Biodiversity and nature risks for financial institutions

Anthea Bowater, Maisie Stewart and **Simon Orton** discuss key developments in the evolving biodiversity risk agenda

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There is a growing appreciation amongst policymakers and regulators of the fact that all economic activity is profoundly reliant on the proper functioning of the earth's natural systems, the degradation of which introduces existential threats to people, communities and businesses across the world. The global and interconnected character of both natural systems and human industrial and commercial activities means that the impacts of change reach far and wide. Put simply, this is an issue that concerns us all.

Indeed, the World Economic Forum estimates that over half of global GDP is "moderately or highly dependent on nature", with construction, agriculture, and food and beverages being the most reliant sectors.[1]

However, although some industries will be more immediately affected by, for example, soil degradation, disruption to the water cycle, or declining populations of pollinating insects, these impacts will also cascade throughout the global economy, with consequences for financing, lending and investment.

As COP28 draws to a close, climate change is front of mind. However, broader (and related) threats to biodiversity and nature present another risk frontier no less challenging (or important) for businesses to address. With that in mind, we spoke with Anthea Bowater, Maisie Stewart and Simon Orton, of Freshfields Bruckhaus Deringer LLP, to get an understanding of the current issues in this important area of the environmental, social and governance (ESG) agenda. While this article adopts a UK focus, the challenges and approaches discussed apply similarly to jurisdictions across the world.

Why should financial institutions be considering biodiversity and nature?

Anthea: *Financial institutions have taken biodiversity and nature risks into account when funding major projects for some time. However, in the last few years there has been increased pressure from investors and action groups for institutions to consider their risks, impacts and dependencies more holistically across their various portfolios. This pressure has combined with a growing recognition from central banks and financial regulators that biodiversity and nature risks, impacts and dependencies can be material financial risks, and should be treated with commensurate importance. The result is that this is the fastest growing area of ESG at the moment – and an area that many financial institutions say they want to focus on in the short term.*

Given the speed with which biodiversity risks have risen up the agenda, do you expect to see mandatory reporting requirements in this area eventually?

Maisie: *While there is currently no requirement for mandatory disclosures on biodiversity in UK legislation, we can expect reporting requirements on biodiversity to follow the pattern of reporting on climate risks. Therefore, I think that it is likely that there will be a period of voluntary reporting, and that mandatory reporting will come into force in the near future. We already saw increasing calls ahead of the 2022 UN Biodiversity Conference (COP15) for large businesses across all sectors to make biodiversity-related disclosures by 2030. Indeed, the agreement of the Kunming-Montreal Global Biodiversity Framework at COP15 at country-level saw 23 targets set on biodiversity. Target 15 called for regular monitoring and assessments and transparent disclosure of risks, dependencies and impacts on biodiversity.*

An important step forward in reporting requirements was made in September 2023, when the Taskforce on Nature-Related Financial Disclosures (TNFD) published its final recommendations. The TNFD has also created specific disclosure guidance for financial institutions. As was the case with the Taskforce on Climate-Related Financial Disclosures, their recommendations will likely provide an impetus for financial regulators to introduce additional reporting obligations. In the meantime, we can expect to see some voluntary reporting in line with the recommendations, and many firms are already considering disclosures on biodiversity.

For those firms with a global presence, disclosure requirements across different jurisdictions will need to be considered. For example, there will be a need to comply with EU legislation where applicable, such as the Corporate Sustainability Reporting Directive, which will require reporting on adverse environmental impacts, including relating to biological resources. We may also see other jurisdictions follow France's example, where financial institutions are already required to disclose biodiversity risks and their targets and strategy for reducing their impacts on biodiversity under Article 29 of the French Law on Climate and Energy.

What will the biggest challenges for financial institutions be in reporting on biodiversity and nature risks?

Simon: *As Maisie has mentioned, a key challenge with reporting (as is the case across many different types of reporting) will likely be the presence of different reporting frameworks in different jurisdictions, which may target similar aims but use different standards to do so. In addition, whilst there are likely to be clear similarities to the journey of financial institutions reporting on climate-related risks, a key difference is the quantum and type of metrics involved. For climate reporting, there is really one key metric – the concentration of greenhouse gas emissions in the atmosphere – and this metric is global. But biodiversity covers so many different elements, from forests to oceans, and the impacts can be much more localised. This requires completely different metrics and identifying the key risks across portfolios and across different geographies will bring challenges.*

Despite the challenges, there are a number of metrics available and being developed. However, before firms get to the measurement stage, they will first need to map out where their operations impact on biodiversity, identifying their key areas of risk. Reporting is likely to be an iterative process, with financial institutions beginning with the data that is readily available, and building on that.

