial sector is instead promoting initiatives that are largely self-serving and fundamentally flawed. These proposals include efforts to establish international biodiversity credit and offset markets, as well as reliance on corporate self-reporting under the Taskforce on Nature-related Financial Disclosures (TNFD). These schemes will do nothing to address the root causes of deforestation and rights violations and further distract from securing financial sector accountability for financed harms.

Missing Voices: 2106 Land and Environmental Defenders were Killed Between 2012 and 2023 (SOURCE: GLOBAL WITNESS)



The Five Key Jurisdictions Needed to Halt Finance Driving Deforestation

Forests & Finance tracks the financial flows and investments to the 300 most important producers and traders of six forestrisk commodities which are responsible for driving tropical deforestation in the three tropical forest regions: beef, palm oil, pulp and paper, rubber, soy and timber. This methodology uses geographic and sectoral adjusters to attribute finance in a conservative manner so as not to overstate the forest-risk in each transaction. In addition, there is little transparency in the financial sector, which means our figures are often lower than actual amounts. Based on an analysis of this data, we identified the five most important jurisdictions to regulate the financing of forest-risk commodities to align with the goals of the GBF. These are: Indonesia, Brazil, China, the European Union and the United States. For each jurisdiction, we identified the specific types of financing most relevant to forest-risk commodity sectors.

Banks active in Indonesia and Brazil

Banks operating in Indonesia and Brazil account for 72% of all credit going to the six forest-risk commodities, with a value of US\$ 285 billion in the past eight years. Brazilian banks account for 48% and Indonesian banks for 10%. Foreign bank subsidiaries in Brazil and Indonesia account for 9% and 5% respectively. Regulations in these two countries which can impact bank credit are therefore crucial. Moreover, Brazilian investment products sold to private investors that finance agribusiness in Brazil have a total outstanding value of US\$ 187 billion as of July 2024 (Ministério da Agricultura e Pecuária, 2024), therefore regulations in this area are also important.

Bond and share issuances in China

Next to bank credit, the six forest-risk commodities are also financed by selling shares and bonds to investors. Chinese banks play a significant role in underwriting share and bond issuances by Chinese traders and producers of forest-risk commodities, to the value of US\$ 18 billion in the past eight years. Chinese regulations related to share and bond issuances are therefore important.

Investments managed in the European Union and United States

As of July 2024, investors held US\$ 41 billion in bonds and shares in forest-risk commodity sector companies. 37% are in the hands of US investors and 8% in the hands of EU investors. Compared to investors from other regions, North American and EU investors had the most diverse portfolios of forest-risk investments. Regulations requiring US and EU investors to influence their investee companies could therefore be significant.

Brazil - 48% **Spain -** 3% Malaysia - 4% **USS 395 Netherlands -** 4% RILLION **Japan -** 6% **Other -** 12% **United States - 6%** China - 7% Indonesia - 10%

Forest-risk credit per country by financier (2016-2024)

The Role of Financial Regulation in the GBF

In December 2022 the parties to the Convention on Biological Diversity (CBD) adopted the Kunming-Montreal Global Biodiversity Framework (GBF), which sets out an ambitious pathway to reach the global vision of a world living in harmony with nature by 2050 (though notably the United States is yet to ratify the Convention). Among the GBF's key elements are four goals for 2050 and 23 targets for 2030. This report aims specifically to address the commitment of countries under target 14 of the GBF, which includes an obligation on states to fully integrate biodiversity into financial sector regulations.

TARGET 14: Integrate biodiversity in decision-making at every level

Ensure the full integration of biodiversity and its multiple values into policies, regulations, planning and development processes, poverty eradication strategies, strategic environmental assessments, environmental impact assessments and, as appropriate, national accounting, within and across all levels of government and across all sectors, in particular those with significant impacts on biodiversity, progressively aligning all relevant public and private activities, and fiscal and financial flows with the goals and targets of this framework.

