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THE EMERGING REGULATORY AGENDA

Improving transparency of nature-related risks in Africa

This position paper seeks to address the key role that regulators play in building transparency on nature related risks in Africa. The paper was commissioned by the African Natural Capital Alliance (ANCA), a collaborative forum for mobilising the financial community's response to the risk of nature loss in Africa. ANCA has a member base of 25 African financial institutions and was established by FSD Africa with support from the United Nations Economic Commission for Africa (UNECA) and the United Kingdom's Department for Environment, Food & Rural Affairs (DEFRA). ANCA is also working with the Taskforce on Nature-related Financial Disclosures (TNFD) in order to provide an African voice in the development of TNFD's reporting framework for nature-related risks and opportunities.

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EXECUTIVE SUMMARY

- Financial regulators around the world are recognising that the depletion of nature poses major risks to financial and economic stability: these are additional to climate change risks.
- They have the opportunity to act on nature-related risks because doing so ensures that they fulfill their core mandate to maintain financial stability.
- Transparency is the cornerstone of strong risk management.
- Regulatory momentum regarding disclosure of nature-related risks has been increasing globally.
- African regulators, in particular, will see the benefit of acting with urgency because the continent is disproportionately exposed to nature-related risks.
- African regulators can engage with this new agenda by following a set of no-regret moves as a key first step in developing a roadmap to incorporate nature-related risks into financial disclosure.
- These no-regret actions include aligning with a government agenda, understanding requirements, determining availability of capacity, and engaging with existing nature alliances.

INTRODUCTION

Degradation of our natural ecosystems poses a significant risk to our financial and economic stability. A significant portion of our global economic product relies on nature and natural systems. As human activity and climate change continue to deplete these systems, we need to create a regulatory agenda to better manage nature-related risks and the harms they can create. This paper offers up next steps for this regulatory agenda, specifically in the context of Africa, illustrating the urgency to do so for African economies, why transparency should be an important component of any regulatory agenda, and what African regulators can do to support stable nature-positive economies.

WHY AFRICAN REGULATORS COULD BENEFIT FROM FOCUSING ON NATURE

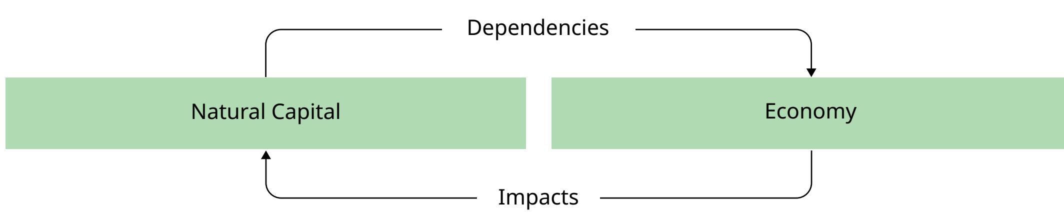
Regulators are increasingly establishing global financial initiatives to respond to nature-related risks. In this section, we outline the case for regulators to act on nature risks because doing so assists their core mandate to maintain financial stability, and the particular urgency for African regulators to do so.

Economies depend on nature

The World Economic Forum estimates that $44 trillion of global economic value generation, corresponding to more than half of the world's GDP, is generated by industries that both depend on nature, while also impacting nature through economic activity[1]. We illustrate this link below:

Exhibit 1: The dependency-impact loop

Organisations that rely on the use of natural capital (and its ecosystem services) may impact natural capital[2], and this may then have a negative effect on these businesses



Source: Oliver Wyman analysis

Economic activity has impacts which result in the degrading and depletion of nature at an unprecedented rate

Nature loss with direct links to human activities has been accelerating in recent years. Seventy-five percent of total land surface has been significantly altered and over 85% of wetlands have been lost. The loss of biodiversity undermines the ability of nature to provide ecosystem support on which human society, economies, and other species rely[3].

The simultaneous dependency on, and depletion of, nature creates risks for businesses and economies

These nature-related risks are defined either as “physical risks,” “transition risks,” or “systemic risks.”

Physical risks result from an organisation’s dependence on nature — for example, an agribusiness that depends on a water resource is exposed to physical risks from the depletion or pollution of that resource.

Transition risks result from a misalignment between an organisation’s strategy and management and the changing regulatory and policy landscape in which it operates — for example, a polluting business may be exposed to regulatory intervention if governments act to protect nature from the harmful effects of pollution.

