Biodiversity is equally vital to people and planet. It gives us clean air and water, food and medicines. As mentioned in The Economics of Biodiversity: The Dasgupta Review¹, Biodiversity is the diversity of life and can be read at various levels, from genes, species, populations to communities that interact with the physical world to create ecosystems. Here we introduce the concept of biodiversity, the current crisis we face and how nature loss is a major risk for companies while nature-based investments offers opportunities. Asset owners and managers have a role to play, and HSBC Asset Management (HSBC AM) is committed to early action.

Preserving Nature is vital for a sustainable world

Nature plays a critical role in providing ecosystems services related to food and feed, energy, medicines and genetic resources. The assets that underpin these services are called natural capital.

According to the Intergovernmental Platform on Biodiversity and Ecosystem services (IPBES), around 4 billion people rely primarily on natural medicines for health care and some 70% of drugs used for cancer are natural or synthetic products inspired by nature. Biodiversity plays a key role in the quality of the air, fresh water and soils, as well as in the regulation of the climate, pollination, pest control and reducing the impact of natural hazards. More than 75% of global food crop including fruits and vegetables, coffee, cocoa and almonds rely on animal pollination. And marine and terrestrial ecosystems are the sole sinks of anthropogenic carbon emissions with the sequestration of around 60% of global anthropogenic emissions.

The biodiversity crisis in brief

While many asset owners continue to work on integrating climate change concerns into their investment processes, the additional concerns of global biodiversity loss continues to gain prominence. In some ways these are distinct issues, but in other ways they share synergies – the loss of biodiversity increases the difficulty of limiting climate change, while climate change leads to an increase in biodiversity loss. It is therefore important that we do not consider biodiversity loss as a separate issue, but as an integrated part of creating a solution to the climate emergency.

As background, between 1970 and 2016 there has been an average of a 68% decrease in population sizes of mammals, birds, amphibians, reptiles, and fish, a decline occurring at a greater rate than at any other time in human history. The IPBES identified the main drivers of biodiversity loss as habitat loss, overexploitation, pollution, climate change, and invasive species. These drivers are continuing to increase at an unsustainable pace, and nearly 1 million species are currently at risk of extinction, with many more within decades.

This is why the upcoming UN Biodiversity Conference (COP15) is expected to establish a new global framework aiming at halting the loss of biodiversity by 2030.

Source: The Global Assessment Report on Biodiversity and Ecosystem Services, IPBES
How can we measure biodiversity?

Measuring the biodiversity footprint of companies presents several challenges. First, there is a lack of standard disclosures. Many initiatives have emerged to guide companies such as the Sustainability Accounting Standards Board (SASB) framework, the Task Force for Nature Related Financial Disclosures (TNFD) framework etc.

Data integration is also challenging. Recently we have seen several approaches from ESG external data providers and fintechs using Artificial Intelligence to measure biodiversity impact at the company and portfolio levels. These are still in their early stages. We have decided to partner with Iceberg Datalab (IDL), a leading fintech firm that develops assessment tools and provides environmental data solutions to financial institutions.

In order to assess the corporate biodiversity footprint, the main approach is to link data on economic activity to pressures on biodiversity and to translate these pressures into biodiversity impacts. The criteria assessed to estimate biodiversity impact may include the pressures below: land use, fragmentation of natural ecosystems, human encroachment, atmospheric nitrogen deposition, climate change, wetland conversion, freshwater eutrophication and ecotoxicity. On this basis, a company’s potential impact on biodiversity is calculated in terms of mean species abundance (MSA) a metric expressed in %, characterising the intactness of ecosystems. MSA values range from 0% to 100%, where 100% represents an undisturbed pristine ecosystem.

In terms of ESG integration HSBC AM is working on creating a heat map of biodiversity risks and opportunities by sector. By the end of 2022 our proprietary ESG rating methodology is expected to change to prioritize factors that significantly influence the risk/return profile of an investment. To this end, teams dedicated to the analysis of a given sector of activity, embodying in-depth knowledge of the specificities of each sector, have been put in place, in order to determine the themes retained within pillars E, S and G. Preservation of Biodiversity is one of the main environmental indicator assessed.

Increasing regulation on Biodiversity

Policymakers and financial regulators are increasingly demanding that financial institutions assess nature-based financial risks and their impacts on nature. Several governments and regulators are already part of the TNFD.

France is leading the way with a new decree under Article 29 of the Energy and Climate Law, requiring disclosures on the biodiversity and climate impact of companies from 2022. Investors will now have to comply with new requirements. They have to measure their alignment with the objectives of the Convention on Biological Diversity and analyze the contribution of their portfolios in reducing the main pressures and impacts on biodiversity.

The EU has launched a biodiversity strategy for 2030, including the establishment of a larger EU-wide network of protected areas on land and sea and the launch of an EU nature restoration plan. The protection and restoration of biodiversity is also one of the main objectives of the EU green taxonomy and Sustainable Finance Disclosure Regulation (SFDR) requirements.

