Laying the Track: The Race to Zero

The role of asset managers in tackling the biodiversity crisis

This briefing is based on a distillation of the findings of the Point of No Returns IV – Biodiversity report which surveyed 75 of the world's largest asset managers[i]. It sets out how the asset management industry is responding to the biodiversity crisis. It aims to shine a spotlight on the state of play in the industry and sets out what policymakers can do to move investors in the right direction. The picture that emerges shows the investment sector overlooking biodiversity considerations when making business and investment decisions, with current biodiversity trends undermining progress towards 80 per cent of sub-targets under the UN Sustainable Development Goals Framework[ii].

Led by the UNFCCC Champions for Climate Action, the global "Race to Zero" campaign aims to rally leadership from investors for a resilient, zero-carbon recovery that unlocks sustainable growth. This is the second in a series of briefings that will outline how we can lay the track for the financial services sector to reach net zero by 2050 and the first briefing about reaching no net loss of biodiversity by 2030.

The term biodiversity refers to the variety of living organisms and ecosystems of which they form a part. The Earth's incredible diversity must be conserved for its own sake and for the existence and prosperity of all species, including human life. Biodiversity also has a key role in maintaining the quantity, quality and resilience of ecosystem services which benefit society and businesses. The World Economic Forum finds that more than half the world's total GDP is moderately or highly dependent on nature and its services[iii].

However, the 2019 report by the Intergovernmental Science-Policy Platform on Biodiversity and Ecosystem Services illustrates the extent to which human activity is destroying the world's ecological foundations. Nearly half of the world's ecosystems have declined in size and condition against their natural baselines and many continue to decline at the rate of four per cent per decade[iv]. In the UK, the population of hedgehogs has declined by about 50 per cent since the turn of the century[v] and there has been a net loss of over 2.7 million pollinator species between 1980 and 2013[vi]. The financial sector is in a prime position to address the dramatic loss of biodiversity. The influence it wields through the ownership and financing of companies worldwide, as well as its potential to advance a new economic agenda that values and fully accounts for nature, puts it in a unique position to tackle the biodiversity crisis.

Linking Biodiversity and Climate Change

The interconnection between biodiversity and climate change means that the climate crisis further accelerates the destruction of nature and the biodiversity crisis inhibits efforts to reach net zero.

Healthy ecosystems play a key role in the capacity to limit climate change, preventing disruptions to society and the markets within which they operate.

Conserved habitats remove CO2 from the atmosphere helping to address climate change by storing carbon. Tidal ecosystems mitigate the impacts on human society of extreme weather events such as flood and storms.

Climate change impacts on biodiversity also affect the stability and resilience of ecosystems to provide crucial goods and services upon which society depends. This is already being seen in agricultural systems that are becoming less resilient to threats such as pests and disease[vii].

Restoring and conserving biodiversity is critical for climate change mitigation and adaptation, economic welfare and societal well-being.

Biodiversity-related policy commitments

The issue: The vast majority of asset managers do not incorporate biodiversity considerations into their investment policies and even when they do, they make no overarching commitments relating to the protection of biodiversity.

The details: 68 per cent of asset managers have a public investment policy which includes no reference to biodiversity and no asset managers have an overarching dedicated policy on biodiversity covering all portfolios under management.

Twenty one per cent of asset managers reference biodiversity in their publicly available documents without, however, adopting a clear approach towards biodiversity.

Eleven per cent of asset managers published a responsible investment policy in which they adopted a clear stance towards biodiversity protection but provide little detail on how this issue is integrated into wider investment strategy.

The barriers: A lack of understanding of the significance of the financial risks of biodiversity-related impacts and dependencies in investments inhibits asset managers from making specific policy commitments on biodiversity.

The UK's Environment Bill

The UK Government's Environment Bill will aim to set a new domestic framework for environmental governance through legally binding targets on biodiversity[1].

The government will consider relevant international best practice and commitments, such as CBD environmental goals, when developing domestic biodiversity targets[viii].

Our recommendation is that global goals to be set out in the upcoming 15th Conference of Parties (COP)[2] of the Convention on Biological Diversity are translated into national targets on biodiversity that are relevant to the private sector, by Governments and regulatory authorities.

CBD goals will likely include a commitment towards no net loss of biodiversity by 2030[ix]. Government legislation and financial regulation that translates CBD goals into clear and measurable targets would push asset managers to align with net zero biodiversity loss in their investment policies.

Biodiversity impacts and dependencies in high-priority sectors

The issue: The majority of asset managers show limited awareness of the material risks of biodiversity to their investments in high impact sectors like agriculture. Even less consideration is given to risks in sectors highly dependent on biodiversity, such as pharmaceuticals.

