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OECD'S WORK ON BIODIVERSITY AND

ASSESSING NATURE-RELATED FINANCIAL RISKS

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Nature Finance Conference 2023

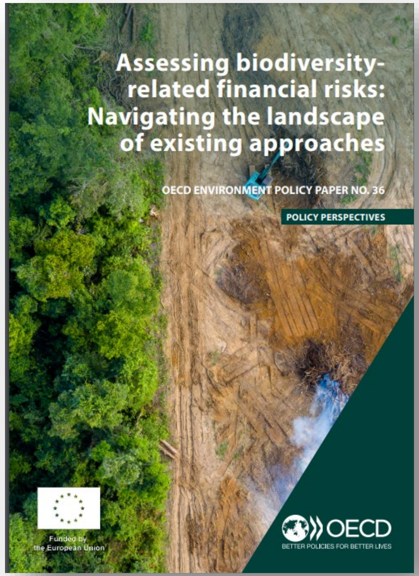
Overview of OECD Project on nature-related financial risks

Project Overview

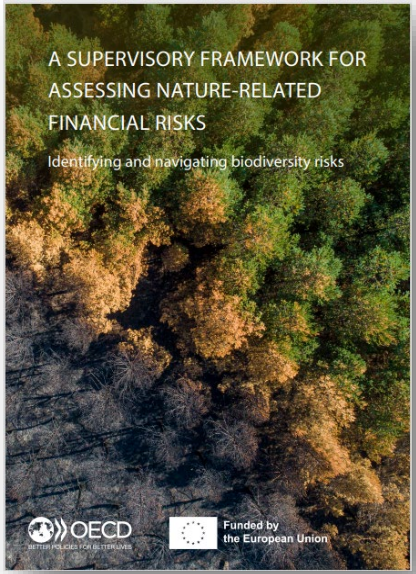
PROJECT OVERVIEW

Phase 1: Research and Development (11 months)

Output 1: Mapping Existing Tools and Metrics



Output 2: Developing a Supervisory Framework



Phase 2: Implementation (11 months)

