Fixed income solutions for biodiversity investing

While climate change mitigation has captured the focus of fixed income in recent years, eyes are now turning to biodiversity and how to incorporate it.

By *Isobel Edwards*

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The Convention on Biological Diversity[1] defines biodiversity as 'the variability among living organisms from all sources'. Climate change has caused the loss of local species, increased diseases, and driven mass mortality of plants and animals, resulting in the first climate-driven extinctions. When human activities produce greenhouse gases, around half of the emissions remain in the atmosphere, while the other half is absorbed by the land and the ocean. These ecosystems – and the biodiversity they contain – are natural carbon sinks, providing so-called nature-based solutions to climate change.[2]

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Current biodiversity financing landscape

There is a significant gap for nature financing. Currently, the annual investment in nature is approximately $ 133 billion, primarily from public sources.[3] To meet global biodiversity, climate, and land degradation targets, it is estimated that investments need to triple by 2030 and increase fourfold by 2050.[3] This indicates a substantial shortfall that needs to be addressed through increased funding from public as well as private sectors.

Closing the gap requires innovative financial instruments such as green debt products and mechanisms to mobilize private sector resources effectively.[4] The green bond market has been focused so far on climate mitigation, although bonds which incorporate biodiversity-related use-of-proceeds are increasingly available. The need for increased investment in these areas, especially in the corporate bond market, is urgent. The global market in biodiversity-focused bonds currently stands at € 675 billion.[5] Most corporate issuers utilize a combined approach of issuing use-of-proceeds and unlabelled bonds for biodiversity initiatives while SSA issuers tend to have more use-of-proceeds bonds focusing on biodiversity.[5]

Europe is leading the way in issuing biodiversity-related bonds, as it does in the markets for labelled bonds, with North America in second place. This ranking is reflected in the currency composition of the market: euro-denominated bonds account for the largest share at 70%, followed by the US dollar at 14%. Nearly all these bonds are investment grade, with the AA rating being the most prevalent at 46% of the market.[5]

Biodiversity-focused use-of-proceeds bonds are on the rise. While only 5% of labelled bonds issued in 2020 listed biodiversity conservation as a use-of-proceeds in their legal documentation, this figure tripled to 16% in 2023.[6]

Building a portfolio

In our view, a combination of use-of-proceeds and

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conventional bonds also allows investors to build a diversified biodiversity-focused portfolio with a risk-return profile comparable to that of a standard corporate-bond portfolio. A fundamental challenge facing fixed income investors in biodiversity is identifying bonds that support relevant projects and activities such as protecting ecosystems and reducing the consumption of natural resources. Labelled sustainable bonds simplify this task by listing the projects eligible for financing in bond documents and issuance frameworks. Finding suitable conventional bonds requires in-depth knowledge of companies' operations and revenue streams.

A targeted biodiversity approach: minimizing risk, enhancing contribution, and engagement

With the struggles of biodiversity investing in mind, we developed an approach based on three core concepts. Firstly, to incorporate the low-biodiversity risk approach by starting with a low-biodiversity risk universe where, for example, the biodiversity PAI violators, the negative biodiversity SDG contributions, the biodiversity controversies, and the high-impact sectors are excluded. Next, from that low-risk universe, we want to find the active contributions towards biodiversity. That active contribution can be made either through the green, social and sustainable use-of-proceeds bonds such as those that are including afforestation use-of-proceeds or land and aquatic conservation projects. Or it can be made through the revenues of vanilla bond issuers that are naturally inclined towards reducing the main biodiversity loss drivers such as pollution-focused companies in the waste management sector. The main biodiversity loss drivers are land-use change, climate change, pollution, natural resource use and exploitation, and invasive species[7].

The final and arguably most important part of our biodiversity approach is engagement. To support companies with their actions on nature, the Biodiversity Engagement Framework is developed. Harmonized with other existing initiatives such as TNFD, CDP, SBTN and Nature Strategy Handbook, the framework consists of six pillars: Ambition, Assessment, Targets, Implementation, Governance and Engagement. It looks at the entity level and helps identify each business readiness for their respective nature-positive journey. Furthermore, our existing green, social and impact bond research analysis team will leverage tools like the Exploring Natural Capital Opportunities, Risks, and Exposure (ENCORE) tool and undertake engagements with issuers who have high or very high impacts and dependencies on biodiversity to discuss mitigative, regenerative, adaptive and transformative actions that the issuer is taking or can take, and discuss what the most relevant metrics are for the issuer depending on their sector such as mean species abundance. Our engagement efforts seek to advance the climate transition and inclusive growth[8] and this targeted biodiversity-engagement approach seeks to improve the biodiversity data-transparency, monitoring and disclosures in the issuers on the green, social and sustainability bonds market as well as the vanilla bond markets. ■

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1 https://www.eea.europa.eu/publications/92-9167-077-4/download#:~:text=The%20Convention%20on%20Biological%20Diversity,between%20species%20and%20of%20ecosystems.
2 https://www.un.org/en/climatechange/science/climate-issues/biodiversity#:~:text=How%20is%20climate%20change%20affecting,of%20all%20ice%2Dfree%20land.
3 https://wedocs.unep.org/bitstream/handle/20.500.11822/41333/state_finance_nature.pdf?sequence=3
4 https://www.unepfi.org/wordpress/wp-content/uploads/2024/06/Nature-finance-overview.pdf
5 Goldman Sachs Asset Management, Bloomberg. As of January 31, 2025.
6 "Biodiversity in ESG: State of the Sustainable Finance Market," Sustainable Fitch. As of October 9, 2023.
7 https://www.ipbes.net/models-drivers-biodiversity-ecosystem-change
8 https://am.gs.com/public-assets/documents/e2ad75db-7b55-11ef-9221-539e739947b3

SUMMARY

Biodiversity loss is driven by climate change and impacts ecosystems that act as natural carbon sinks.

Annual nature investment needs to triple by 2030 and quadruple by 2050, which requires innovative financial solutions.

Biodiversity-focused bonds are increasing, with Europe leading and investment grade ratings dominating.

Combining use-of-proceeds and conventional bonds helps build a balanced, biodiversity-focused portfolio.

Excluding high-risk sectors, investing in conservation projects, and engaging with issuers can help improve biodiversity practices.

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