

Biodiversity Principles
Recommendations for
the Financial Sector



Preface

Starting in 1994, the Verein für Umweltmanagement und Nachhaltigkeit in Finanzinstituten e.V. (VfU; Association for Environmental Management and Sustainability in Financial Institutions) has encouraged German-speaking financial institutions to exchange their thoughts and expertise on topics of sustainability. Its aim is to develop strategies and tools that promote sustainable development within the financial sector.

Since 2008, the VfU has been particularly concerned with the issue of biological diversity and its relevance within the financial sector. In cooperation with the Centre for Sustainability Management (CSM) at the Leuphana Universität Lüneburg (Germany) and other contributors, the “VfU Forum Biodiversity“ task force compiled these biodiversity principles. The development of the principles was facilitated by the German Federal Agency for Nature Conservation (BfN, Bundesamt für Naturschutz).

The following principles serve as a guide for business companies within the financial services and insurance sectors, helping them develop individual strategies and integrate the conservation of biodiversity into their business practices.

The principles offer a recommended course of action for the financial services and insurance sectors. They help individual companies further specify and implement specific biodiversity management strategies.

Further recommendations for implementing these principles can be found at www.vfu.de:

- Guideline for Assessing Biodiversity-Related Risks and Opportunities – A Support for the Implementation of the VfU Biodiversity Principles
- Best Practice Examples and Support Tools – A Support for the Implementation of the VfU Biodiversity Principles

These principles are based on the following publication:
The Climate Principles – A Framework for the Finance Sector (2008),
see www.theclimategroup.org/programs/the-climate-principles

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1

The Present Situation

The protection of global biodiversity serves as a major challenge for the global community. After all, biodiversity lays the foundation for many vital processes, such as the provision of raw materials, food and drinking water, the regulation of climate and flood events, or the production of oxygen and nutrients. Furthermore, biodiversity can provide inspiration, recreation, and even be of spiritual or religious value.

However, scientific research proves that the global loss of biodiversity has reached a critical point. Reasons for this include the increase in resource and land consumption, nutrient pollution, and last but not least, the continuous progression of climate change.

In order to put a stop to the global loss of biodiversity, the United Nations Conference on Environment and Development (UNCED) passed the International Convention on Biological Diversity (CBD) in 1992 in Rio de Janeiro, Brazil. Its objectives are the conservation of biodiversity, the sustainable use of its components, and the fair and equitable sharing of the benefits arising out of the utilization of genetic resources. (Art. 1, CBD)

Biological diversity, or biodiversity, means the variability among living organisms from all sources including, inter alia, terrestrial, marine and other aquatic ecosystems and ecological complexes of which they are part; this includes diversity within species, between species and of ecosystems. (Art. 2 CBD)

Every organization and every business directly or indirectly utilizes services stemming from biodiversity. Consequently, businesses play a crucial role in achieving the goals of biodiversity conservation.

This gives rise to new challenges for the financial and insurance sectors. The objective is thus to manage the risks resulting from the loss of biodiversity and benefit from the entrepreneurial opportunities linked to its conservation.

Hence, it is necessary to cooperate with major actors within the fields of science, politics, and civil society, and collectively develop indicators based on practical circumstances, as well as viable methods. The objective of this process is to set defined standards through cooperation and compliance. Previous integration of climate protection into business proceedings may also prove to be a highly valuable experience.

Businesses will have the opportunity to become leaders of biodiversity conservation within their sector. However, the decision to analyze a company's risk in the field of biodiversity, to define the resulting consequences and the individual activity framework, lies in the hands of each individual company.

The Importance of Biodiversity for the Financial Sector

In light of anticipatory risk management and the exploration of new business areas, biodiversity will prove to be of key importance for the financial sector.