Systemic risks can arise from the breakdown of critical ecosystems, triggering cascading socioeconomic impacts. Systemic risks may also arise from the aggregation of nature-related risk exposures across financial institutions — for example, concentrations of lending to businesses that depend on a particular natural asset or ecosystem[4].

Exhibit 2: Nature-related risk categories

Physical risks + **Transition risks**

Acute risk
Short-term, event-based risks

Chronic risk
Risks from long-term changes in environmental conditions

Policy & legal risk
Changes in the legal operational context due to new (or enforcement of existing) legislations, regulations and policy

Market risk
Changing dynamics in overall markets, including changes in consumer preferences, which arise from another risk category as a result of changing physical, regulatory, technological and reputational conditions and stakeholder dynamics

Technology risk
Substitution of products or services with a lower/improved impact on nature or reduced dependency on nature

Reputation risk
Changes in perception concerning a company's actual or perceived nature impacts, incl. a local, economic and societal level, can result from direct company impacts, industry impacts and/or impacts of upstream/downstream operations

Systemic risks

Ecosystem collapse
Risk that a critical natural system no longer functions e.g. tipping points are reached and the natural ecosystem collapses resulting in wholesale geographic or sectorial losses (summing of physical risks)

Aggregated risk
Linked to fundamental impacts of nature loss to levels of physical and transition risk across one or more sectors in a portfolio (financial or corporate)

Contagion risk
Originates in the financial or real economy as a risk that financial difficulties as one or more financial institution spill over to the financial system as a whole

Source: Task Force on Nature-Related Disclosures[5]

Financial systems are exposed to these risks through lending, investing, and underwriting. Therefore, financial institutions could benefit from better understanding how the businesses in their portfolio are exposed to the physical and transition risks through underlying nature-related impacts and dependencies.

African economies are disproportionately exposed to nature-related risks

African economies are highly exposed to nature-related risks because they are especially dependent on nature and quickly losing natural capital. Africa is home to 65% of the world's arable land[6], and 20% of the global tropical rainforest area[7]. These natural endowments offer large natural-capital opportunities[8].

The dependence of Africa's economy on natural capital exceeds the global average, with over 70% of people living in sub-Saharan Africa depending on forests and woodlands for their livelihoods[9], compared to about half of the world's total GDP generated in industries that depend on nature[10].

Africa's loss of natural capital also exceeds the global average, having seen a decline in its Biodiversity Intactness Index (BII) score of 4.2% between 1970 and 2014, considerably higher than the global BII score decline of 2.7% over the same period[11].

There is a growing recognition of the impact of nature risks on financial stability on all levels

Exhibit 3: Non-exhaustive list of voluntary initiatives to address nature risks in the global financial services sector

2022

African Natural Capital Alliance (ANCA)
Collaborative forum of African financial institutions to mobilise a response by the broader financial community to the risk of nature loss in Africa[12]

Nature Action 100
Global investor engagement initiative focused on driving greater corporate ambition and action to reduce nature and biodiversity loss[13]

2020

Finance for Biodiversity Pledge
Call for global leaders to commit to protecting and restoring biodiversity through their financial and investment activities[14]

2019

Business for Nature
Global coalition that has brought together businesses, conservation organisations and institutions to call for ambitious nature policies[15]

2017

Network for Greening the Financial System (NGFS)
Network of central banks and financial supervisors who share best practices and contribute to the development of environment and climate risk management in the financial sector[16]

2016

Sustainable Insurance Forum (SIF)
Network of insurance supervisors across the globe who are working together on sustainability challenges facing the insurance sector[17]

2012

Biodiversity Finance Initiative (Biofin)
UNDP-managed global programme, which exists to demonstrate how nature-positive economies can work for people and the planet[18]

Source: Oliver Wyman analysis

Regulatory momentum regarding integration of nature-risks is increasing

Financial sector policymakers and regulators around the world are also recognizing the threat of biodiversity loss.

Exhibit 4: Key milestones of regulatory response on biodiversity loss

2020

The Dutch Central Bank was the first central bank to publish a report exploring biodiversity risks for the Dutch financial sector.

2021

Summit statements from leaders of the G7, G20, and COP26 committed to a 'net-zero and nature-positive transition'.

