



TC Podcast: Biodiversity Loss and Threats to Financial Stability

Speaker:

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Transcript:

Opening automation: You're listening to a Toronto Centre podcast. Welcome. The goal of TC podcasts is to spread the knowledge and accumulated experience of global leaders, experts, and world-renowned specialists in financial supervision and regulation. In each episode, we'll delve into some of today's most pressing issues as it relates to financial supervision and regulation, the financial crisis, climate change, financial inclusion, FinTech, and much more. Enjoy this episode.

Prasanna: Hello, everyone. Greetings to you and welcome to this podcast. I'm Prasanna Seshan, Program Director with Toronto Centre. In this podcast, I'm going to present you an opportunity to hear from an expert on various key aspects of biodiversity loss, its implications for financial stability, and its interrelationships with a wider set of climate change-related risks. As members of the financial sector supervisory community, I'm sure you will be very interested to hear about the issue, which has implications for financial stability, the preservation of which is a critical objective for all of us.

Prasanna: I'm very happy to present to you our guest today, Dr. Janet Terblanche. Let me introduce Janet to you briefly. Janet heads up the policy division of the South African Reserve Bank Prudential Authority. She is a member of the South African Intergovernmental Sustainable Financial Working Group, and she's the acting chair of the Intergovernmental FinTech Working Group. Her experience spans both industry and the regulatory environment in banking, financial market infrastructures, insurance, sustainability, FinTech, and various other micro-credential matters. She holds a doctorate in legal risk management in banking, is an admitted attorney and Notary Public, and is an internationally certified compliance practitioner. A more complete version of Janet's bio is available on the



TC webpage for the benefit of the listeners. Welcome Janet. Thank you for taking the time to talk to us.

Janet: Thank you, Prasanna. It's an absolute honor to be here today. Thank you.

Prasanna: Thanks Janet. Let me start with a brief background about the UN Biodiversity Day, which is celebrated on 22nd May every year. The theme of the Biodiversity Day 2022 is building a shared future for all life. UN has proclaimed 22nd May as the International Day for Biological Diversity, with the aim of increasing awareness and understanding of issues related to biodiversity. The compendium of issues includes the conservation, management, valuation, and sustainable use, as well as loss of global biodiversity. These aspects are related to some of the sustainable development goals.

Prasanna: Biodiversity continues to be seen as the answer to several sustainable development challenges from nature-based solutions to climate change, health issues, food and water security, sustainable livelihoods, biodiversity is the foundation on which we can build back better. With this background, let me start by asking you about the work of NGFS. South Africa is a member of the NGFS, a network for greening the financial system, a group of central banks and supervisors doing some great work on sharing best practices and developing environment and climate risk management in the financial services sector. Our listeners would like to know about some of the latest developments from NGFS, in particular, those relating to biodiversity loss and financial stability.

Janet: Thank you, Prasanna. Quite correctly, we joined the NGFS in 2019 as South Africa, and they are doing a lot of research. As part of their research, they have published three occasional papers: a vision paper, then an interim report, and most recently a final report. So, biodiversity is a major factor in just keeping the earth habitable for all of us. When we go back to what the NGFS has done in this space, in June of 2021, to be exact, they published a vision document which sets out a link between biodiversity loss and the macroeconomic and the financial systems. So, policy efforts have been increasing in order to slow down the global loss of biodiversity that we are seeing across our planet. Some central banks and then our financial sector supervisors, have started to recognize the potential of biodiversity loss as a threat to their core mandates and also to monetary and financial stability.

Janet: Biodiversity could pose a risk to the financial system and there are complex feedback loops that we see, including transition and physical risk into the real economy. So, the economy is embedded in the biosphere. For example, all of us, and companies are no exception, need fresh air and clean water. So, we need to protect our biodiverse environment in order to sustain our fresh air and clean water supplies. The financial system can both contribute to and be a detrimental factor in the depletion of biodiversity, or we can promote conservation through sustainable use. An interim report was then published in October of 2021 and then the final



report was published in March 2022. Maybe what I should do is summarize the final report for our listeners.

Janet: In this final report, there's an analysis of the different approaches to the design of nature-related scenarios. They go further and they identify gaps in the knowledge that we have on biodiversity in the financial sector. They also propose a research agenda, and then they identify short-term or more immediate policy options that regulators, governments, and central banks can take. They make specific recommendations for actions to be taken by central banks and then they also support investments that are likely to have a positive impact on the preservation of nature. So, if I can go into a bit more detail, there are various contributors to biodiversity and climate change more specifically.

Janet: Climate change is more often a result of an increase in greenhouse gas emissions than anything else. Investment in conservation efforts to reduce biodiversity loss could very well have a positive impact on climate change. For example, protecting a forest, which would then result in less greenhouse gas. There are uncertainties regarding the extent and the severity of biodiversity loss. There is sufficient evidence that it is a systemic concern and not isolated.

Janet: So, policy makers, central banks, financial sector regulators, need to develop strategies to manage nature-related financial risks as well. So, if we look at biodiversity more specifically in the context of financial stability, there are two main risks that we see. The one is physical risk, and the other one is transition risk. For physical risk, there are economic activities that are dependent on the ecosystem and on biodiversity and the environment more holistically. Transition risk is a move away from the traditional activities and to reach a global positive nature for us all.