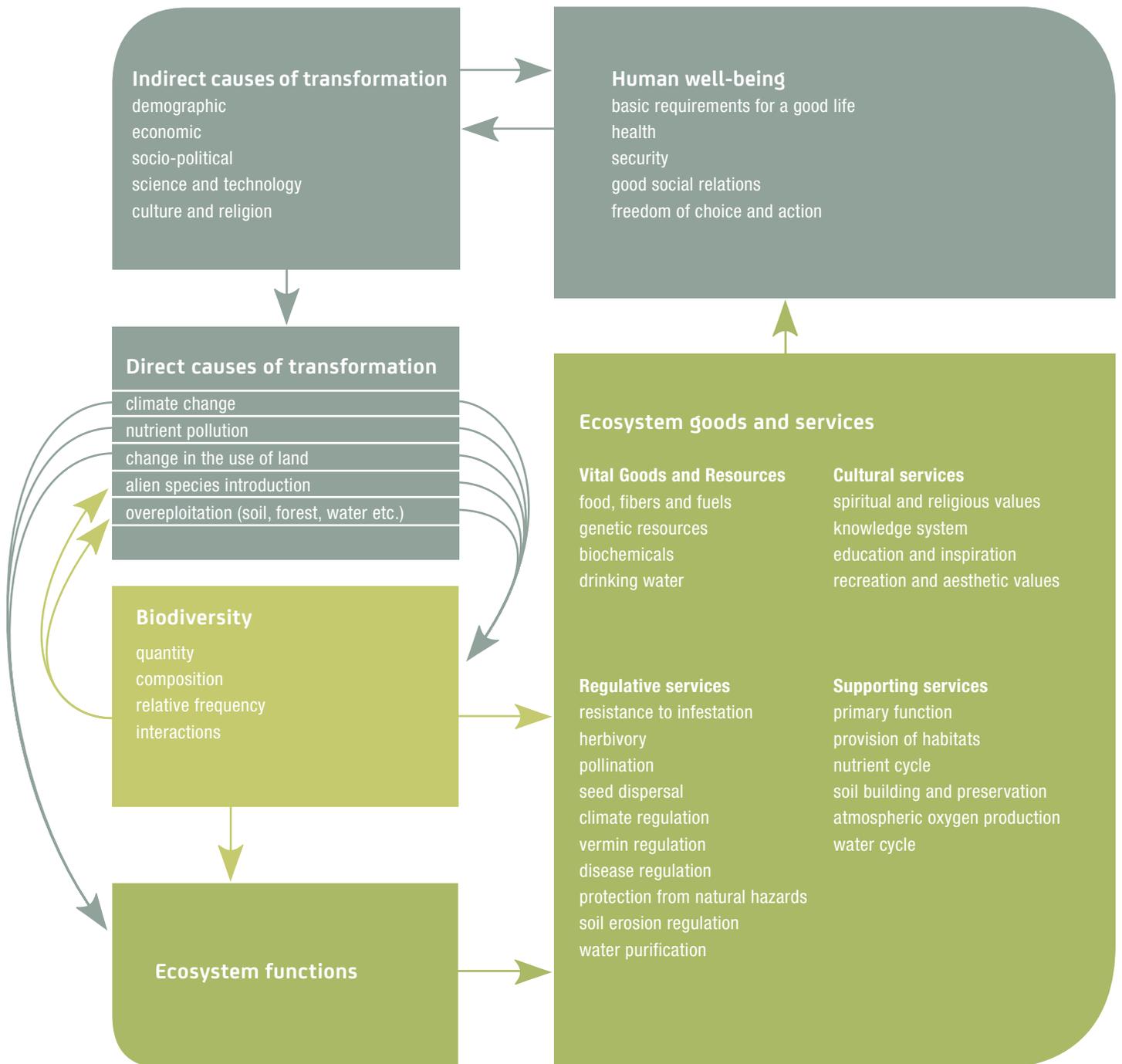
2.1 Biodiversity and Ecosystem Services

Preserving biodiversity does not only mean protecting certain individual species. Many vital natural services, so-called ecosystem services, depend on a certain degree of biodiversity. The provision of natural resources and food, the regulation of climate and flood events, or the degradation of harmful substances are just a few examples. Moreover, biodiversity contains aesthetic and emotional components, and therefore not only provides a recreational space but can also serve to inspire innovation.