2021

At the COP26 conference, 45 governments pledged to protect nature through wide-ranging reforms in agriculture, food systems, and marine industries[1].

2022

The COP15 in Montréal, Canada, concluded with a historic deal in the form of the Kunming-Montreal Global Biodiversity Framework (GBF). The agreement between 195 countries contains global goals and targets aiming to protect and restore nature for current and future generations[2].

2022

The Network for Greening the Financial System, representing 114 central banks and financial supervisors, concluded that 'nature-related financial risks should be considered by central banks and supervisors for the fulfilment of their mandates'.

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Source: Oliver Wyman analysis

Exhibit 5: Overview of Global Biodiversity Framework targets

Conserve

- Biodiversity-inclusive spatial planning, near -0 loss
- Effectively restore 30% of degraded nature
- Effectively conserve 30% of lands and seas
- Halt human-included extinctions

Avoid

- Stop unsustainable use, harvest, trade of species
- Reduce alien species spread by at least 50%
- Reduce pollution risks, impacts by at least 50%
- Reduce climate change impacts

Safe-guard

- Sustainably manage and use wild species
- Sustainable agri/aquaculture, fisheries, forestry
- Restore and enhace nature’s goods, services
- Increase area, quality of urban green/blue spaces
- Fair sharing of benefits from genetic resources

Act

- Mainstream biodiversity into all policy, practice
- Business to monitor, disclose nature impacts
- Sustainable consumption, halve food waste
- Phase out ‘perverse’ subsidies, increase finance
- Strengthen capacity, participation, IPLC, women

Four overarching goals to be met by 2050

• Halt loss, restore nature • Use lands and seas sustainably • Share benefits and services • Mobilise neccessary resources

● 2030 goals ● Not time specific

Source: Kunming-Montreal Global Biodiversity Framework

Based on the number of governments that signed the GBF, regulators can expect their governments to begin to act. This will increase the need for regulators to act, as transition risks will increase and will lead to expectations for them to be involved in implementation (such as the target on disclosure of nature related risks).

The mandate of financial regulators requires action on nature risks

In line with regulatory mandates, the threat to African financial stability posed by nature-related risks warrants closer regulatory scrutiny.

As an extension of their mandates, central banks and financial supervisors could benefit from ensuring that financial institutions do not contribute to biodiversity-related financial risks.

Nature and climate are closely related

The interrelation between climate and nature

The use of land for food production is the main driver of biodiversity loss
Nearly 95% of the Earth's surface shows some form of human modification[19]. When land is converted for agriculture, some animal and plant species may lose their habitat and face extinction.

But climate change is playing an increasingly important role in the decline of biodiversity
Climate change has altered marine, terrestrial, and freshwater ecosystems around the world. It has caused the loss of local species, increased diseases, and driven mass mortality of plants and animals, resulting in the first climate-driven extinctions.

Biodiversity loss also exacerbates the impact of climate change
In many cases, when an ecosystem loses biodiversity, it becomes less able to store carbon, contributing further to climate change. Damaged ecosystems also exacerbate climate change by releasing carbon dioxide into the atmosphere, undermining food security, and putting people and communities at risk[20]. Biodiversity loss also exacerbates the climate crisis by diminishing the natural world's ability to withstand and restore itself from physical climate impacts such as droughts and floods. For example, the loss of mangroves lowers the Earth's defence against floods. A good regional example is that of West Africa, where mangroves play an essential role in coastal fisheries. This region has experienced a 4.8% decline in mangrove area between 1975 and 2013[21].

The risk of species extinction increases with every degree of warming
On land, higher temperatures have forced animals and plants to move to higher elevations or higher latitudes, many moving towards the Earth's poles, with far-reaching consequences for ecosystems. In the ocean, rising temperatures increase the risk of irreversible loss of marine and coastal ecosystems. Live coral reefs, for instance, have decreased by half in the past 150 years, and further warming threatens to destroy almost all remaining reefs.

Overall, climate change affects the health of ecosystems, influencing shifts in the distribution of plants, viruses, animals, and even human settlements. This can create increased opportunities for animals to spread diseases and for viruses to spill over to humans. Human health can also be affected by reduced ecosystem services, such as the loss of food, medicine, and livelihoods provided by nature[22].