Under the EU green taxonomy, an economic activity is considered aligned namely if it substantially contributes to at least one of the six environmental objectives without causing significant harm to the others. Amongst the six objectives, three of them are related to preservation of biodiversity (sustainable use and protection of water and marine resources, pollution prevention and control, the protection and restoration of biodiversity and ecosystems).

Under SFDR regulation, the impact on biodiversity is a key mandatory indicator that defines a ‘sustainable investment’. Moreover SFDR requires the disclosure of Principle Adverse Impact (PAI) indicators including one related to biodiversity. Companies will have to disclose activities that negatively affect biodiversity sensitive areas. The first provisions of the SFDR legislation came into effect on 10 March 2021, and the majority of the mandatory, standardised ESG disclosure obligations for asset managers and other financial markets participants will start to apply in January 2023.
The role of asset managers and asset owners

Asset managers can play a key role in preserving biodiversity. In allocating the capital they manage to economic sectors that contribute less, or not at all, to the loss of biodiversity, and in discussing new policies with decision-makers along the lines of reducing risks to ecosystems, we are able to do our part in protecting ecosystems.

By mapping out impacts and dependencies on biodiversity, outlining methodologies of addressing trade-offs, engaging with companies to promote best practices and creating investment products that include companies exhibiting such best practices, HSBC AM has decided to take a leading position in preserving biodiversity.

A new partnership has been announced with Pollination, a consulting firm specialising in sustainable development. The HSBC AM and Pollination joint venture - Climate Asset Management, which has arisen from this, aims to become the world’s largest natural capital fund manager. Its ambition will be to propose and manage investment funds in a wide range of activities aiming to protect and strengthen nature over the long term, preserve biodiversity and combat climate change. Its mission will be to conduct research that tends to consider nature as a financial asset in its own right and to determine the right methods for valuing natural capital.

We are also participating in the Task Force for Nature Related Financial Disclosures (TNFD), at the HSBC Group and Asset Management level. The Taskforce consists of 34 individual Taskforce Members representing financial institutions, corporates and market service providers with USD19.4trn in assets. The mission is to develop and deliver a risk management and disclosure framework for organisations to report and act on evolving nature-related risks.

Finally we are a member of the Business for Positive Biodiversity Club (B4B+ Club) initiated by the French Caisse des Depots (CDC) Biodiversity since September 2020. This financial working group aims to promote the use of their Global Biodiversity Score and enhance discussions between financial institutions on sector and companies.

What we expect from companies we engage with, and how we drive policy dialogue

HSBC AM has been engaging with companies on biodiversity as a standalone topic since 2019 when we discussed the impacts of deforestation, and before that as part of broader engagements focused on climate change. More recently, we published our 2022 Stewardship Plan, of which biodiversity and nature is one of the key themes we focus on. In addition to engagement, we have introduced thematic voting guidelines to ensure that we exercise our shareholder rights at companies where biodiversity and nature capital are at risk. Our objectives under this theme is aligned with our biodiversity policy, and we focus on areas including but not limited to deforestation, circularity by design, and sustainable food and water.

The impact of biodiversity on financial investments

Biodiversity loss impacts businesses with potential transition and physical risks, as well as litigation and regulatory risks. Those risks can affect investment value. It is important to understand the potential impact on an investment portfolio while some sectors have higher impacts than others. For example Energy, Mining & Metals, Utilities, Food & Beverages are amongst the most exposed industries.

Investors can also allocate capital to sectors that are increasing opportunities for biodiversity including nature restoration. Large-scale investment in nature-based solutions such as restoring peatlands, mangroves or ocean ecosystems are some of the opportunities.

HSBC Asset Management pledges to preserve biodiversity

As an extension of several collective commitments to combat climate change (Climate Action 100+, IIGC, One Planet Asset Managers, etc.), in September 2020 HSBC AM joined the Finance for Biodiversity Pledge, which aims to protect and restore biodiversity through its financing activities and investments. HSBC AM pledges to use its expertise and global set-up to identify more sustainable approaches to investments in agriculture, forestry, land use and other investments affecting nature.
Engagement case study example

On deforestation, we have been carrying out objective-led and milestones-based engagement with a leading Brazilian meat company.

Rationale for engagement: Our objective is for the company to enforce its zero deforestation policy more robustly, as it had made this commitment, yet continues to experience deforestation in its supply chain. Deforestation remains one of our major concerns, as the Amazon is of utmost importance to addressing both biodiversity loss and climate change.

What we did: We engaged with the company on numerous occasions to raise our concerns and to learn more about the company’s plans to address them, which includes blockchain technology and geospatial data to monitor deforestation and try to ensure it is eliminated in the supply chain. We stressed the importance of this process applying it to both direct and indirect suppliers, as well as the need to ensure that all suppliers are trained so that they are able to use the technology and its results are accurate.

Outcomes and next steps: We believe that conversations have been productive and that we have seen the company putting improvements in place, however we will continue to monitor the issue so that over time we can see the required improvements and can continue to push for best practices.

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