Using Target 14 as the research starting point, the authors of this report then devised an indicative assessment framework to test how the current state of financial regulations is equipped to meet a selection of critical GBF targets. The additional targets selected for this assessment were **Target 1**: Plan and manage all areas to reduce biodiversity loss; **Target 10**: Enhance biodiversity and sustainability in agriculture, aquaculture, fisheries and forestry; and **Target 15**: Businesses assess, disclose and reduce biodiversity-related risks and negative impacts.

Types of financial regulation assessed

This report uses a broad definition of 'financial regulations', beyond what is normally defined as financial regulation or supervision. This definition encompasses all types of government laws, regulations and guidelines which have impact on how financial institutions operate, especially when it comes to financing of, and investing in, companies in the real economy.

The following types of regulation are evaluated:

- Risk management and financial stability
- Financial market functioning
- >> Monetary policy
- Money laundering and financial crime
- >> Corporate disclosure
- Stimulating sustainable activities
- Protecting human rights and/or the environment

Key Findings and Indicative Assessment

The table below presents a top-level summary of the detailed assessment findings (available in the full report). Each jurisdiction was evaluated for its unique combination of policies and regulations relevant to addressing credit and investment connected to harmful biodiversity and rights impacts. Overall, the results were extremely concerning, indicating poor integration of biodiversity into financial-sector regulation and supervision across the board.

The report found that the United States performed the worst, with no meaningful consideration of biodiversity in its financialsector regulations. Indonesia and China also scored poorly, though both show some references to biodiversity. Brazil performed slightly better, with some restrictions on financing companies involved in biodiversity destruction. The European Union scored marginally higher, adopting the double materiality principle in investor disclosure requirements. However, the EU still maintains exemptions for the financial sector from other biodiversity-related regulations, reflecting overall inadequate protection.

Regulations assessment scoring table

Color Score Assessment:		-
	Financial regulations do not make any reference to the GBF target.	l
	Financial regulations make a reference to a topic related to the GBF target, but only as a recommendation.	
	Financial regulations require financial institutions to take relevant steps towards the GBF target.	l
	Financial regulations require financial institutions to align all their financing and investment decisions with the GBF target.	

Assessment criteria	Target 1 Assessment:	Target 10 Assessment:	Target 15 Assessment:
(As defined by authors for the purpose of this study)	Financial regulations do not allow financing of, or investment in, companies involved in conversion of natural landscapes.	Financial regulations expect financial institutions to stimulate a just transition in the Agriculture, Aquaculture, Fisheries and Forestry sectors which supports the rights of workers, peasants, fisher folk, indigenous peoples, traditional and local communities.	Financial regulations require transparency of all financing and investment flows and full disclosure of biodiversity and social impacts of these flows.
Indonesian regulations for banks	Financial regulations do not limit financing or investing in conversion of natural landscapes in any way.	Financial regulations and taxonomies do give some guidelines on social and environmental issues, but these do not cover all relevant sectors and are not obligatory.	Financial regulations do require ESG reporting by banks, but do not demand transparency on financial flows and have no obligations on reporting on social and biodiversity impacts.
Brazilian regulations for banks and investment products	Restrictions related to the conversion of natural landscapes exist for government-controlled rural credit, but not for normal bank loans or for (tax-exempt) investment products benefiting the agricultural sector.	Financial institutions are required to elaborate a policy on Social, Environmental and Climate Responsibility, but are not explicitly expected to work towards a just transition in relevant sectors.	Financial regulations do require ESG reporting by banks, but do not demand transparency on financial flows (by banks and investment products) and have no obligations on reporting on social and biodiversity impacts.
Chinese regulations on share and bond issuances	Financial regulations do not limit security issuers being active in conversion of natural landscapes in any way.	The issuance of green bonds, whose proceeds can be used for a just transition of relevant sectors in China itself, is stimulated. But this does not cover foreign investment, nor normal corporate bonds.	Stock exchanges have issued guidance on disclosure on biodiversity and social impacts, but progress is expected on stricter reporting requirements. For now, they hardly cover impacts overseas, nor require transparency on where funds are invested (except for green bonds).
EU regulations for investors	Financial regulations do not prohibit investing in conversion of natural landscapes in any way. The EUDR does not yet cover financiers, while the SFDR does set some expectations in this respect but leaves it to fund managers how to implement them.	Financial regulations encourage financial institutions to stimulate a just transition in relevant sectors through the EU Taxonomy framework and the related Green Bonds Regulation. But these regulations fall short on sector- specific targets and do not cover social criteria.	Investment funds need to be transparent on the companies they invest in, but not pension funds and other investors. EU regulations and the reporting standard ESRS require disclosure of biodiversity and social impacts of investment. However, ESRS still lacks sectoral standards and not all investors are in scope.
United States regulations for investors	Financial regulations do not prohibit investment in companies involved in conversion of natural landscapes.	Financial regulations do not expect financial institutions to stimulate a just transition in relevant sectors.	Financial regulations do require investors to be transparent on the companies they invest in. Investors are not required to report on biodiversity and social impacts of their investment.