Output 3: Applying the Framework

Implementation of the Supervisory Framework to the Hungarian financial sector

Output 4: Capacity Building and Knowledge Sharing

Capacity building and knowledge sharing with key stakeholders

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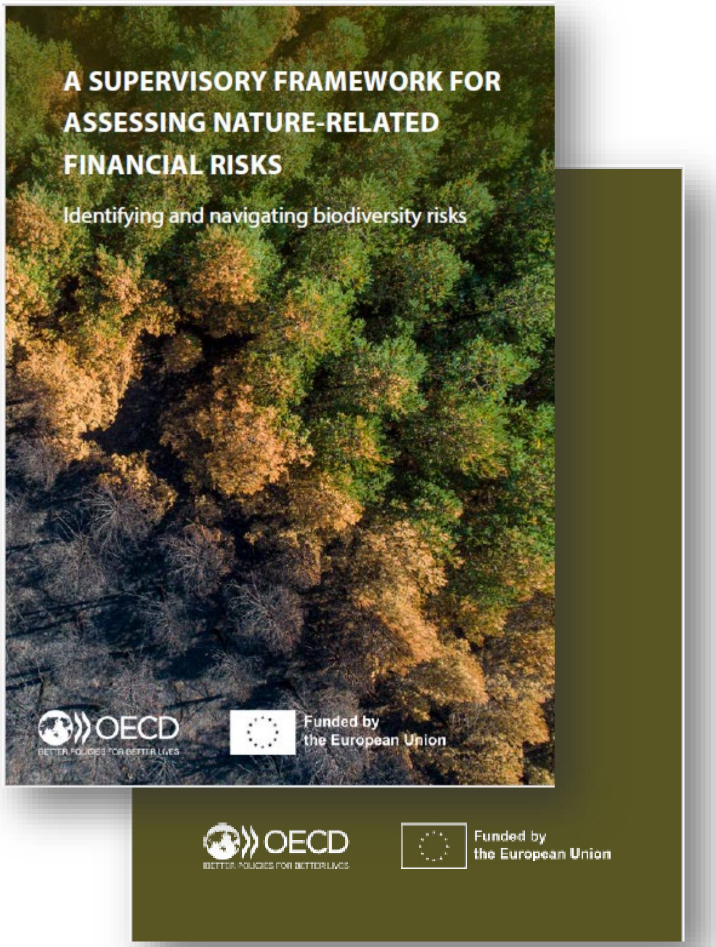
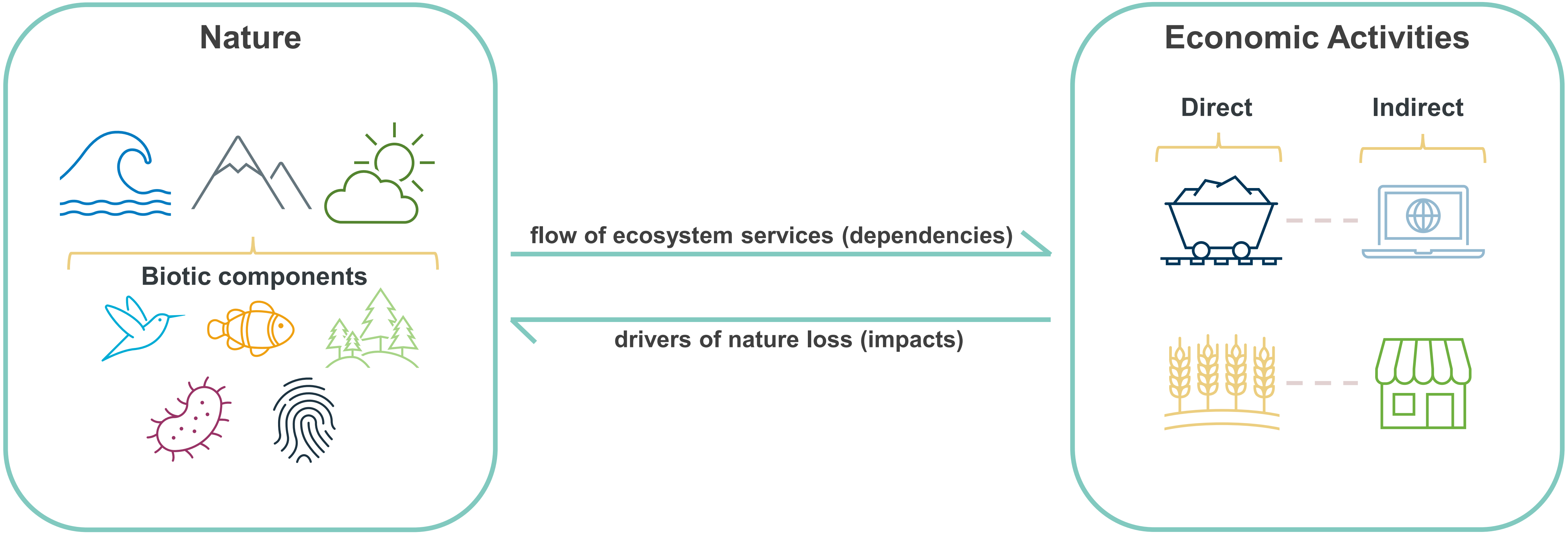
A Supervisory Framework for Assessing Nature-related Financial Risks



- The framework was published on the 28th of September.
- The focus is on central banks and financial supervisors to provide technical guidance on how these institutions may identify, assess, and monitor nature-related financial risks.
- The project is undertaken jointly with the Hungarian Central Bank and the European Commission.

Interlinkages between nature and the economy

Economic activities in the economy are connected to nature through their dependencies and impacts on ecosystems and the services they provide – either directly or indirectly through their value chain.



