BIODIVERSITY
AND NATURAL CAPITAL

EXECUTIVE SUMMARY

Nature and the services it provides are the basis of our societies and economic activities. They also play a vital role in helping regulate our climate and adapt to climate change. Since the EBRD's inception in 1991, the environment has been central to the Bank's work, from the Agreement Establishing the Bank to our Environmental and Social Policy.

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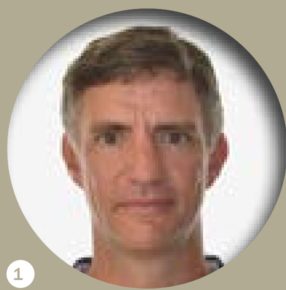
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More recently, climate action has provided additional momentum to the work done under the Convention on Biological Diversity since 1992. Nature-based solutions are attracting growing attention as a means to deliver co-benefits for addressing biodiversity loss and climate crises. In that sense, financial institutions in general, and multilateral development banks (MDBs) in particular, are now going beyond the traditional precautionary *do no significant harm* principles into supporting substantial net biodiversity gains. This is being supported, for example, by assessing nature-related financial risks and opportunities, investing in nature-positive programmes, and tracking and reporting nature impacts.

There are still important challenges ahead, from the development of accurate methodologies that value natural capital to the complexity of identifying and tracking biodiversity indicators in multiple ecosystems. Nevertheless, technology, standards and regulations are rapidly evolving and should help tackle the next major issue on the global sustainability agenda.

NATURE, THE GLOBAL BIODIVERSITY AGENDA AND THE EBRD

Nature is essential to all human activity, and much more. Therefore, protecting biodiversity and our collective natural capital is vital for the future of our societies and the planet. The EBRD has committed, in a joint statement by the major international development banks at COP26,[1] to increase its focus on nature, ecosystems and biodiversity across all of its work – in our advice to our clients, in our investments and operations, in our work on law and policy and in the way we communicate our impact.[2]

Historically, we have been working on projects that deliver benefits to nature and biodiversity since our inception as a development bank in 1991. Article 2 of our founding document, the Agreement Establishing the Bank,[3] requires us to assist recipient member countries through measures that promote environmentally sound and sustainable development. Meanwhile, across the EBRD's portfolio, all of the projects we finance must comply with our Environmental and Social Policy (ESP),[4] and in particular with Performance Requirement 6 (PR6), which highlights the importance of protecting biodiversity and the sustainable management of living natural resources in the economies where we operate. Projects must also comply with PR3 on pollution prevention and control, combating the emission of harmful substances for the environment, including greenhouse gases.

In 2015, the EBRD adopted the Green Economy Transition approach. The original objective was to increase the financing of projects that advanced the transition to an environmentally sustainable, low-carbon economy. The Bank has subsequently committed to raise its green financing to more than 50 per cent of its annual business volume by 2025 and align all its activities with the objectives of the Paris Agreement.

> “HISTORICALLY, WE HAVE BEEN WORKING ON PROJECTS THAT DELIVER BENEFITS TO NATURE AND BIODIVERSITY SINCE OUR INCEPTION AS A DEVELOPMENT BANK IN 1991.”

As a signatory to the European Principles for the Environment,[5] together with the European Investment Bank and three other European development banks, the EBRD is already committed to ensuring that our projects are structured to meet applicable European Union (EU) environmental principles, practices and substantive standards. For example, the EU Habitats Directive[6] ensures the conservation of a wide range of rare, threatened or endemic animal and plant species. As new EU legislation evolves, the EBRD will apply it in conjunction with our own ESP, regardless of the jurisdiction of the investment.

So a framework for the protection and conservation of nature is already in place. But the recent acceleration of the broader international environmental policy agenda, and the emergence of a growing body of performance standards, laws and regulations in the field of sustainable finance, provide the Bank with a welcome opportunity to re-evaluate and intensify its efforts across the full spectrum of environmental activities. It enables us to look beyond climate change and think more broadly about the impact the Bank's activities have on our natural environment. As an institution we are looking to move beyond a mindset of conservation and protection, towards holistic risk management (financial and non-financial) and ultimately to the development of a new asset class of “nature-positive” investments.