However, several socio-economic developments lead to the growing loss of global biodiversity. The main reasons for this downturn are:

1. **Loss of habitats:** This loss is caused, for instance, by large-scale cultivation, the fragmentation of natural habitats, or the replacement of traditional cultivation methods.
2. **Climate change:** Ecosystems and living environments for plants and animals change due to the increase of global warming.
3. **Introduction of non-domestic species:** Non-domestic species can suppress domestic species, transmit diseases or change the existing genetic pool through hybridization.
4. **Overexploitation of ecosystems:** The overfishing of oceans or the increasing intensification of agriculture are examples of overexploitation.
5. **Emissions:** In addition to toxic substances, this particularly includes the growing overfertilization in agriculture that results in the loss of low-nutrient ecosystems.

Chart 1: Biodiversity is transformed due to several factors. Simultaneously, it has an impact on ecosystem functions and contributes both directly and indirectly to the provision of ecosystem goods and services.



Source: Secretariat of the Convention on Biological Diversity (2006): Global Biodiversity Outlook 2

2.2 Business Risks

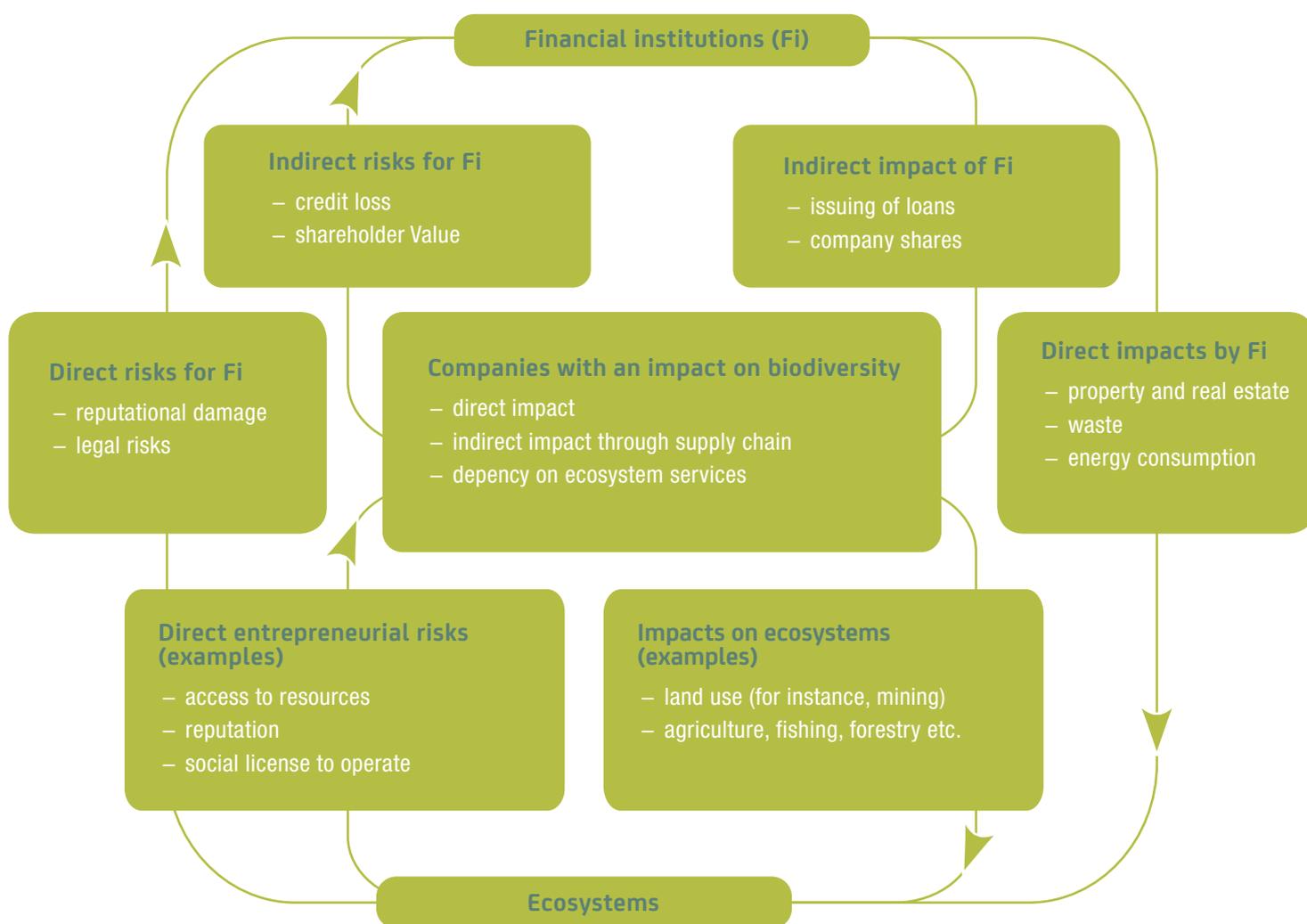
The decline of biodiversity entails a loss of ecosystem capacity. This also affects the economy. For example, plants can no longer pollinate, food sources and natural resources run dry, and tourist destinations lose their appeal. Socio-political reactions to the loss of biodiversity give rise to new risks (and opportunities) for business companies. Entrepreneurial risks may be categorized as the following:

1. **Operational risks:** If degraded ecosystems fail to provide ecosystem services, or only a limited amount of them, this can be conducive to a shortage and price increase in natural resources, and/or to cutbacks in entrepreneurial productivity.
2. **Regulatory, liability, and litigation risks:** In order to protect biodiversity, governments will tighten their regulations with regards to accessing natural resources. Their potential approaches include regular decrees and bans, as well as quota systems, financial instruments or compensatory systems. Moreover, business companies might have to compensate for damages to biodiversity more so than before due to new liability standards.
3. **Market risks:** These risks emerge if companies do not react to consumer and business client demands for (more) environmentally friendly products and services. Usually consumers and business clients expect environmentally friendly production methods, and therefore, may avoid a product or company due to negative media coverage.
4. **Reputational risks:** Activities with a negative effect on biodiversity can lead to the stigmatization of individual companies or an entire industry.
5. **Financial risks:** The aforementioned risks also have an impact on the financial performance of the companies in question, and might thus have an influence on the financial sector.

2.3 Opportunities and Risks for the Financial Sector

The interdependency of entrepreneurial success and biodiversity affects different industries to different degrees. Chart 2 illustrates how the ongoing loss of biodiversity directly or indirectly affects all business companies as a matter of fact – including those in the financial sector.

Chart 2: The financial sector directly and indirectly impacts biodiversity. In turn, changes in biodiversity also have a direct and indirect impact on the financial sector.



Source: Mulder & Koellner (2011) Hardwiring green: how banks account for biodiversity risks and opportunities. Journal of Sustainable Finance & Investment

Table 1 summarizes the assessments made by several finance experts with regard to emerging risks in the financial sector. The risk of reputational damage due to the funding of projects that have a negative impact on biodiversity is of particular relevance to capital lenders (loans or other capital market operations).

	Reputational risk	Credit risk	Regulatory risk	Operational risk	Market risk	Liquidity risk	Legal liability/ litigation risk	Systemic risk
Banking	association with adverse impacts on BES ¹ can result in severe damage to a company's brand	natural-capital-associated risks that can cause the default of investments, inaccurate information on counterparts	governments restricting access to and/or finance in biologically diverse areas	acceleration of natural disasters, or ecological degradation on business losses and outputs, such as agriculture	market volatility influenced by BES loss	BES loss affecting availability of liquidity	Finance Institutions being held liable for BES degradation	BES loss affecting the functioning of (a segment of) the finance sector
Project finance	2	1	1	1	1	1	1	1
Other structured finance	1	1	1	1	1	1	1	1
Corporate finance	1	1	1	1	1	1	1	1
Investment								
Private wealth management	1	1	1	1	1	1	1	1
Pension funds	1	1	1	1	1	1	1	1
Insurance funds	1	1	1	1	1	1	1	1
Mutual funds	1	1	1	1	1	1	1	1
Sovereign wealth funds	1	1	1	1	1	1	1	1
Hedgefunds	1	1	1	1	1	1	1	1
Private equity	1	1	1	1	1	1	1	1
Insurance								
Insurance	1	1	1	1	1	1	1	1
Reinsurance	1	1	1	1	1	1	1	1