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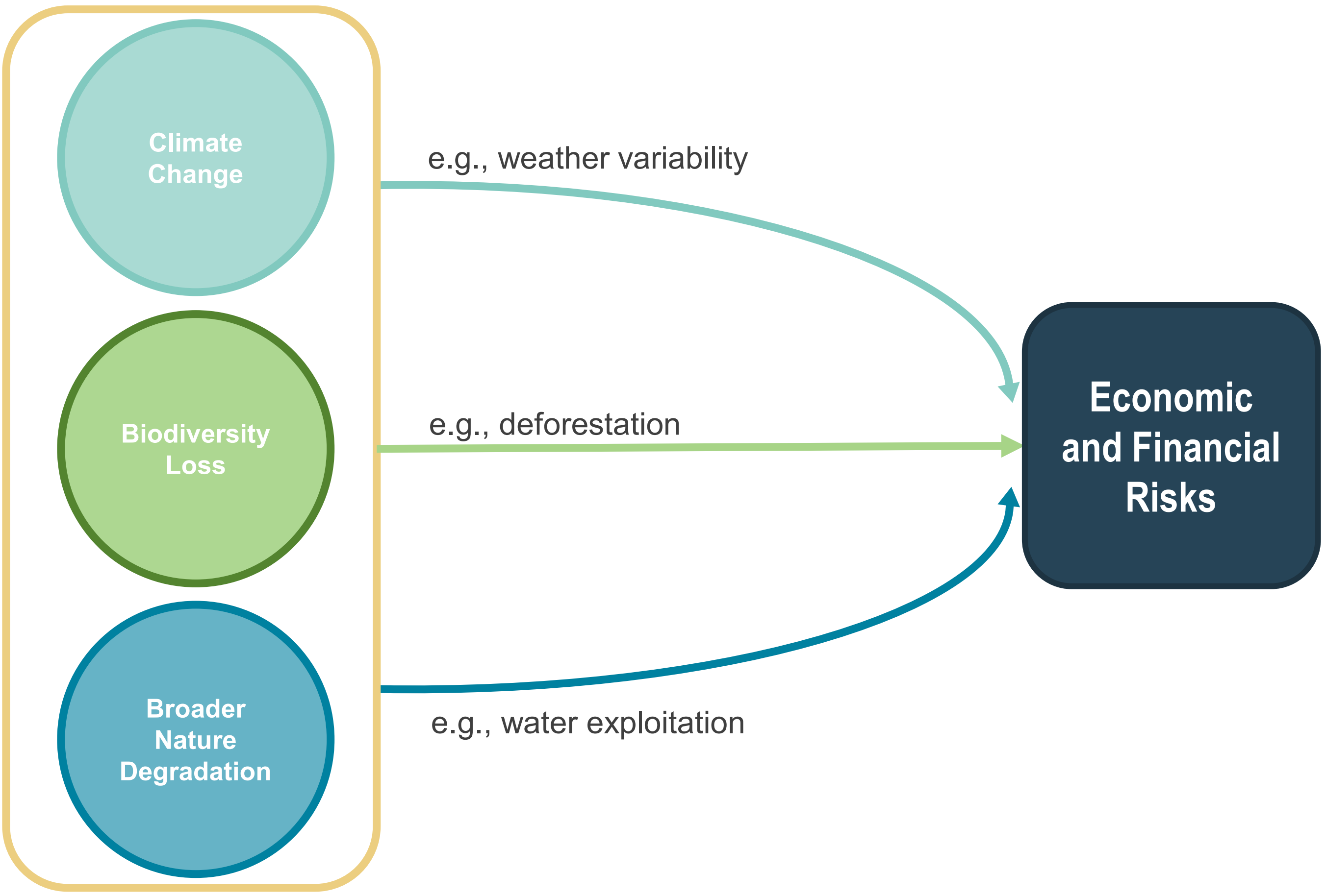
An integrated approach to nature-related risks

- Biodiversity loss, climate change, and broader nature degradation all interact to exacerbate the risks.