In this article, we will consider the evolution of law and policy in this field, how the EBRD is working to mainstream nature-positive activities to tackle the environmental crisis and what our contribution might be in the future.

1 The 26th United Nations Climate Change Conference of the Parties (COP26), held in Glasgow from 31 October to 13 November 2021.

2 https://ukcop26.org/mdb-joint-statement/, 2 November 2021.

3 https://www.ebrd.com/news/publications/institutional-documents/basic-documents-of-the-ebrd.html

4 https://www.ebrd.com/news/publications/policies/environmental-and-social-policy-esp.html, 25 April 2019.

5 https://www.eib.org/attachments/strategies/european_principles_for_the_environment_en.pdf, 30 May 2006.

6 https://ec.europa.eu/environment/nature/legislation/habitatsdirective/index_en.htm, 21 May 1992.

INTERNATIONAL AND EUROPEAN LAW: CONVENTION ON BIOLOGICAL DIVERSITY, TAXONOMY REGULATION

Shortly before COP26 opened in Glasgow in November 2021, the first half of the "other" COP took place virtually in October. The United Nations Biodiversity Conference, COP15, gathered 154 of the parties to the Convention on Biological Diversity (CBD), an international treaty that entered into force in December 1993.[7]

In broad terms, the CBD focuses on the conservation of biodiversity and the sustainable use of the components of biodiversity, defined as the variability among living organisms from all sources including terrestrial, marine and other aquatic ecosystems, and the ecological complexes of which they are part. According to the World Economic Forum, humanity has already been responsible for the loss of 83 per cent of wild mammals and half of all plants, while one million species are at risk of extinction in the coming decades.[8]

The economies where the EBRD operates are diverse in their geography and habitats and face a range of environmental challenges, from airborne emissions to climate change, soil degradation and water pollution. In the Palearctic region where EBRD economies are located, species population declined by more than 30 per cent between 1970 and 2014.

The EBRD regions also encompass some of the most pressured seas including the Aral, one of the largest human-made environmental catastrophes of the 20th century. The environmental degradation along the Mediterranean, Black Sea and Atlantic coasts due to overfishing, untreated waste and real estate overdevelopment represents a major human and environmental threat at the heart of our region.

7 https://www.cbd.int/doc/legal/cbd-en.pdf

8 https://www.weforum.org/reports/nature-risk-rising-why-the-crisis-engulfing-nature-matters-for-business-and-the-economy

At CBD COP15, all parties committed in the Kunming Declaration[9] to develop, implement and monitor an effective post-2020 framework that will put biodiversity on the path to recovery by 2030 and achieve the vision of "living in harmony with nature" by 2050. This is consistent with the Leaders' Pledge for Nature,[10] announced in September 2020 and now endorsed by 93 governments, to reverse biodiversity loss by 2030; and the EU's biodiversity strategy for 2030.[11]

Also at the EU level, the Taxonomy Regulation[12] is the central plank of the bloc's sustainable finance legislation. In force since July 2020, it contains the EU's attempt to answer the question: what does "green" mean? Or rather, what constitutes an environmentally sustainable economic activity?

Article 9 of the EU Taxonomy Regulation sets out six environmental objectives, one of which is protecting and restoring biodiversity and ecosystems.[13]

To qualify as an environmentally sustainable economic activity, an activity must "contribute substantially" to one of the objectives, "do no significant harm" to any of the objectives, be carried out in compliance with certain minimum safeguards (focusing particularly on human rights) and comply with technical screening criteria published by the European Commission.

This conceptual framework provides a useful mechanism for considering situations where there may be tension between competing environmental objectives. For example, when the construction of a renewable energy facility is proposed in an area of natural beauty, it may be that the potential for "significant harm" to biodiversity and ecosystems outweighs the "substantial contribution" to climate change mitigation. In other situations, achieving an environmental objective might be counterbalanced by human rights concerns, such as where benefits in the production of certain agricultural products are compromised by forced or child labour issues in their supply chain.