Table 1: Biodiversity risks and their possible impact on the financial sector

¹BES = Biodiversity and Ecosystem Services

The respondents were asked to complete the table with regard to clients from the following sectors:

- Agriculture / food and beverages
- Forestry
- Fishing
- Tourism
- Oil and gas
- Mining and metals
- Building and construction
- Supplies (thermal energy and hydropower)

The respondents were asked to assign on figure to each category

- Not material (0)
- Starting to become material (1)
- Material (2)

The figures derive from the quantity per field, divided by the number of times they were mentioned. Average figures below 0.67 were defined as "not material". Figures between 0.67 and 1.33 were defined as "starting to become material". Figures above 1.33 were defined as "material".

Source: UNEP FI (2010) CEO briefing - Mythos Naturkapital

Acknowledging biodiversity also offers opportunities for financial institutions. For instance, they can assess a client's operational and strategic handling of biodiversity, and in turn, also evaluate potential economic success. For example, biodiversity can play a central role in the appeal of a tourist destination, and consequently have an effect on the financial performance of tourist-related services. By taking a look at the investment business, one sees that changes in client demands have already lead to new business opportunities for financial service institutions. A few examples of this include:

- Combining climate protection projects with sustainable reforestation investments
- Offset trading
- Funds with companies that support the preservation of biodiversity
- Covering damages and liabilities with regard to biodiversity

When taking biodiversity into account, financial institutions can be pioneers in client business activities as well as in their everyday practices. This improves reputation and signals a company's commitment to consistent sustainable activities.

Practical solutions

- Acknowledging biodiversity in material procurement (such as paper produced and office furniture made from sustainable forestry products, a lunchroom offering local and sustainable food, marketing and promotional products made from recycled material)
- Maintaining and designing commercial property in a sustainable way (such as careful maintenance, rooftop greening, and avoiding soil sealing)
- Offering events and external information that raise biodiversity awareness among staff members and service contractors,
- Promoting local projects that seek to foster biodiversity (for example, through financial donations and foundation contributions)

3

The Biodiversity Principles for the Financial Sector

The following recommendations are based on the goals set by the Convention on Biological Diversity:

1. The conservation of biological diversity
2. The sustainable use of its components
3. The fair and equitable sharing of the benefits arising from utilization of genetic resources

The recommendations are guided by the following basic principles:

1. The goal is to alleviate negative effects on biodiversity caused by business operations.
2. Business decisions are conducive to the conservation and equitable use of biodiversity and ecosystem services (goods and services provided by biodiversity).
3. The aforementioned goals set by the Convention of Biological Diversity will be incorporated into the generation of products and services when this is possible and economically viable. Companies will seek to build an open exchange with clients about biodiversity-related risks and opportunities.
4. Functional approaches to the preservation of biodiversity shall be developed by means of exchange and cooperation with stakeholders.
5. Companies will strive towards continuous improvement and transparency in regards to their reporting practices.
6. Anything that seems to be relevant in the context of client risk and product development will also apply to operational processes, i. e. the selection, production, and use of operational equipment such as property, infrastructure, articles of daily use, and energy consumption.

3.1 Incorporation into the Management System

Integrating the aim to “conserve biodiversity” into strategic business operations leads to its long-term incorporation, and consequently, to the continuous alleviation of negative effects on biodiversity caused by business activities. In this way, companies can serve as role models.

