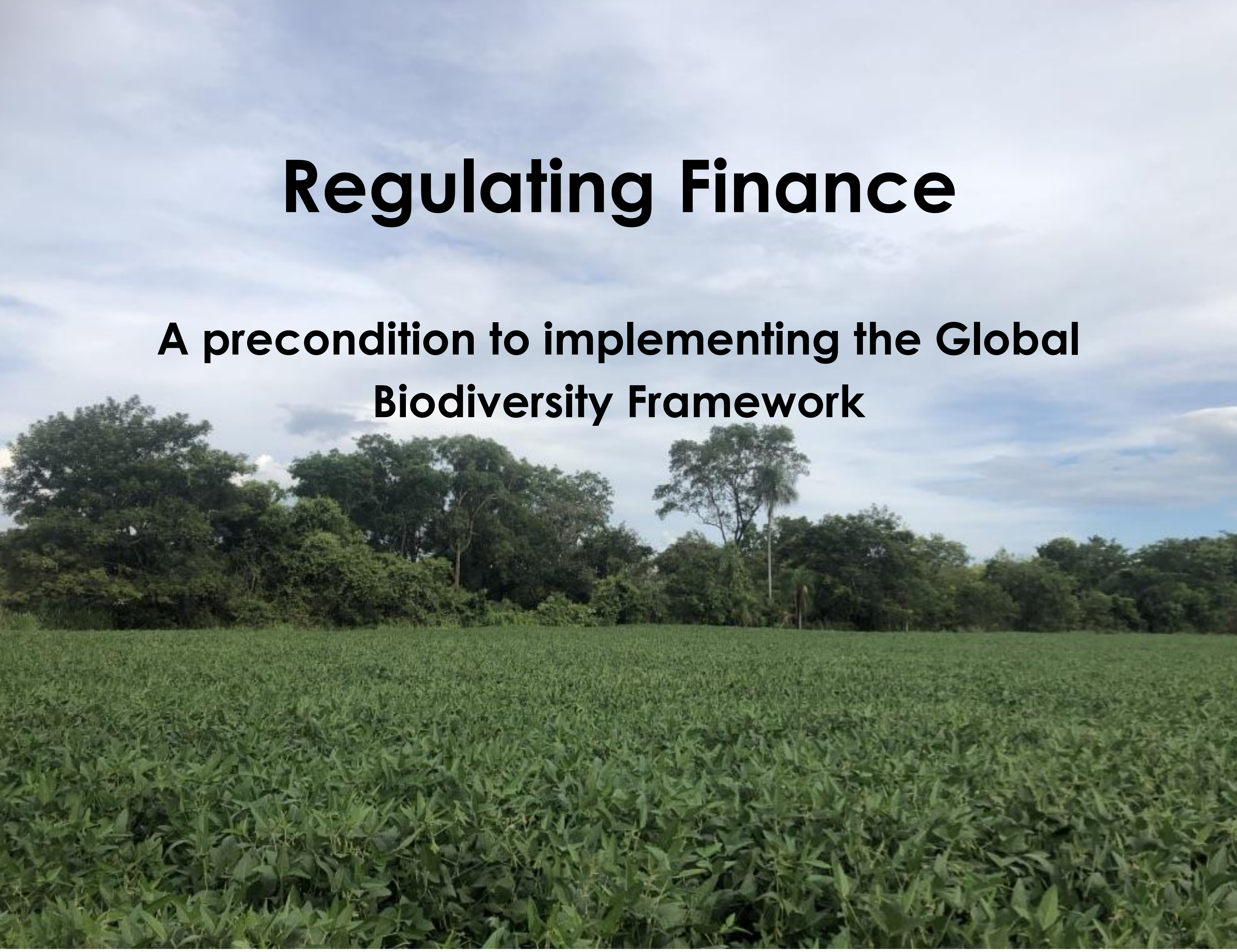
Regulating Finance

A precondition to implementing the Global Biodiversity Framework



Introduction: Finance and the Global Biodiversity Framework

In December 2022, almost all Governments on the planet committed formally to halt biodiversity loss by 2030 by adopting the Global Biodiversity Framework (GBF). However, as concluded by the State of Finance for Nature report published by the UN in December 2023, these Governments are yet to put their money where their mouth is. The report concluded that private financial flows to biodiversity conservation are less than 1 percent of private financial flows spent on activities that harm biodiversity, while harmful public financial flows are 10 times greater than public investments in conservation. It is obvious that mobilizing resources for biodiversity conservation makes little sense as long as the overwhelming majority of resources continues to be spent on exactly the opposite goal. For that reason, governments committed to progressively align all financial flows with the GBF (GBF target 14). They also committed to identify and eliminate subsidies and other perverse incentives that might trigger biodiversity loss (GBF target 18). They are currently discussing how to align the resource mobilization strategy of the Convention on Biodiversity (CBD) with these targets, and with a target on ensuring sufficient finance (GBF target 19). Moreover, they agreed on a target to take legal, administrative or policy measures to ensure that financial institutions transparently disclose their impacts on biodiversity ... in order to progressively reduce negative impacts (GBF target 15).

This briefing paper will highlight why binding regulations and commitments to implement these crucial targets are a pre-condition for implementing the GBF as a whole, and why corporate-driven voluntary initiatives are a dangerous distraction from such regulations and commitments as they have proven to be ineffective or even contra-productive to the GBF.

The Problem: Private and Public Financial Flows that are Harmful to Biodiversity