Outcome-oriented Policy Recommendations

Fundamental financial sector reform is critical for the achievement of the Global Biodiversity Framework goals. Governments should update their National Biodiversity Strategy and Action Plans (NBSAPs) to strengthen financial-sector regulations to support central banks, financial regulators and supervisors to include biodiversity and human rights criteria as core to their mandate. Based on the research and assessment presented, the report provides specific recommendations for each of the assessed jurisdictions, as well as providing a compiled set of recommendations relevant for all countries. These recommendations are briefly summarised below (a detailed version is available in the full report):

Risk Management and Financial Stability: Financial institutions should be required to integrate biodiversity and human rights risks and impacts into their risk management processes at the corporate group level of their clients. They must develop transition plans with specific targets and hold board members accountable for risk management. Regulators should mandate higher capital reserves for high-risk activities. System-wide stress tests should also include biodiversity considerations.

Financial Market Functioning: Regulations should mandate regular disclosure of investment and loan portfolios, including exposure to biodiversity risks and impacts, with verifiable proof required for biodiversity-related claims. Financial products should be labelled based on their genuine sustainability impacts, and investment funds with harmful biodiversity impacts should be phased out.

Monetary Policy: Central banks should prioritize bonds from issuers making concrete and verifiable positive contributions to biodiversity and human rights in any quantitative easing programs and collateral frameworks. They should assess and address the contribution of their own investment portfolios to biodiversity and human rights impacts. They should also offer reduced interest rates to financial institutions investing in genuinely sustainable and socially just activities.

Money Laundering and Financial Crime: Biodiversity risks should be incorporated into due diligence and Know Your Customer processes. The financing of companies should be prohibited if they and their suppliers are not able to demonstrate clear adherence to all legal requirements in the areas where they operate. Financial institutions should be held accountable for crimes connected to the corporate groups that they finance, including those impacting biodiversity and human rights, and should be liable for remedy.

Corporate Disclosure: Annual public reporting on biodiversity and human rights risks and impacts should be required for companies under the common control of all medium and large corporations. This should include detailed, verifiable data on biodiversity and rights impacts, including geolocation data of its operations. All companies should be required to publish annual profit and loss statements and provide details on their funding sources and (legality of) their assets.

Stimulating Sustainable Activities: Expand taxonomies to include biodiversity, social, and human rights criteria and include categories for inherently harmful sectors. Financial institutions should be required to align their portfolios accordingly. Create robust, transparent and verifiable criteria for finance that incentivises community-led sustainable land use and restoration.

Human Rights and Environmental Protection: Develop due diligence obligations for the financial sector to prevent the financing of embedded deforestation, forest degradation and human rights violations. Establish independent grievance and accountability mechanisms for affected communities and third parties to bring complaints against financial institutions.

Strengthening Institutions: Financial regulators to develop in-house expertise on biodiversity and human rights and establish inclusive stakeholder platforms to consult with Indigenous Peoples, civil society and other experts. Outcome-focused financial regulations that align with the objectives of the GBF and shift the economy away from harmful activities must be supported by a robust sanctions regime. These should include stringent penalties for non-compliance and mandatory obligations to fund mitigation and remedy efforts for affected communities and ecosystems.

