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Environmental Finance

How private finance can raise efficiency in conservation markets

12 September 2017

Private finance can provide efficient net gains in biodiversity through the OTC offset market, say **Jenni Laininen** and **Brent Matthies**.



Photo: Ira Haltia

Key points:

- Public conservation finance gap is 80% below the required level for current biodiversity conservation objectives.
- Private finance offers a way forward to address funding gaps.
- Over-the-counter biodiversity offsets create greater market liquidity and efficiency, while addressing additionally under the no net loss principle.
- Current regulations and incentives could be improved to facilitate greater market participation by private companies.

The European Union's (EU) 2011 Biodiversity Strategy obliges Member States to halt net biodiversity loss by 2020. However, the mid-term review of that strategy noted that [considerable efforts were still required](#) to halt the loss of ordinary biodiversity outside the EU's coordinated network of protected areas (the Natura 2000 Network). Those efforts include maintaining and restoring ecosystems and their services, halting deterioration of critical habitats and increasing the contribution of forestry to maintaining biodiversity.

The mid-term report also recommended that current activities be scaled-up, but a [recent review of network funding](#) found only 20% of the required level is being met. Despite the large shortfalls in financing, the [2017 report on integrated EU biodiversity](#) financing only mentioned, but did not explore further, the potential role of private finance.

Given the interest of investors and financing needs, private finance options should be more widely considered in the development of conservation markets. Private ecological compensation mechanisms, such as biodiversity offsets and other 'payment for ecosystem service' (PES) mechanisms, facilitate financially efficient and environmentally beneficial transactions of [ecosystem services and biodiversity](#).

Markets for other ecosystem services, such as the provisioning of timber, already operate efficiently and effectively based on private sector participation, and private financial institutions have already demonstrated an ability to conduct the acquisition and management of biological assets in a responsible manner. The [ownership of sustainably managed private timberland portfolios](#) provides one such example.

Role of the private sector

Private market participation does not replace the roles of civil society, public funding, or actions by private citizens towards conservation finance. Instead it can lead to concurrent financial, environmental and social returns on investment. Such 'impact investing' [provides a profitable space](#) for co-operation between public, private and third-party actors linked to the environment. Thus, conservation investments can address not only efficiency and effectiveness of environmental objectives but also social equality through positive externalities from investments¹.

In Europe, there is considerable experience in conservation market development providing a strong foundation for private participation. [Habitat banking regulations](#), requiring the offsetting of biodiversity degradation, have a long history in Germany starting from 1976. In Finland, the [METSO programme](#) for private sellers of forest conservation has laid the groundwork for a broader conservation marketplace.

These efforts and others aim to address the central concept of biodiversity offsetting: additionality. The mitigation hierarchy for biodiversity offsets stipulates that impacts are avoided, minimised and restored, and residual impacts are offset with the opportunity for [additional benefits](#) to accrue from those activities (see Figure 1).

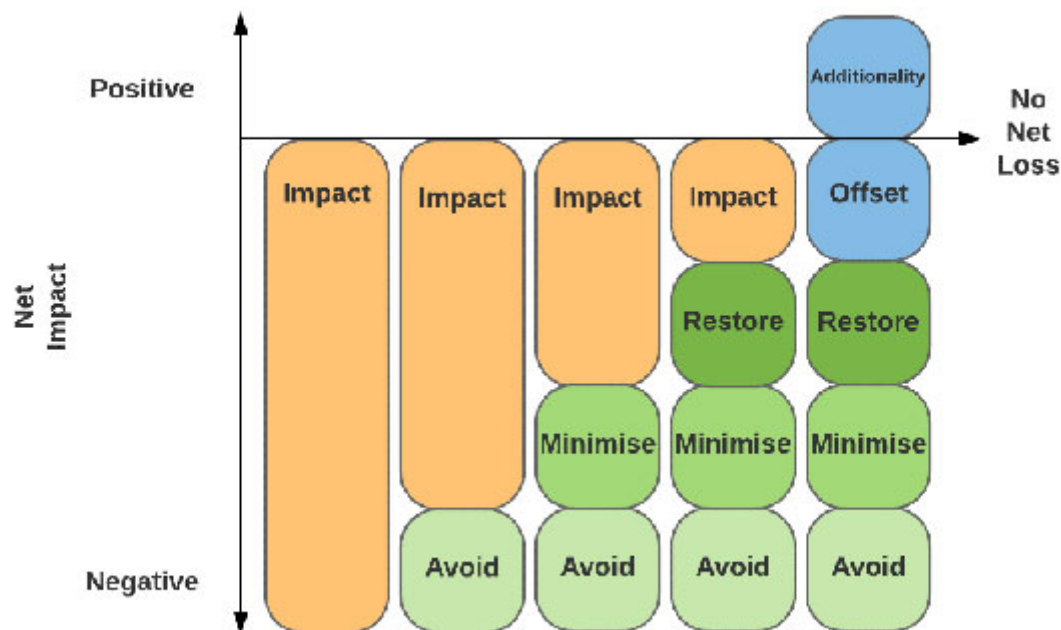


Figure 1: Mitigation hierarchy for biodiversity offset mechanisms (adapted from IUCN (2013))

Although public habitat banking and PES schemes provide critical financing for conservation, there are also shortfalls to a [public-offset-buyer model](#) including additional profits accruing to private sellers from the possession of payoff-relevant information and [land market distortions](#). Moving the liability of 'conservation asset' ownership to private companies' balance sheets, as some regulations currently stipulate for project sites, does not increase the efficiency of conservation either. Rather, it leads to a net loss or net neutral outcome as indicated in the mitigation hierarchy.