The financial sector has a tremendous impact on biodiversity as it provides credit and capital for activities that cause environmental impacts. The 2023 Banking on Biodiversity Collapse report revealed that at least $307 billion in credit had been directed to the main tropical forest-risk sectors from 2016 to September 2023. The March 2024 Bankrolling Ecosystem Destruction report estimated that over 1 trillion USD in global credit went to major corporate groups involved in so-called ecosystem risk sectors, including agricultural commodities associated with deforestation risks; sectors using large inputs of such commodities to produce animal feed; sectors consuming large quantities of this feed; and timber and wood pulp, since the adoption of the Paris Agreement in 2015. The Deforestation Dividends report concluded that between 2016 and 2020, financial institutions earned 1.54 billion USD in revenue from a portfolio of 20 deforestation-risk agro-industrial companies. And the Banking on Climate Chaos report shows that 60 of the world’s largest banks poured over USD 6.9 trillion into the fossil fuel industry over the past 8 years, driving climate chaos, biodiversity loss and deadly local community impacts.

Perverse subsidies and other harmful public financial flows continue to be a significant cause of biodiversity loss as well. An estimated 1.69 trillion USD were spent by the world's Governments on harmful subsidies and other perverse incentives in 2022, including an estimated 345 billion USD on harmful agricultural subsidies and 160 billion USD on harmful subsidies to the forestry sector.

In total, public and private financial flows causing biodiversity loss and associated environmental harm added up to 7 trillion USD in 2023, whereas only 200 billion USD was spent on conserving or restoring biodiversity (UNEP, 2023). It is clear that a binding commitment to eliminate these harmful financial flows is a precondition for reaching the GBF's objective of halting and reversing biodiversity loss by 2030.

The False Solution: The Failure of Corporate-led Voluntary Initiatives by the Finance Sector

The draft updated resource mobilization strategy that will be discussed at the 4th meeting of the CBD Subsidiary Body on Implementation (SBI) acknowledges the need that public and private financial flows need to be aligned with the GBF. In a rather contradictory recommendation, it also expresses support for the Taskforce on Nature-related Finance

Disclosures (TNFD), as a tool to achieve this, despite the fact that voluntary initiatives like this are not aligned at all with the GBF, and have proven to fail in the past.