TRANSPARENCY: THE FOUNDATION OF A NATURE-RELATED RISK REGULATORY AGENDA

Transparency is the cornerstone of ensuring strong risk management. In this section, we highlight a global nature disclosure framework that is in the final stages of development. We also highlight the urgency for action, given the unique and consequential challenges facing the African continent.

Transparency is the cornerstone of ensuring strong risk management

Enhanced transparency of nature-related risks is fundamental to managing them effectively. Individual financial institutions need visibility of the nature-related risks in their lending, underwriting, and investment portfolios. Regulators could benefit from identifying nature-related risk concentrations for regulated entities and assess whether they are being managed effectively. Fortunately, there is already work completed that offers disclosure guidance for nature-related risks.

The Task Force on Nature-Related Financial Disclosures (TNFD) is currently being developed as a global disclosure and risk assessment framework

Task Force on Nature-Related Financial Disclosures (TNFD) Framework

The Task Force on Nature-Related Financial Disclosures (TNFD) was launched in 2021 as a risk management and disclosure framework that aims to enable organisations to report and act on evolving nature-related risks.

The TNFD takes its inspiration and approach from the Task Force on Climate-Related Financial Disclosure (TCFD). Both initiatives seek to use the power of risk management and disclosure of financial and non-financial information from companies to investors and lenders to shift capital flows to more sustainable outcomes. The draft disclosure recommendations included in TNFD's beta v0.4 use the four pillars of the TCFD as a base, and the draft disclosure recommendations are also closely aligned to encourage early adopters to move towards integrated climate-nature disclosures. While the two frameworks are complementary, there are important differences in the draft guidance of both frameworks as to how organisations assess nature-related risks.

The framework draws from, and feeds into, relevant standards throughout, including those of the International Integrated Reporting Council (IIRC), the International Sustainability Standards Board (ISSB), the Global Reporting Initiative (GRI), and others[23].

African regulators and supervisors could benefit from being proactive given challenges that came to light in responding to the climate crisis

The nature agenda was accelerated by the 2022 United Nations Biodiversity Conference (COP15) in Montreal, Canada, where a landmark agreement to guide global action on nature through to 2030 was signed by 188 governments. This agreement built on the adoption of the Paris Agreement, an international treaty on climate change, by 196 Parties at the UN Climate Change Conference (COP21) in Paris, France in 2015. Given the significant gap between the global acceleration of the climate and nature agendas, we see value in outlining and considering lessons from challenges that hindered African authorities in their efforts to integrate climate risk into their financial systems.