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How developed are firms' biodiversity and nature strategies at the moment, and are any particular sectors leading the way in terms of best practice?

Anthea: *Different firms are at different stages. Some of the firms we've talked to are just beginning to develop their strategy, and others have quite sophisticated strategies in place already which they are building on and refining. I would say that asset management firms, in particular, are the most likely to have existing biodiversity strategies in place, but a wide range of different financial institutions are focussed on this area.*

We know that some firms are particularly determined to develop their biodiversity strategy and reporting capabilities quickly as they felt that they didn't move as fast as they could have on climate, and that therefore they want to be a leader in biodiversity. Firms have also seen how important climate reporting has become to both investors and regulators, and are therefore mindful of the work that needs to be done on biodiversity and nature-related risks.

Has there been any litigation against financial institutions yet in this area?

Maisie: *Although there have not been many, a number of biodiversity-related cases have been brought against financial institutions over the years. These cases have been brought in different forums, with many of them taking the form of complaints under the OECD Guidelines. These earlier cases generally involved similar themes, alleging that banks, asset managers or pension funds failed to identify, prevent and/or mitigate the biodiversity impacts caused by clients, projects or investments which they were financing.*

More recently, as more legislation has developed in respect of biodiversity, we have seen cases with causes of action based on specific legislative requirements. Again, France provides another example of this, with Oxfam France having recently brought a claim against a large financial institution for breach of the French duty of vigilance.

All of the cases brought against financial institutions in a biodiversity and nature context have been what we call strategic cases – where claimants want to force a change in the strategy and policies of a financial institution. The dynamics are therefore quite different from a traditional claim for damages.

How can we expect the litigation risks to develop for financial institutions, and what can firms do to mitigate their risks in this area?

Anthea: *As firms begin to disclose more about their biodiversity and nature risks, impacts and dependencies, their litigation risk in this area will likely increase too. As well as the types of cases that Maisie has described, we may start to see cases in which claimants are alleging that financial institutions have made misrepresentations about their biodiversity strategies and commitments. These are difficult cases to bring successfully though – it is often challenging for claimants to establish causation and loss in this context.*

To protect themselves from these types of claims, firms can consider the governance surrounding their biodiversity and nature reporting – do they have a record of why particular decisions and commitments were made? Are the commitments monitored so that they can be updated when needed? Are there processes in place to make sure that each part of the firm understands the strategy and how their activities contribute to it? It can be helpful to have drafts of any public reports reviewed by a litigator too.

With this issue coming ever more to the fore, what would you recommend that firms focus on in developing their biodiversity and nature strategies?

Simon: *It's clear from what we have discussed already that biodiversity and nature risks are very wide in scope. It will therefore be important for financial institutions to really focus on material risks, impacts and dependencies, and to make meaningful progress on those in the first instance. Firms should make sure they are engaging stakeholders along the way, and accept that this is likely to be an iterative process. Stakeholder expectations are important and firms need to ensure they make progress against targets set. Firms will also have a wealth of experience from work done on climate reporting, and lessons learned, which they can build on in their journey on biodiversity and nature reporting.*

What did COP28 mean for biodiversity and nature?

Anthea: *The agenda for COP28 on Saturday 9 December focussed on Nature, Land Use and Oceans, and it culminated in the signing of a joint statement on Climate, Nature and People by 18 countries. In the statement, the countries agreed to put nature at the heart of the climate strategies which are being developed. There is acknowledgement that the long term goals of the Paris Agreement or the Cumming-Montreal Global Biodiversity Framework cannot be achieved without addressing climate change, biodiversity loss and land degradation together in a coherent, synergetic and holistic manner. The statement contains five objectives which the countries agreed to work towards, in accordance with the Paris Agreement and the Cumming-Montreal Global Biodiversity Framework, including the objective of fostering stronger synergies, integration and alignment in the planning and implementation of national climate, biodiversity and land restoration plans and strategies, and the objective of the scaling of finance and investments for climate and nature, from all sources, both public, private and philanthropic. This encouragement to fold biodiversity and nature into climate plans – which are often significantly more advanced – may mean that progress on biodiversity and nature-related plans now accelerates, so it is certainly an area that is worth investing some time in.*

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1. Half of World's GDP Moderately or Highly Dependent on Nature, Says New Report > Press releases | World Economic Forum (weforum.org)