Institute for Innovation and Public Purpose

Biodiversity loss and the financial system

The role of policymakers in managing risks and impacts

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Key arguments in our research

Financial risks of nature loss

- **Radical uncertainty**: practical and conceptual challenges to measuring biodiversity risk
- **Trade-offs** between knowledge-building and immediate action to mitigate emerging threats
- **Precautionary approach**: avoiding worst case outcomes, building system resilience
- **Blind spots** in understanding interconnections of nature- and climate-risks

Finance as a leverage point for real economy transformation

- **Double materiality:** impacts of finance on nature matter, not just risks to finance
- **Market shaping policy** (providing direction) not just market fixing (adjusting relative prices)
- **Coordination** required between Bank of England and broader set of policymakers

Challenges to quantifying biodiversity-related financial risks

Physical risks

- Multiple interconnected threats
- Non-fungibility / incommensurability
- Unprecedented and irreversible
- Endogenous
- System complexity
  - Interlinkages, feedback loops
  - Tipping points, non-linearities

Transition risks

- Multiple anthropogenic drivers
- No carbon price equivalent
- Lack of coordinated policy action
- Solutions inherently political
- Uncertainty on future policy /tech
- Impossible to predict human/social behaviours and reactions

Subject to **radical uncertainty**

(Cannot assign meaningful probabilities)

1. ESG/disclosure initiatives cannot capture 'unknown unknowns' → **there may never be sufficiently 'good data'**
2. Risk models cannot overcome radical uncertainty → **cannot be relied upon to capture all relevant tail risks**

Disclosure and risk modelling initiatives alone are insufficient

- Trade-off between research/modelling vs. intervention with imperfect knowledge
- Biodiversity methodologies more complicated, but threats may emerge sooner than for climate
- Slow progress of climate disclosure initiatives – not translating through to capital allocation
- ECB Board Member Frank Elderson on EU bank climate risk disclosures:

  ’a lot of white noise and no real substance’

Evidence of financial materiality is not necessary to address biodiversity-negative finance

Strong case for ‘precautionary’ action to prevent emergence of systemic risks

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Outlining steps towards precautionary financial policy

Risk assessment – next steps

- Focus quantitative efforts on key risk transmission channels, e.g., 'tipping points'
- Assess system-wide risk using qualitative or indicator-based approaches
- Existing actions (e.g., Biennial Exploratory Scenario) to integrate biodiversity

Risk management policies – next steps

- Public taxonomy clearly defining biodiversity-harmful activities
- Exclusionary policies on harmful finance and credit policy to encourage green innovation
- Mandatory environmental due diligence

Institutional considerations

Relevant to Bank of England's **primary mandate** to protect price and financial stability

BOE has **secondary mandate** to support the government's goals for the ecological transition

Government must lead transition policy but **active coordination** with BOE required to align finance

More information

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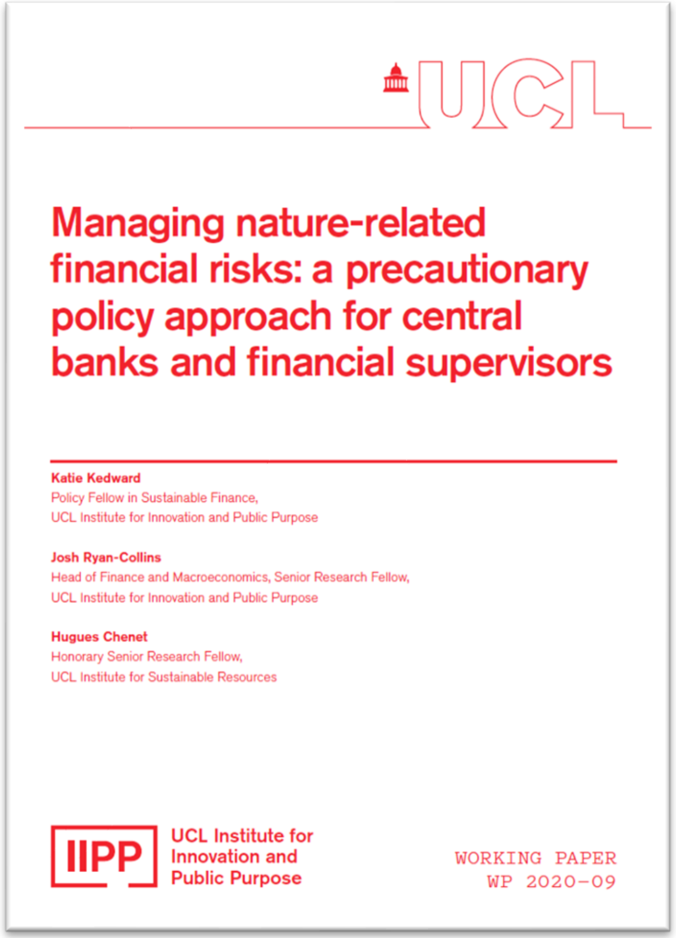
https://www.ucl.ac.uk/bartlett/public-purpose/publications/2020/aug/managing-nature-related-financial-risks



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Managing nature-related financial risks: a precautionary policy approach for central banks and financial supervisors

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WORKING PAPER
WP 2020–09

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Quantitative easing and nature loss:
Exploring nature-related financial risks and impacts in the European Central Bank's corporate bond portfolio

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POLICY REPORT
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