Banks at Risk: Quantifying Endogenous Nature Risk Exposure of G-SIBs

Authors: Emma O'Donnell, Nicola Ranger, Juan Sabuco, Nathalie Seddon

Abstract:

The financial sector's role in biodiversity loss and ecosystem degradation is gaining attention from civil society, policymakers, and financial institutions. Previous studies on nature-related financial risks have focused on the risks of exogenous nature loss to the financial system without explicit recognition that their portfolios also drive nature loss. This paper frames nature-related risks as directly linked to economic activities causing degradation, attributing risk exposure to investments with harmful ecological impacts. For the first time, we quantify the risk financial institutions generate for themselves through the financed impacts of their portfolios, their endogenous nature risk exposure. Using data on 29 globally systemically important banks (G-SIBs), we assess this risk at the sector-, portfolio-, and financial system-level. Our findings reveal high correlation in endogenous nature risk exposure among these "too-big-to-fail" banks, amplifying systemic risks and threatening financial stability. The results underscore the need for policy interventions that recognize that the financial sector must reduce their own financed nature impact to ensure financial and ecological stability.

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