- There are four ways climate change, biodiversity loss, and broader nature degradation may interact:

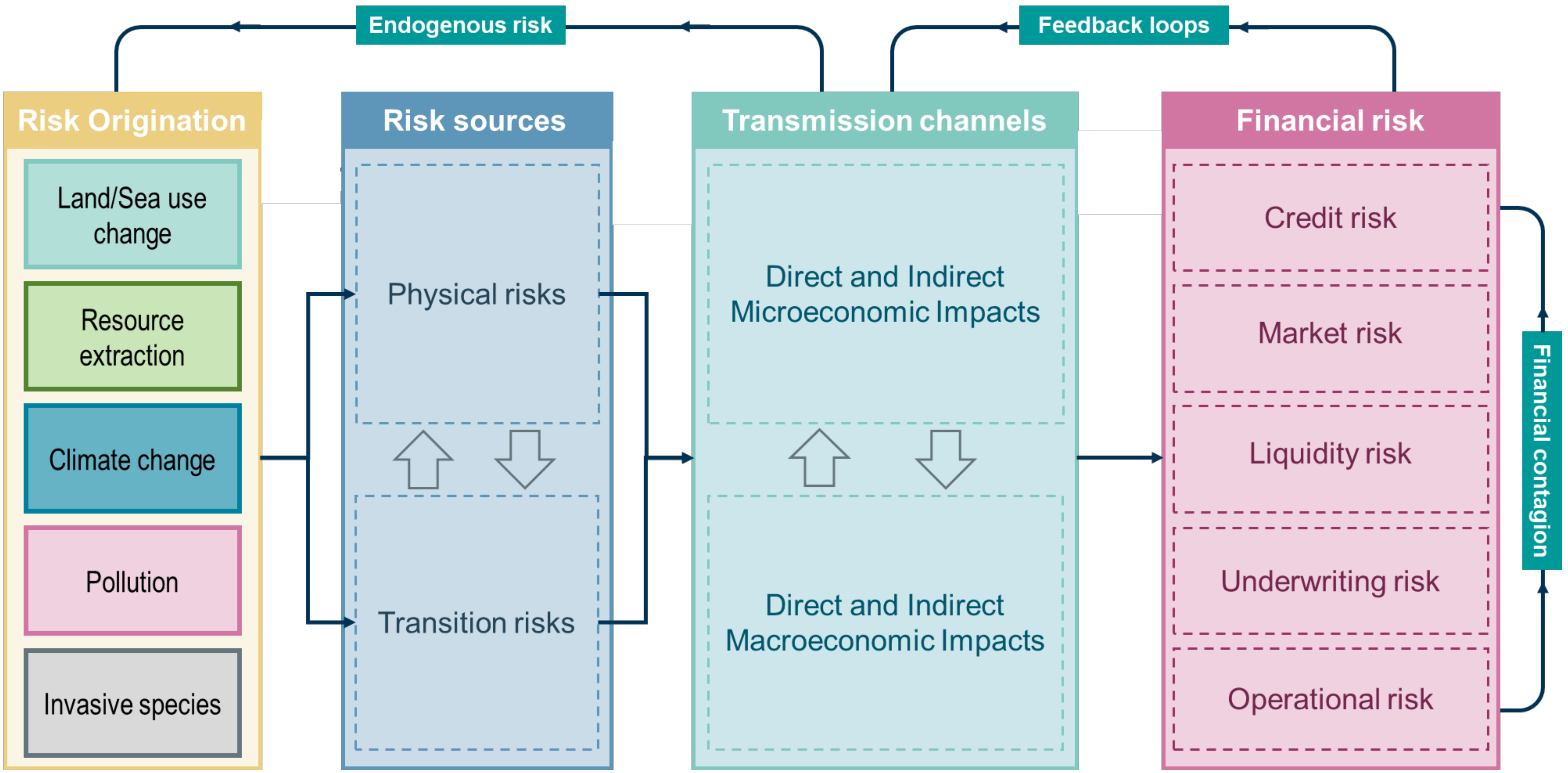
I. Climate change as a driver of nature degradation;
II. Unintended consequences of climate change mitigation or adaptation as a driver;
III. Nature degradation as a driver of climate change;
IV. Nature restoration as a mitigator of climate change.