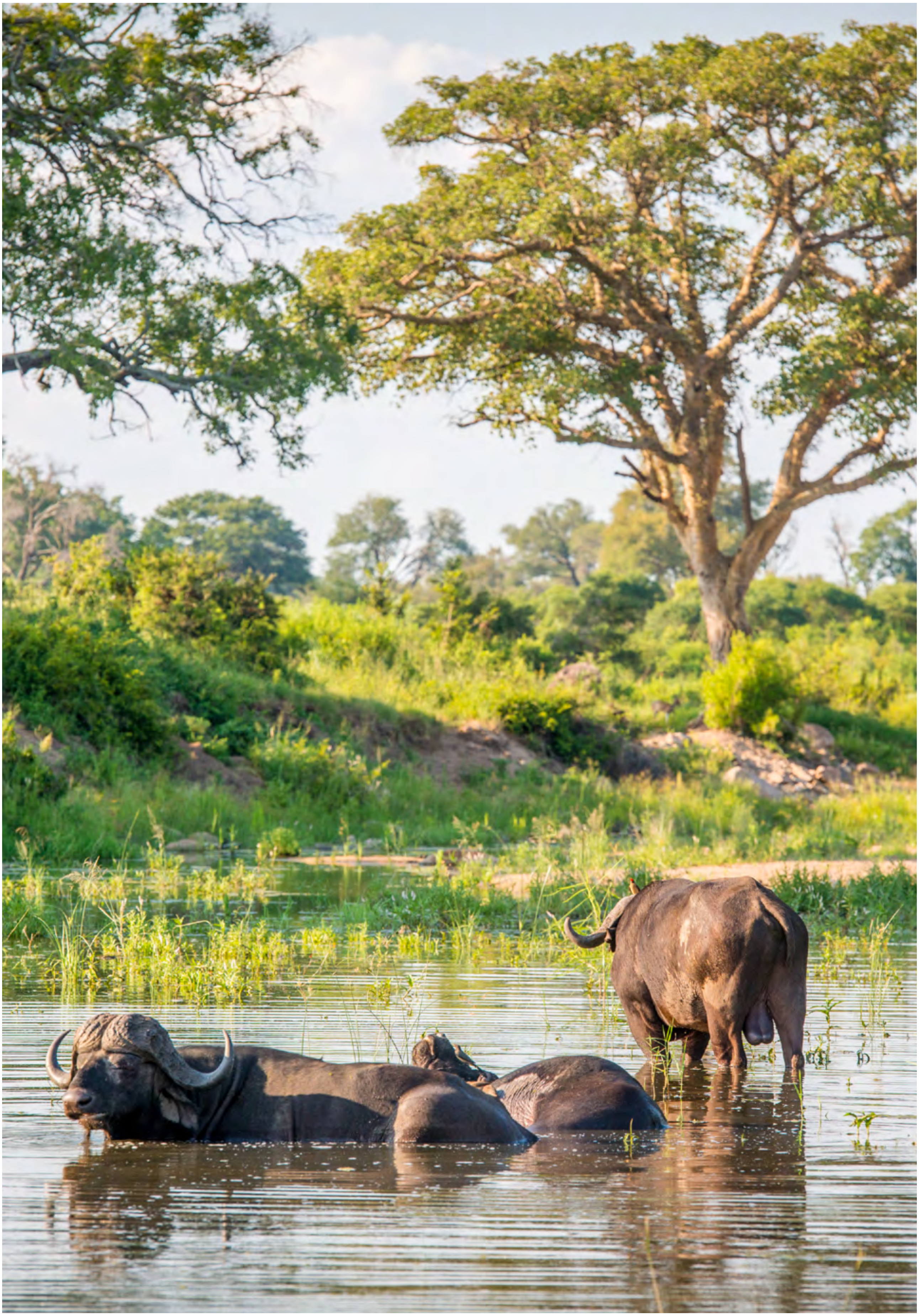
The challenges of integrating climate risks into financial systems by African regulators can be used to draw lessons on what can be done to integrate nature risks into African financial systems. These learnings are outlined in the table below.

Exhibit 6: Challenges faced by African regulators and financial institutions in responding to climate change

Challenges	Implications for what regulators can do for nature
Data quality on climate	Enable the advancement of measurement of nature risks by ensuring that nature-related data is easily accessible from public sources. (Key nature-related metrics include, amongst others, the population sizes of a cross section of species and ecological diversity within a geographical location).
Shortage of internal capabilities to implement the climate risk agenda (training, expertise)	Promote knowledge transfer on nature-related issues to ensure that business/strategy and sustainability teams are capacitated with specific skills that are fit for purpose.
Limited alignment between regulators and regulated entities	Facilitate trainings that allow a better understanding of nature risk, such as seminars on nature risk regulation. Develop a roadmap to integrate nature risks into the financial system.
Available climate-related frameworks and guidance not developed for the African context	Ensure Africa participation in development of global standards, such as the TNFD, to ensure frameworks are fit for purpose in the African context.
Climate policies fail to adequately incentivise climate risk reduction and undermine the case for ambitious regulation	Develop regulation in parallel to supporting nature policies aimed at incentivising nature-positive business actions.

Source: African Development Bank Report: Climate risk regulation in Africa's financial sector and related private sector initiatives[24] & Oliver Wyman analysis

These learnings can be taken into consideration by African regulators in responding to the nature agenda through the integration of nature-risks into their financial systems.



THE ROLE OF AFRICAN REGULATORS: LEVERAGING TRANSPARENCY IN SUPPORT OF FINANCIALLY STABLE NATURE-POSITIVE ECONOMIES

The Task Force on Climate-Related Financial Disclosure (TCFD) was introduced as a disclosure framework that would enhance transparency in supporting efforts to address the climate change crisis. In this section we show how the TCFD has been widely adopted by highlighting the financial sector regulators that integrated the TCFD framework into their climate responses. We make the case that regulators could follow a similar approach by adopting the TNFD disclosure framework to integrate transparency into a regulatory agenda.