To address additionality and improve market efficiency, private finance acts to provide offsets for those companies looking to offset their unavoidable impacts. Private financial actors, such as the Dasos Habitat Foundation, buy land, improve the biodiversity quality and quantity for society and offset buyers, and sell use rights to finance the improvements. This creates further options for companies to take responsibility for their environmental impacts under the *no net loss* principle.

Role of the regulators

Although [there are limitations](#) to such over-the-counter (OTC) transactions currently, including matching environmental impacts with equivalent offsets and measuring additionality, [regulators should create further incentives for companies](#), define acceptable thresholds for improvements to compensate losses, and outline the requirements for equivalence between sites.

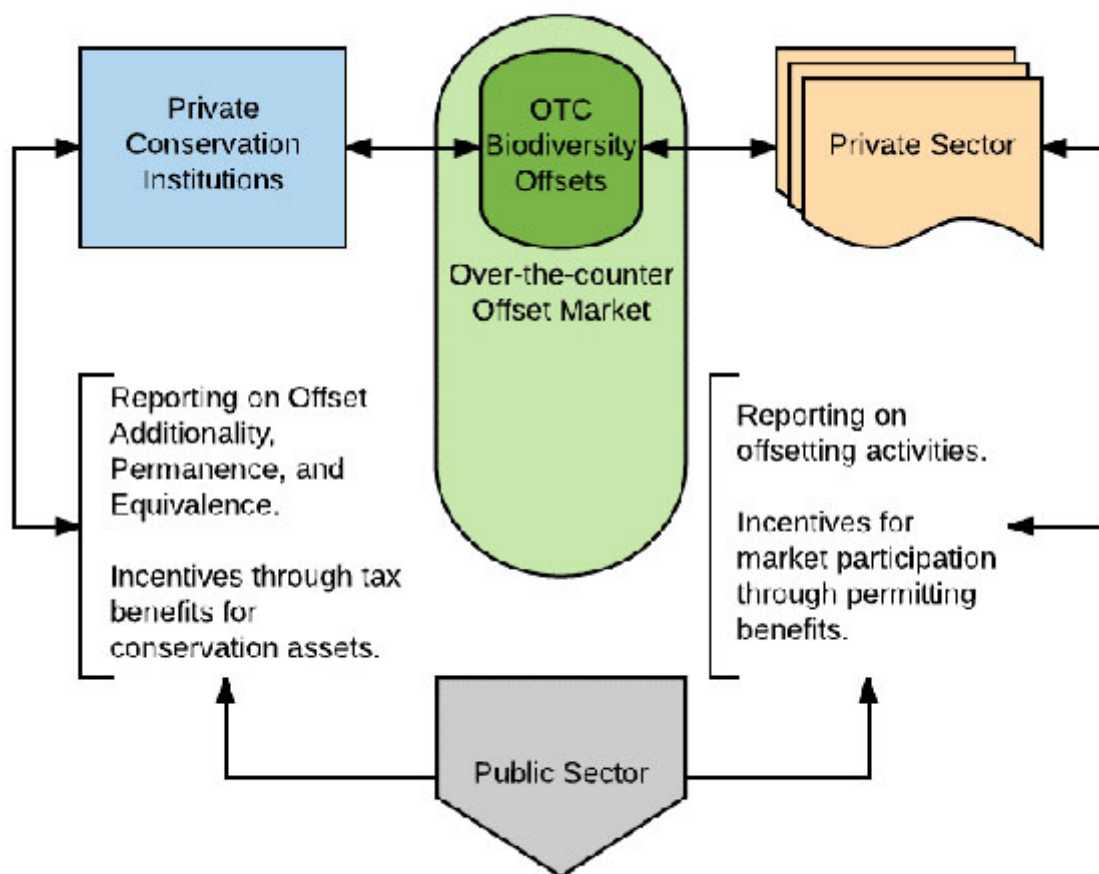


Figure 2: Proposed approach for OTC biodiversity offsets in conservation markets.

Facilitating greater participation in conservation markets by companies will require increased environmental performance and financial incentives. Private companies are often unwilling or [unable to act in an environmentally-friendly manner](#) on a voluntary basis. European decision-makers should consider environmental permitting rules that favour companies who compensate unavoidable and negative biodiversity impacts, expediting processing of environmental permit applications that include offset measures, and [environmentally-linked tax relief measures](#) to spur investments in permanent conservation assets.

Incentives for companies to participate in OTC offset markets would lead to net biodiversity gains per unit cost for society and more liquid and well-functioning conservation markets.

Large funding gaps in public conservation finance do not need to continue. Private finance can provide efficient net gains in biodiversity through offsetting where companies aim to address the *no net loss* principle. Socially and environmentally-friendly actions can be achieved through investments in conservation assets, and increase the liquidity and functioning of the conservation marketplace in parallel. Private finance is part of that solution, and the creation of institutions to provide OTC offsets has already begun.

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1) Engel, Stefanie, Stefano Pagiola, and Sven Wunder.
"Designing payments for environmental services in theory and practice: An overview of the issues." *Ecological economics* 65.4 (2008): 663-674.

2) Juutinen, Artti, Erkki Mäntymaa, and Markku Ollikainen.
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