II

Supervisory Framework on Nature-related Financial Risks

Conceptual framework of nature-related financial risks



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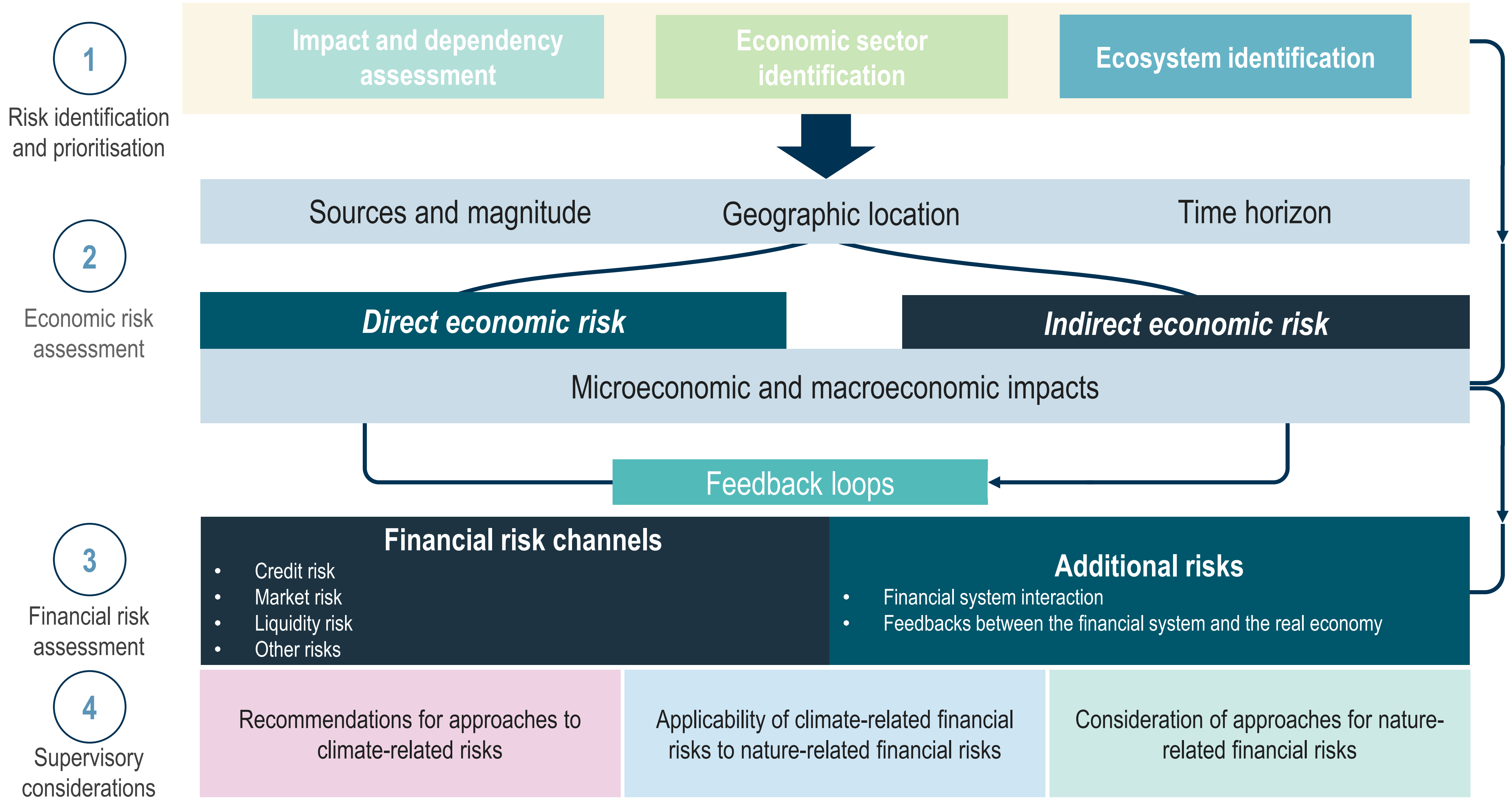
OECD supervisory framework overview