Janet: So, what can happen? These risks can be transmitted into the real economy by households, firms and sovereigns, and that can lead to credit risk, market risk, liquidity risk, and operational risk. And if you're an insurer, solvency risk is also threatened by these risks materializing. Financial institutions play a definite role by choosing to finance or to not finance specific aspects of the economy.

Janet: So central banks, regulators, and our policy makers in turn have a responsibility to take action and with appropriate speed. You don't want to act too quickly or too slowly. There's a body of empirical evidence that is making a link between biodiversity and the work of policy makers and this is growing by the day. So forward-looking approaches are starting to be adopted and we're seeing this increasing across the globe. Work has also started on the impact of biodiversity on price stability, because inflation could increase due to extreme biodiversity events.

Janet: Then the last thought that I want to touch on this NGFS paper is their recommendations and they make a number of recommendations, and I can summarize it for us in five points. Firstly, we need to recognize that biodiversity is a source of economic and financial risk, and we need to develop a response



strategy. We need to build skills and capacity. Thirdly, we need to assess the degree of exposure that we have in the financial sector. Fourthly, we need to consider what the supervisory options are. And lastly, we need to build the financial architecture for mobilizing investment in a biodiverse and positive economy.

Prasanna: Very interesting to hear about the work by NGFS and SARB's contributions to the body of work, Janet. Thanks for expanding on them. Continuing on from this about the paper from NGFS, the paper states that the biodiversity loss and climate change are closely and strongly interconnected. The risks of biodiversity loss are being seen as part of a wider set of risks which include climate change-driven risk. Given these intense relationships, listeners would like to know as to what SARB is doing to address the wider set of nature related risks, including climate risks.

Janet: I actually want to tell you a little bit more about South Africa, not just what the South African Central Bank is busy doing. So, if you are familiar with our economy and with our biodiversity at all, you might know that the western half of our country is really prone to droughts and that the eastern half of our country is more prone to flooding. So physical risk is a real concern in South Africa.

Janet: So, what we have in South Africa after the Paris Agreement and joining the NGFS, we have a Presidential Climate Change Commission. And below that we have a Presidential Climate Finance Working Group, which is being headed up by one of our deputy governances. Then, our Ministry of Finance has a Climate Risk Forum, which is a collaboration between industry and then policy makers and regulators. We have an Intergovernmental Sustainable Finance Working Group, which is, as the name implies, only for government departments and regulators. We do not have industry representation there. Then in the Central Bank itself, we have a strategic project called our Climate Change Program. And then in the Prudential Authority, we have a Prudential Authority Climate Think Tank, which also then focuses on climate initially, but ultimately all of these will work on sustainable finance more broadly.

Prasanna: Thanks Janet, for sharing this. It's really exciting to hear about the work being carried out by South Africa and SARB in this domain. It sounds like the South African financial services sector as a whole is taking a multifaceted approach to address this critical issue facing us in the future. Are there any nuances or further details you would be able to share with our listeners?

Janet: Yes, certainly. So, we are looking at this from both a macro and a microeconomic perspective, or rather prudential perspective, to be more exact. So specifically at the Climate Risk Forum, we are focusing on disclosure and mandatory disclosure requirements for our firms, a taxonomy or a framework in which they need to capture the data and then report on it. We are working on scenarios.

Janet: We intend to have benchmark scenarios that industry can then use in their stress testing and in their modeling. And then we're also working on capacity building.



And then in the Prudential Authority specifically, we have a roadmap document, which is quite closely aligned to what we're doing at government level and there we work on disclosures, the taxonomy, and then regulatory and supervisory guidance more specifically. So, it's quite exciting to be in a regulatory space at the moment.

Prasanna: Thanks for elaborating on the details to our listeners, Janet. You seem to be covering all the bases. Let me move to the next question. Are there any other recent publications or reports that in your considered opinion would be vital and useful to the financial sector supervisory community?

Janet: Oh yes, there is. The United Nations Intergovernmental Panel on Climate Change or the IPCC have published a sixth assessment report on climate mitigation. So, part one was published in October of 2021 and the second part and the final part, as I understand it, has been published in March of 2022. And in this document, they cover various aspects of the topic, but specifically they touch on emission trends and drivers, mitigation pathways, social aspects, energy systems, specifically looking at the role of agriculture, forestry, urban perspectives, innovation, and the role of FinTech. They also look at what should be happening on an international cooperation level and then what national policies should consider covering. So, I would really encourage our listeners to go to the internet and look for this paper. It's the sixth assessment report on climate mitigation. It is quite an interesting and comprehensive read.

Prasanna: Thanks Janet, for sharing your knowledge and providing a useful reference to the reports, which I'm sure would be very useful for the supervisory community in enhancing their knowledge and understanding of this domain.

Janet: Thank you, Prasanna. Much appreciated.

Prasanna: Thanks Janet, for your time and participation. It's been a real pleasure hosting you and hearing from you on a topic which is going to assume increasing importance for the financial sector supervisory community going forward. Thanks also for being such a strong supporter of Toronto Centre's activities to equip financial sector supervisors worldwide, much appreciated. I'm here today with Janet Terblanche and you're listening to another episode of TC podcast series. Thanks for joining us today and stay tuned to the next episode of TC podcasts.