The TNFD framework, which was formally launched in September 2023, was written by a corporate task force that includes no representatives of governments, academia, NGOs or rightsholder groups. The framework provides voluntary reporting guidelines for companies, including financial institutions. It is not in line with GBF target 15, which mandates governments to ensure that impacts are not only reported on, but also addressed. To make things worse, TNFD's baseline recommendations do not even expect businesses to disclose their negative impact on biodiversity. The framework itself mainly requires disclosure of information that is financially "material", which means risks will only be reported if they might impact on the financial interests of -potential- investors in the company - unless national laws require otherwise. By excluding full impact reporting, this advocates for a weaker standard than already in law in for example the EU, and under consideration in China. In most cases the negative impacts of biodiversity loss are public. They affect, in an often highly gendered manner, the Indigenous Peoples and the local communities that depend on forests or other ecosystems for their livelihood, and society as a whole. Moreover, a 2021 World Bank report highlighted that low and middle low income countries will suffer 10 to 15 times larger economic impacts from biodiversity loss than high income countries. The wealthy companies causing the harm are often the last to suffer from the impacts of the damage they cause.

Even investors are not benefiting from TNFD guidance, as companies are not even obliged, for example, to report if they are facing serious complaints over biodiversity destruction or human rights violations. According to the Canary, TNFD members themselves faced no less than 300 rights-related allegations over the last 10 years. Yet, TNFD does not oblige them to set up a grievance mechanism, and/or to pay redress and compensation if they are found liable for biodiversity harm in a certain community. Nor does TNFD oblige companies to disclose where they are operating or buying from, which makes it impossible for local communities to verify whether a certain company or bank is linked to the biodiversity loss in their area. TNFD also allows investors to determine freely which data they want to disclose and through which methodology such data are gathered, which makes it impossible for independent auditors or other actors to verify whether these data are correct, and virtually ensures that these data will not be consistent and comparable. It does not indicate what will occur in the event that a financial institution, or other company, is using TNFD reporting to greenwash and share blatantly false or misleading information.

Voluntary corporate initiatives have proven to be ineffective and out of step with CBD and GBF agreements as well. An analysis of the forest-risk policies of more than 100 financial institutions concluded that despite some marginal improvements since 2016 "vague language, unclear timeframes, and other loopholes persisted, leading to continued facilitation of human rights violations and deforestation." (BOBC, 2023)

An independent review of an earlier corporate initiative by the financial sector, the "Soft Commodities Compact" revealed an overall failure to reach its targets. The 12 banks that signed up to this compact actually increased their investments in forest-risk companies during the 6-year duration of the compact and they were not even able to comply with the commitment that all their clients were to join voluntary sustainability certification schemes. The certification schemes they were embracing as a guarantee for their sustainability are under severe criticism themselves as well. Analysis found critical gaps in the Roundtable on Sustainable Palm Oil certification scheme, the Forest Stewardship Council has been found to have had "minimal impact on tropical deforestation" in general, and independent audits of the Round Table on Responsible Soy concluded that certified companies "show a failure to achieve any social or environmental benefit".

The Real Solution: The Need for Ambitious Binding Regulations and Commitments in NBSAPs

The Convention on Biodiversity is a legally binding instrument, and it has become clear that an approach that embraces corporate-driven voluntary initiatives will not enable Governments to reach the targets that were set under the GBF to ensure compliance with the Convention. Instead, such compliance requires legally binding regulations for the financial sector to ensure banks and other financial institutions cease to finance the destruction of our planet. It requires Governments to perform immediate and thorough reforms of all subsidies and other incentive systems so that they facilitate a just transition towards sustainable, gender just economies that conserve and restore biodiversity. And it requires binding commitments to ensure sufficient resources are mobilized to safeguard GBF implementation.

The first cautious steps towards regulating the financial sector to ensure its compliance with biodiversity and other environmental agreements have already been taken. For example, the French Duty of Vigilance Law requires that large multinational corporations, including financial institutions, operating in France establish a plan covering all their international activities that "includes reasonable due diligence measures to identify risks and prevent serious violations of human rights and fundamental freedoms, the health and safety of people and the environment, resulting from the activities of the company and those of the companies it controls." Most critically, it also allows communities to seek remedy for harms.