1. A biodiversity strategy, corresponding sustainability policy, or guideline that includes biodiversity-related aims, supports the aim – “to preserve biodiversity” – within strategic and operational decision processes.
2. The biodiversity strategy, corresponding sustainability policy, or guideline should include clearly defined objectives.
3. It is vital that the management board, or the senior management, clearly commits itself to the aim of “conserving biodiversity” by means of a voluntary agreement or as an element of the sustainability policy. Moreover, the management board or senior management should designate one of their members as responsible for the implementation and realization of the biodiversity strategy, sustainability policy, or guideline that includes biodiversity-related aims, and any ensuing goals.
4. The implementation of the biodiversity strategy, sustainability policy, or guideline should be regularly reported on, both within the company and to the public.
5. Whenever possible, operational processes should exclude the use of products and services that have clear and recognizable negative impacts on biodiversity.
6. Staff members must be informed about the issue of biodiversity and must be offered support in their attempts to implement the biodiversity strategy, sustainability policy, or guideline into their everyday business activities.

3.2 Incorporation into Business Areas

3.2.1 Research Activities

Integrating aspects of biodiversity into company research activities encourages new product- and service-related insights. The results are beneficial for both the clients and the environment.

3.2.2 Asset Management

1. There are different risks and opportunities when it comes to aspects of biodiversity. Asset managers should therefore be capable of including possible biodiversity impacts into their analysis and investment decisions.
2. Clients should be informed if investments involve considerable biodiversity-related opportunities or risks.
3. Products and services must be designed so that risks emerging in the context of biodiversity can be managed and business opportunities can be acted upon.
4. Institutional investors should act according to the best long-term interest of their beneficiaries. This fiduciary responsibility also includes the acknowledgement of biodiversity.

3.2.3 Retail Banking

1. Ensuring client readiness and commitment to the preservation and sustainable use of biodiversity is highly recommended.
2. Suitable communication methods help raise awareness among clients.
3. By means of offering the corresponding products, support should be given to client contributions to preserving biodiversity.

3.2.4 Insurance and Reinsurance

1. When consulting, supporting and insuring clients, it is imperative to acknowledge their potential liability for direct and indirect damage to biodiversity, and In order to prevent illegitimate claims in the event of a loss, comprehensive consultancy services for the customers should be ensured via active and passive legal protection.
2. Whenever possible, clients should be provided with information on ecological risks and alternative courses of action, and enjoy support when attempting to avoid or alleviate negative impacts on biodiversity.
3. Product development should be based on current and future client demands, as well as on the protection of natural resources. In this way, product development can reduce the clients' economic and financial risks, and make an important contribution to a society's economic growth.

3.2.5 Corporate Banking

1. Day-to-day business demands the development of functional methods for better quality management of biodiversity risks and opportunities.
2. Financial solutions that support investments compatible with and beneficial to biodiversity should be developed and offered.
3. Clients should be encouraged to deliberately think about their specific biodiversity risks and opportunities, as well as about the preservation of biodiversity.
4. Provided that client business activities have a negative impact on biodiversity, they should be presented with suggested biodiversity offset schemes.
5. Staff members must be provided with training and information in order to help them assess biodiversity-related client risks and opportunities.

3.2.6 Investment Banking & Global Markets

1. It is imperative to compile schemes and tools that reveal biodiversity risks and opportunities to clients regarding their planned business activities.
2. In the Structured Lending & Venture Capital business divisions, investments in biodiversity-friendly technologies and environmentally friendly projects should be supported by functional financial solutions.
3. In trade, biodiversity expertise should be indirectly incorporated in the fields of weather derivatives, renewable energies or other environmentally relevant commodities.

3.2.7 Project Finance

In the context of projects with high impact on biodiversity (for example, in mining and mineral extraction, agriculture and forestry, tourism and hydropower), clients should be encouraged to:

1. Incorporate the conservation of biodiversity into their project design and follow the criteria defined in the IFC Biodiversity Performance Standards
2. Evaluate technical and financial options in order to avoid, minimize, replace or offset negative impacts on biodiversity to a sufficient degree
3. Include biodiversity into project progress reports in order to monitor the success of biodiversity preservation schemes

The IFC Performance Standards 6 – Biodiversity Conservation and Sustainable Natural Resource Management (www.ifc.org) provide guidance for project finance. This helps support the preservation of areas that are particularly in need of protection, such as tropical rainforest, swamps and wetlands, and other old-growth forests.

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