The EBRD follows an equivalent approach for its green finance investments, considering joint MDB climate finance and/or other environmental objectives alongside compliance with its ESP and the 10 performance requirements. The latter set the minimum standards for managing environmental and social impact and the risks caused by projects, and establish the strategic goal of promoting net benefits. The performance requirements cover areas from labour, health and safety, and stakeholder engagement to pollution prevention and biodiversity protection.

9 https://www.cbd.int/doc/c/df35/4b94/5e86e1ee09bc8c7d4b35aaf0/kunmingdeclaration-en.pdf

10 https://www.leaderspledgefornature.org/

11 https://ec.europa.eu/environment/strategy/biodiversity-strategy-2030_en

12 https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32020R0852&from=EN

13 Those six environmental objectives are climate change mitigation, climate change adaptation, sustainable use and protection of water and marine resources, transition to a circular economy, pollution prevention and control, and the protection and restoration of biodiversity and ecosystems.

NATURAL CAPITAL AND THE DASGUPTA REVIEW

From a policy perspective, one of the leading texts in this area is the Dasgupta Review, a study commissioned by the UK Treasury entitled *The Economics of Biodiversity*,[14] for which the EBRD provided comments. The study highlights the importance of "natural capital", defined as the stock of renewable and non-renewable natural assets (for example, ecosystems) that yield a flow of benefits to people (that is, ecosystem services). The term is used to signify that nature is intrinsically valuable because it provides the resources and environmental services upon which peoples' well-being and economic activity rely, and should therefore be treated as an asset base whose value needs to be preserved and enhanced.

This well-being refers not only to that of the current population, but also of future unborn generations who will need to draw on the stock of natural assets for their own welfare and economic activity. In fact, research by the World Economic Forum suggests that US$ 44 trillion of economic value generation – representing more than half the world's total gross domestic product – is moderately or highly dependent on nature and its services.

Introducing the concept of natural capital is important from a banking perspective because it enables institutions like the EBRD to begin to measure and monitor the impact that a project might have on nature. Consider, for example, the development of a coastal or mountain resort to which we attribute an initial natural asset value of x, yielding yearly returns of y. (Those returns could be physical, in the form of "ecosystem services" such as fresh air, clean water and agricultural produce, as well as monetary, in the form of revenue streams for governments and local communities). With sustainable tourism policies in place, it should be possible to maintain returns at y or even increase them, and enhance the value of the natural asset value above x. However, if poorly managed or overexploited from a sustainability perspective, the asset may temporarily provide y returns, but its value would be rapidly depleted below x, eroding returns in future years permanently below y.

The EBRD is leading a combined effort by a number of multilateral development banks to put in place a methodology for assessing the value of biodiversity and natural capital in the ecosystems where we operate. This work tries to ascribe an economic value to the services ecosystems provide to society and then feed that value into the decision-making of key economic actors. Previously, the lack of any natural capital valuation methodology meant that biodiversity was typically treated as an externality and given a null residual value in economic models, thus being ignored in socio-economic decision-making. To avoid this "tragedy of the commons" on climate, MDBs have successfully implemented a similar approach with their shadow carbon pricing methodology. In addition, valuing biodiversity and natural capital is an essential step to assessing and disclosing nature-related risks associated with projects and clients.

DISCLOSURE OBLIGATIONS FOR COMPANIES

Year-on-year, corporates and banks are required to disclose increasing amounts of information about the environmental impact of their operations. In the EU, which includes 12 of the economies where the EBRD operates, the Non-Financial Reporting Directive (NFRD)[15] already imposes obligations on 11,000 of the bloc's largest companies, which must publish an annual management report containing disclosure on environmental matters (among other things). In its review of EU environmental disclosure in 2020,[16] the Climate Disclosure Standards Board observed that only 46 per cent of companies reporting under the NFRD had included biodiversity disclosure, and subsequently published specific guidance for firms on this issue.[17]

14 https://www.gov.uk/government/publications/final-report-the-economics-of-biodiversity-the-dasgupta-review, 2 February 2021.