China has adopted Green Finance Guidelines for the Banking and Insurance Industries, which instruct banks and insurance companies to strictly restrict financing industries that face significant environmental and social risks. The guidelines are unfortunately not yet legally binding, but it is hoped the key provisions will be incorporated in the Chinese Law on Commercial Banking, which is currently being revised. The EU has introduced mandatory sustainability reporting for certain undertakings, including banks and insurance companies from 2025 onwards. It has adopted a detailed reporting standard on biodiversity and ecosystems specifying disclosure requirements that should enable users to understand the compatibility of the undertaking's strategy and business model with regard to relevant local, national and global public policy targets related to biodiversity and ecosystems, including the GBF.

Meanwhile, the recently adopted EU Regulation on Deforestation-free Products has so far excluded the financial sector. This allows EU financial institutions to finance companies and commodities that trigger deforestation, whose products will subsequently be banned from entering the EU. The European Commission is preparing an impact assessment on the need to provide for specific legal obligations for financial institutions. Although the landmark Corporate Sustainability Due Diligence Directive limits due diligence requirements for financial institutions to their upstream suppliers, it tasks the European Commission with submitting a report on the necessity to lay down additional sustainability due diligence requirements with respect to their lending and investment activities within two years after entry into force. These reviews offer an opportunity for legislative action to regulate the EU financial sector, which is currently responsible for more than 22% of all financial flows to forest-risk commodity production, from bankrolling biodiversity destruction.

Some other weaker but potentially interesting initiatives include the Sustainable Finance Taxonomy that was adopted by the EU in 2023, although it was heavily criticized and even legally challenged for classifying forest bioenergy and industrial forestry in general as sustainable. The Government of Brazil has decided to exclude industrial livestock activities from its sustainable sovereign bonds and Malaysia already adopted a Value-based Intermediation Financing and Investment Impact Assessment Framework in November 2019. In 2022 Indonesia introduced a Green Taxonomy to expedite financing for sustainable sectors.

Recommendations

Governments and financial regulators must adopt strong regulations to ensure that the financing of biodiversity collapse is halted, and that public and private resources are channeled to finance a just transition. They must adopt regulations that:

- Establish strong legally binding social and environmental standards that financial institutions must comply with. Among other requirements, these must prohibit the financing of deforestation, forest degradation and conversion or degradation of natural ecosystems, set high pollution and emission threshold standards and fully protect human rights, with specific considerations for the rights of Indigenous Peoples and other vulnerable populations;

- Require strong due diligence by financial institutions for all their financial services including across client company groups;

- Require financial institutions to have contract and client on-boarding requirements on biodiversity and human rights risks, including repercussions for non-compliance;

- Require financial institutions to disclose:
  - the name of the project and company (or company group) they are financing, including financial intermediaries
  - their full impacts on biodiversity with methods that allow data to be publicly and independently verified, and scrutinized
  - complaints they face about their biodiversity and human rights impacts;

- Require financial institutions to adopt holistic transition plans, with clear metrics and targets, that address biodiversity, climate and social impacts with a systemic approach;

- Clearly establish the responsibility of financial institutions for their contribution to adverse impacts through financing or investing in companies that cause harms;

- Establish mechanisms to hold financial institutions accountable for the adverse impacts they have caused or contributed to in their financing and investment. Such mechanisms should include Financial Institutions that fail in their due diligence and include a mechanism that holds senior management accountable, that establishes fines that are orders of magnitude higher than the profits made, and a mechanism for remedy and redress for affected communities and the environment.

As a very first step, Governments should clearly indicate in the updated National Biodiversity Strategies and Action Plans they are supposed to publish before the next CBD Summit in October 2024 what regulatory steps they are planning to make to prohibit the allocation of public or private capital to corporations and sectors that drive ecosystem destruction, so as to align all financial flows with the GBF objective to halt and reverse biodiversity loss by 2030.

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