A few African financial sector regulators have published disclosure guidance notes on the integration of climate-related risk

African regulators have recognized the importance of disclosure in promoting the effective management of climate risks. The table below outlines voluntary disclosure guidance publications that have been published by African regulators that aim to guide financial market players in responding to the climate agenda.

Exhibit 7: Selected African financial service regulators that introduced TCFD-aligned requirements (non-exhaustive)

2016 — Moroccan Capital Authority
Roadmap for aligning the Moroccan financial sector with sustainable development[25]
Lays the groundwork for a real roadmap for the alignment of the financial sector, in all its components, with the challenges of sustainable development.

2018 — Nigerian Exchange Group
Sustainability Disclosure Guideline[26]
Provides guidance for alignment to global frameworks in identifying the material sustainability matters.

2019 — Bank of Ghana
Sustainable Banking Principles and Sector Guidance Notes[27]
Provides guidance to assist banks with the practical application of the Sustainable Banking Principles.

2021 — Central Bank of Kenya
Guidance on Climate-Related Risk Management[28]
Provides guidance to financial institutions to manage their climate-related risks by integrating climate-related risk management into their business decisions and activities, benchmarked to the TCFD framework.

2022 — Johannesburg Stock Exchange (JSE)
Sustainability Disclosure Guidance[29]
Provides guidance to JSE-listed companies on the disclosure of sustainability-related impacts, risks, and opportunities.

2022 — Bank of Mauritius
Guideline on Climate-related and Environmental Financial Risk Management[30]
Sets out expectations of a prudent approach to climate-related and environmental financial risks with a view to enhancing the resilience of the banking sector against these risks.

Several global financial sector regulators integrated the TCFD framework into their climate change responses

There are also global examples of countries where regulators have implemented the TCFD in some way, which include requirements that have been finalised in the U.K[31] and Switzerland[32] by the respective financial conduct/supervisory authorities. Examples of requirements that have been proposed but not yet finalised include the U.S Securities and Exchange Commission[33], and the European Commission[34].

Regulators across various geographies have adopted the TCFD in promoting transparent integration of climate risks by financial sector participants. These regulators have been proactive in addressing an issue of public interest given that climate change has been a driver of vigorous political debate globally.

With the Task Force on Nature-Related Financial Disclosures (TNFD) set to release v1.0 of its disclosure framework in September 2023, African regulators could either adapt or adopt the TNFD to promote transparency in the integration of nature risks.

IMMEDIATE NEXT STEPS FOR AFRICAN REGULATORS

African regulators could benefit from engaging with the new nature agenda rather than be left behind. First, they need to develop a roadmap for integrating nature-related disclosure. This entails consultation, voluntary disclosure, and mandatory disclosure. The no-regret actions that the regulators can take towards their nature-related disclosure roadmaps are outlined below.

- **Engage with finance and environment ministries to align regulatory approach with government's policy agenda on nature along with implications for the financial sector.** Regulators could benefit from establishing an understanding of the agenda and priorities of the national policymaking regime in their respective jurisdiction. This not only secures political backing, but also ensures that the interventions are contextually relevant. Aligning with the government and across relevant regulators — for example, banking and insurance regulators, capital markets authorities, pensions regulators, and financial reporting authorities — means that everyone is working towards the same goal endorsed by the government. Regulators can also influence the actions of financial institutions by introducing incentives.
- **Assess internal capacity and act on gaps.** Regulators could benefit from establishing a firm understanding of the capacity and capability requirements to respond to the call for nature-related disclosure transparency by integrating nature risks into financial sector regulation. Given the complexities of identifying and reporting on nature-related dependencies, impacts, risks, and opportunities, African regulators can work to clearly understand what this exercise would require.
- **Assess capacity among regulated entities to act.** Regulators could benefit from determining the capacity and capabilities of financial institutions within their jurisdictions to respond to the call for nature-related disclosure transparency. A key output of this exercise is a detailed view of capacity gaps, along with a clear plan on how these will be addressed across the short-term, medium-term, and long-term time horizons.
- **Engage in voluntary nature networks like Sustainable Insurance Forum (SIF), the Network for Greening the Financial System (NGFS), African Natural Capital Alliance (ANCA), and the Task Force on Nature-Related Financial Disclosures (TNFD).** Regulators could benefit from creating a plan on how they will engage global, regional, and local nature alliances. This effort will position regulators to harness their contributions to shape emerging frameworks such as the TNFD.

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