15 Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014L0095&from=EN

16 https://www.cdsb.net/nfrd2020, December 2020.

17 https://www.cdsb.net/what-we-do/nature-related-financial-disclosures/biodiversity-related-disclosures, January 2022.

The European Commission published a proposal for a Corporate Sustainability Reporting Directive (CSRD)[18] in April 2021. Extending the scope of the requirements to all EU listed companies – some 50,000 entities in total – the CSRD is scheduled to apply to large firms from 1 January 2023 and to listed small and medium-sized enterprises from 1 January 2026, and will require much more detail than the NFRD. See the previous chapter for further details on the NFRD, the CSRD and disclosure issues more generally.

The CSRD will introduce mandatory reporting standards. The information disclosed will need to cover the full range of environmental matters, including biodiversity and nature. In November 2021, the IFRS Foundation Trustees announced the formation of a new International Sustainability Standards Board (ISSB)[19] to develop a comprehensive global set of sustainability disclosure standards.

The European Commission has asked the European Financial Reporting Advisory Group (EFRAG)[20] to represent European views in the preparation of the ISSB's draft standards, which are scheduled for adoption in October 2022 and are expected to mirror the environmental objectives of the Taxonomy Regulation.[21] EFRAG's work to date includes developing a draft European Sustainability Reporting Standard on Biodiversity and Ecosystems.

EBRD representatives are closely involved in shaping the future regulatory landscape, contributing to a number of the bodies and initiatives described above. Our contributions have been focused on aspects that are most relevant to our mandate to promote environmentally sound and sustainable development, particularly in the private sector, across the EBRD regions.

> “EBRD REPRESENTATIVES ARE CLOSELY INVOLVED IN SHAPING THE FUTURE REGULATORY LANDSCAPE, CONTRIBUTING TO A NUMBER OF THE BODIES AND INITIATIVES.”

The Bank is part of several working groups helping to develop the EU Taxonomy for Sustainable Finance and the technical screening criteria that define the economic activities that can be considered sustainable, in line with the six environmental objectives. EBRD experts are members of EFRAG and the Bank is represented on two of the expert working groups: environment (excluding climate change) and governance.

We have also contributed to the work of the ISSB in preparing the standards themselves and specifically to its Biodiversity Working Group.

Looking beyond the EU, the Taskforce on Nature-related Financial Disclosures (TNFD)[22] was created in September 2020 to develop a risk management and disclosure framework for organisations to report and act on evolving nature-related risks. Even while the TNFD was being conceptualised, the EBRD participated in the informal expert working groups that led to the creation of the taskforce. The project's ultimate goal is to shift global financial flows away from nature-negative outcomes towards nature-positive outcomes. This mirrors the example of the Taskforce on Climate-related Financial Disclosures, created in 2015 by the Financial Stability Board to develop consistent, climate-related financial risk disclosures for use by companies, banks and investors in providing information to stakeholders.

The TNFD produced a work plan in June 2021[23] that envisages the development of a set of standards and their launch in the market from 2023.

18 Proposal for a Directive of the European Parliament and of the Council amending Directive 2013/34/EU, Directive 2004/109/EC, Directive 2006/43/EC and Regulation (EU) No 537/2014, as regards corporate sustainability reporting, https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52021PC0189&from=EN

19 https://www.ifrs.org/news-and-events/news/2021/11/ifrs-foundation-announces-issb-consolidation-with-cdsb-vrf-publication-of-prototypes/

20 https://efrag.org/

21 Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088 https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32020R0852&from=EN

22 https://tnfd.global/

23 https://tnfd.global/wp-content/uploads/2021/07/TNFD-Nature-in-Scope-2.pdf

Meanwhile, the EBRD as an institution participates in the TNFD Forum, alongside other development and commercial banks. The forum has a consultative role and liaises closely with the working group, providing feedback at key stages on the path towards implementation. We are also collaborating with *Agence Française de Développement* and the other multilaterals under the TNFD Development Finance Hub to promote a better understanding of biodiversity-related risks and share risk disclosure, case studies and sectoral experience. The biodiversity and natural capital valuation work fits within those efforts to find a common approach among multilateral institutions for the assessment and disclosure of nature-related risks.