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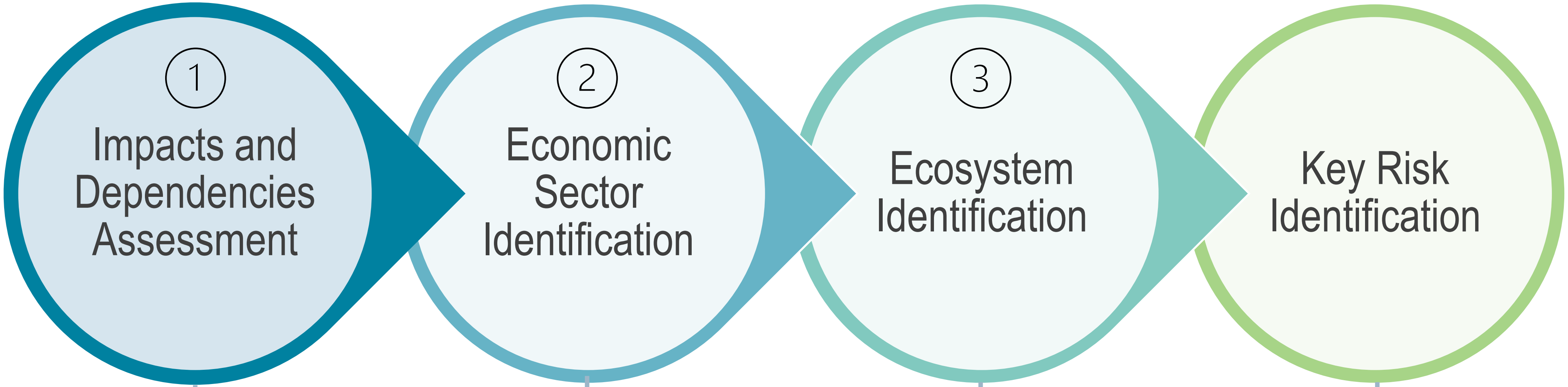
Identification and Prioritisation Overview

A three-phase approach to identify and prioritise the most relevant risks for financial materiality.



Impacts and Dependencies Assessment	Economic Sector Identification	Ecosystem Identification	Key Risk Identification
• Link financial assets to economic activities. • Exposure to impacts and dependencies on ecosystem services.	• Identification of direct and indirect economic activities. • Domestic and foreign exposures.	• Geographic location of ecosystems. • Assessment of current and expected future state of ecosystems.	• Identification of key ecosystem services and sectors.

Economic risk assessment

Feedback loops

Risk sources

Physical risk
Loss of ecosystem services:

- Acute (e.g., extreme events) or chronic (e.g., soil degradation)
- Interactions with other ecological issues

Transition risk
Adjustments aiming to restore nature through:

- Regulation/policy
- Technology
- Consumer and investor sentiment

Economic risk and transmission channels

Direct Impacts | *Indirect Impacts*

Microeconomic Impact

- Earnings decline
- Increased cost of capital
- Stranded assets/capital degradation
- Land use restrictions
- Raw material price volatility
- Value chain disruption, lower profitability

Macroeconomic Impact

- Structural changes
- Public finance deterioration
- Productivity changes
- Socioeconomic changes
- Inflation
- Trade and capital flows