The details: 41 per cent of asset managers recognise the material risks of biodiversity to their investments in the agricultural sector. However, it is crucial for asset managers to identify

1 The UK's Environment Bill sets a comprehensive plan to enhance wildlife, tackle air pollution, transform the management of resources and waste and improve the resilience of water supplies in a changing climate, to ensure the protection and restoration of the natural environment. Long-term legally binding targets on biodiversity, air quality, water and resource and waster efficiency are to be developed by October 2022. A new independent Office for Environment Protection will be created to hold government and public bodies to account on their progress towards achieving environmental targets.

2 The UN Convention on Biological Diversity (CBD) is the international legally-binding treaty for the sustainable development of biodiversity. Its main objectives are the conservation of biological diversity, the sustainable use of its components and the fair and equitable sharing of benefits arising out of the utilisation of genetic resources. The upcoming CBD Conference of the Parties (COP15) will be held between 17-30 May 2021 in Kunming, China. While the exact biodiversity targets are yet to be decided, they will determine the post-2020 Global Biodiversity Frameworks to be adopted by countries.

other high-priority sectors[3] so that they fully understand the financial risks that biodiversity impacts and dependencies pose to their investments.

Twenty nine per cent of asset managers consider the financial risk of biodiversity to be relevant for their investments in the oil and gas sector. Through its use of terrestrial, freshwater and marine areas, its emissions of atmospheric pollutants and its high potential for spreading invasive species in the transportation process, it has highly intense impacts on biodiversity[x].

Eight per cent of asset managers acknowledge the pharmaceutical industry as relevant in the context of biodiversity-related portfolio risk. However, this industry is highly dependent on the preservation of the genetic diversity of plant and animal species. 70 per cent of drugs used in cancer treatment are natural or synthetic products inspired by nature[xi] and 50 per cent of all prescription drugs are based on molecules naturally occurring in plants[xii]. The high dependence of the pharmaceutical sector on biodiversity exposes it to a great degree of financial risk arising from its loss and diminishes humanity's ability to treat diseases.

The Task Force on Nature-related Financial Disclosures (TNFD) could help increase understanding of the impacts and dependencies that business sectors have on nature's ecosystems. This is a new reporting framework designed to capture the financially material risks of biodiversity impacts in the corporate and financial sectors[4].

The barriers: Institutional investors are not pricing in or putting value on the consequences of nature loss, so opportunities to mitigate biodiversity loss are not identified and prioritised.

Our recommendation is for governments and regulatory authorities is to build awareness of the financial risks of biodiversity impacts by introducing mandatory biodiversity-related disclosures in line with TNFD recommendations for asset managers, companies and asset owners. This would replicate the recent commitment from the UK government to make climate disclosures mandatory by companies and financial institutions using the framework developed by the Taskforce on Climate Related Financial Disclosure (TCFD).

Biodiversity-related corporate engagement

The issue: Most asset managers are not engaging systematically on biodiversity-related issues with portfolio companies.

3 High-priority sectors refer to the industries where financial activities have the highest potential dependencies and impacts on biodiversity. They are based on their inherent reliance on ecosystem services that are underpinned by biodiversity and their direct impacts on biodiversity. The identification of these high-priority sectors is regarded as the first step towards setting biodiversity-related targets as businesses can prioritise action to mitigate material risks.

4 Endorsed by 34 financial institutions and cross-continent governments, the TNFD framework will be launched in 2021 and tested in 2022 before made available worldwide. The UK Treasury's ongoing review into the economic value of biodiversity will provide the formal underpinning of the framework.

The details: Engagement with investee companies can help investors gain an insight into biodiversity-related corporate activities, convey and advance expectations on biodiversity performance and set out escalation strategies where enough progress is not being made. However, only 49 per cent of asset managers indicate that they discussed corporate biodiversity strategies in their engagement with companies, without specifying whether this engagement covered mainstream investment products or ESG impact funds.

When asset managers do engage on biodiversity issues with companies, the focus tends to be around disclosure. 56 per cent of asset managers engage with companies to request improved disclosures of the biodiversity-related impacts of companies' direct business operations and 46 per cent engage with companies to request improved disclosure of companies' supply chains.

Engaging companies on the opportunities of positive interventions on biodiversity or engaging with sectors that are high impact or highly dependent on biodiversity, are critical activities that are too often ignored by investors.

French disclosure legislation

The French Parliament recently amended Article 173 of the French Energy Transition Law to require the disclosure of biodiversity impacts by asset managers, companies and asset owners[xiii].

The barriers: Lack of understanding of what constitutes good corporate engagement on biodiversity inhibits asset managers from engaging with businesses on biodiversity-specific corporate objectives.

In the UK, the Financial Reporting Council (FRC)'s new Stewardship Code prioritises engagement and disclosure of engagement outcomes with companies as part of wider environmental, social and governance considerations.

Our recommendation is that the FRC develops a library of resources to support effective stewardship and ensure they signpost UK investors, particularly those that are signatories of the new Code, to high quality resources on topics like biodiversity.

The International Corporate Governance Network should develop a similar resource repository to incentivise corporate engagement on biodiversity-related issues amongst investors internationally.

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