OUTLOOK FOR FUTURE DEVELOPMENTS, “NATURE-POSITIVE” INVESTMENTS

Across these initiatives our work is informed by the experience of developing the EBRD’s own policies and instruments over our 30 years of operations.

So what should the Bank do better, or more of, in the coming months and years?

The MDB joint nature statement at COP26 provides a suitable roadmap for action. We have undertaken i) to show leadership in achieving the objectives set out in the key international treaties in this field, ii) to develop and make “nature-positive” investments, and iii) to foster synergies between the governments of different countries and regions, and between the private and public sectors. We have also undertaken iv) to help our clients value nature and natural assets to deliver development benefits and v) to develop tools and methodologies for tracking nature-positive activities across our portfolio, then report on our efforts publicly.

We expect that developing and identifying nature-positive investments will lead to many innovative and exciting projects. This should involve both specific investments in nature-based solutions, such as the creation of an orbital forest around Tirana, and by changing the parameters of projects to prioritise conservation and mitigation activities, thereby generating net gains in natural capital and biodiversity.

Our bankers are speaking with clients across the EBRD regions in the agribusiness, municipal and property and tourism sectors, to name just a few, about different investment structures. For example, an agriculture business could be incentivised to progressively eliminate its water pollution discharge by entering into a sustainability-linked loan where the coupon payment steps up or down depending on the company's achievement (or otherwise) of a specific key performance indicator. Elsewhere, a public-sector infrastructure project could involve the "construction" of a mangrove swamp or forest, with benefits from reduced coastal erosion to improved air quality and the introduction of additional species to an ecosystem.

The creation of platforms where different stakeholders find synergies and collaborate to achieve systemic impact will be essential. This was achieved in the Baltic and Barents seas after the Helsinki Convention was established[24] and the Northern Dimension Environmental Partnership created. And we now have the opportunity to replicate this environmental remediation work in the Mediterranean, Black and Red seas, strengthening the Barcelona Convention.[25]

Meanwhile, our environmental specialists are already working with other multilateral development banks on biodiversity accounting and natural capital valuation. This may provide the grounds to develop a shadow nature pricing to internalise nature-related externalities in our decision-making process. The approach would mirror the established shadow carbon pricing and could be integrated in our environmental and social due diligence processes. This joint

24 https://helcom.fi/about-us/convention/, most recently updated in July 2014.

25 https://www.unep.org/unepmap/who-we-are/barcelona-convention-and-protocols

multilateral work should also lead to the use of new technologies, such as the use of technological advances in DNA to improve understanding of ecosystem function and resilience, and satellite images to foster better and broader disclosure of project-related biodiversity data and impacts.

We will continue to contribute to the development of disclosure and risk management frameworks for nature and biodiversity, drawing on our experience in assessing biodiversity and resource impact under PR6.

Of course, there will be challenges along the way. Regulatory fragmentation and the emergence of rival taxonomies and standards at different levels of ambition could lead to uncertainty for our clients and for stakeholders in general. Tensions between competing political agendas and irreconcilable environmental and social objectives could result in important and useful projects being delayed or cancelled. And the sheer pace of regulatory change could lead to an increase in reputational risk and the risk of litigation for participants.

But the direction of travel is clear, and the EBRD will continue to communicate with its clients and contribute to the evolution of the legal and regulatory framework in the coming years. Our aim is not only to protect and conserve nature and biodiversity, but to develop and enhance them in a way that benefits nature, the people across the EBRD regions and the planet.

“OUR AIM IS NOT ONLY TO PROTECT AND CONSERVE NATURE AND BIODIVERSITY, BUT TO DEVELOP AND ENHANCE THEM IN A WAY THAT BENEFITS NATURE, THE PEOPLE ACROSS THE EBRD REGIONS AND THE PLANET.”