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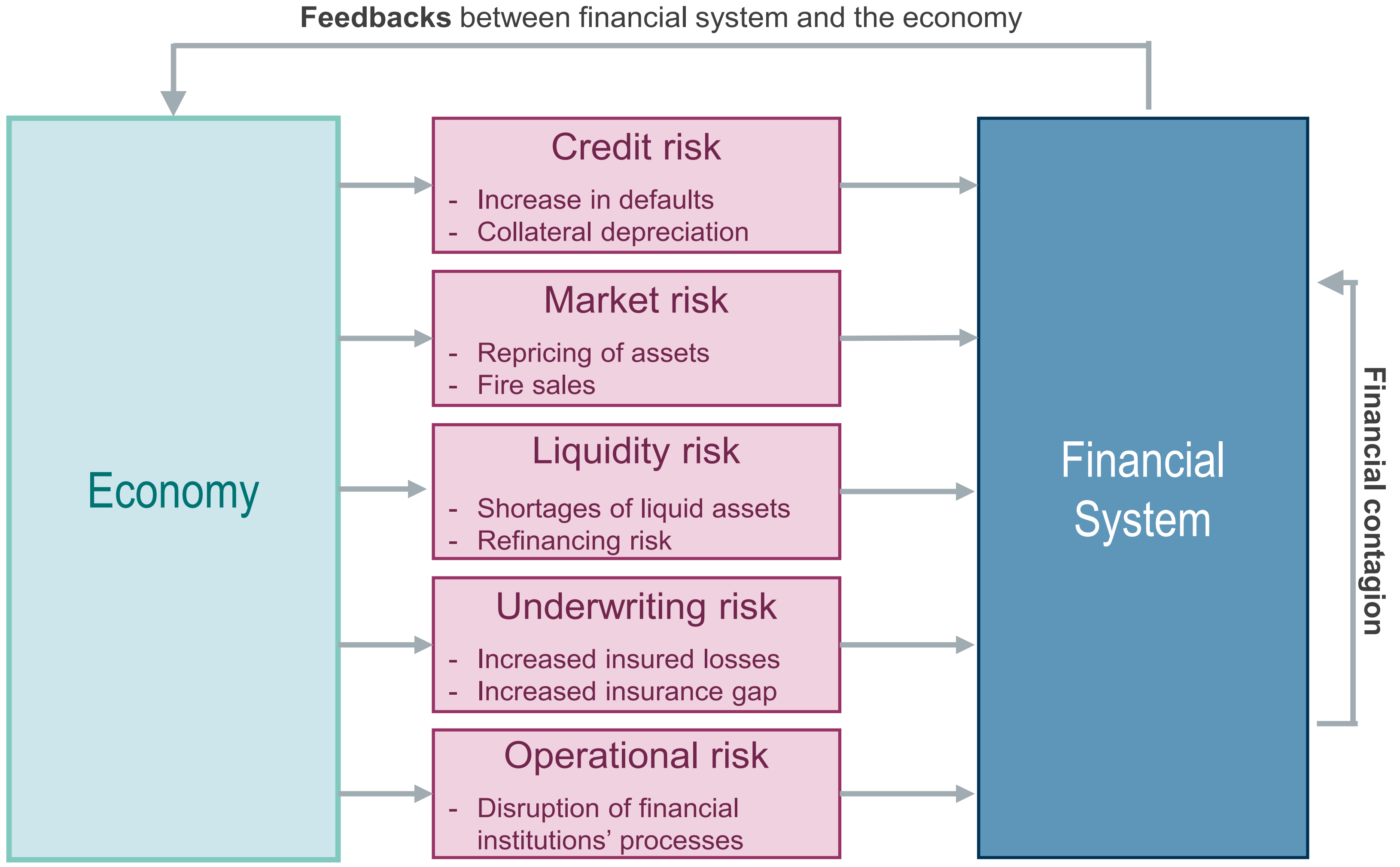
Financial risk assessment

Risks stemming from biodiversity loss and broader nature degradation may lead to new financial risks as well as magnify those from climate-related risks.



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Financial contagion

Four considerations for the potential for financial contagion stemming from nature-related financial risks.

Additionally, there are two feedback loops between the financial sector and real economy: (i) financed activities which exacerbate nature-related risks; (ii) market responses to the materialization of nature-related financial risks.

1. Concentration of nonfinancial corporates in high-risk sectors
2. Concentration of exposures to high-risk sectors in the financial system
3. Interconnectedness of highly exposed financial institutions
4. Potential of information asymmetries between the real economy and financial system

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Links to supervisory framework - considerations

Short term considerations	Medium term considerations	Long term considerations
- Accelerate efforts on data needs and key metrics. - Establish common definitions and language. - Global coordination towards common regulatory frameworks. - Consider widespread risks across the financial system. - Engage across jurisdictions to establish best practices.	- Develop supervisory expectations on governance, processes, and controls on relevant data. - Supervisors to request qualitative information from financial institutions. - Expand scenario analysis to account for nature-related risks. - Consider credit, market and other risk channels.	- Design nature scenarios tailored to domestic contexts and informs a system-wide view. - Joint scenario exercises to help inform cross-border risks. - Make use of future nature scenarios which are developed for financial institutions.

Thank you