

SPEECH

# **Nature-related risk: legal implications for central banks, supervisors and financial institutions**

## **Keynote speech by Frank Elderson, Member of the Executive Board of the ECB and Vice-Chair of the Supervisory Board of the ECB, at the ESCB Legal Conference 2024**

*Frankfurt am Main, 6 September 2024*

As a lawyer, I am always glad to discuss the novel legal issues affecting the work of central banks and supervisors.

At last year's conference I spoke to you about climate-related litigation and its impact on the financial sector.<sup>[1]</sup> This year I want to talk about the risks that nature degradation poses to the economy and the financial sector.

As I have said before, assessing nature-related risk is not some kind of tree-hugging exercise. We are talking about material financial risks, which – like any other type of risk – must be assessed, analysed and managed.<sup>[2]</sup>

Today, I want to focus on the legal implications of nature-related risk for our central banking and supervisory work. I will first outline the growing trend of nature-related litigation. Then I will look at how nature-related risk should be considered in the context of the mandates of central banks and supervisors.

### **Nature degradation: risks for the economy and the financial sector**

Scientists worldwide agree that nature has been declining at an unprecedented rate over the past 50 years. The Intergovernmental Science-Policy Platform on Biodiversity and Ecosystem Services (IPBES) already sounded the alarm back in 2019, shortly before the outbreak of the global pandemic. The IPBES report even warned us that nature degradation was exacerbating emerging infectious diseases in wildlife, domestic animals, plants and people.<sup>[3]</sup>

The decline of nature is primarily caused by human activity and is being made worse by climate change. Scientists have calculated that humanity is using natural resources 1.7 times faster than ecosystems can regenerate them – in other words, we are consuming resources equivalent to 1.7 planet Earths.<sup>[4]</sup>

This decline undermines the planet's ability to provide ecosystem services, which are the benefits we obtain from nature to support and sustain our society and economies. Examples of ecosystem

services include food, drinking water, timber and minerals; protection against natural hazards, such as floods and landslides; or carbon uptake and storage by vegetation.<sup>[5]</sup>

The degradation of nature not only threatens these ecosystem services, but also increases the risk of us reaching ecosystem tipping points, i.e. non-linear, self-amplifying and irreversible changes in ecosystem states that can occur rapidly and on a large scale.<sup>[6]</sup> Through these tipping points, we are at risk of going beyond the Earth's safe operating space for sustaining life on the planet.<sup>[7]</sup>

From the perspective of central banks and supervisors, the degradation of nature makes our economies, our companies and our financial institutions increasingly vulnerable.

We cannot ignore these vulnerabilities. Indeed, we need to deepen our understanding of how nature-related financial risk affects the economy and the financial system.<sup>[8]</sup>

Work is progressing at the ECB: for example, our research has found that 72% of euro area companies are highly dependent on ecosystem services and would experience critical economic problems as a result of ecosystem degradation.<sup>[9]</sup> Moreover, research by the European Commission has detailed that several sectors of the European economy – in particular agriculture, real estate and construction, and healthcare – are heavily dependent on nature and thus exposed to associated risks.<sup>[10]</sup>

Work is also progressing at international level. The Financial Stability Board recently took stock of supervisory and regulatory initiatives among its members and established that a growing number of financial authorities are considering the potential implications of nature-related risks for the financial sector.<sup>[11]</sup> In addition, the Network for Greening the Financial System (NGFS) – a network of 138 central banks and supervisors from around the world – had already acknowledged the relevance of nature-related risks for the mandates of central banks and supervisors back in March 2022.<sup>[12]</sup> The NGFS has since developed a conceptual framework offering central banks and supervisors a common understanding of nature-related financial risks and a principle-based risk assessment approach.<sup>[13]</sup>

All these efforts are improving our ability to quantify the financial implications of nature degradation. And of course, there are also important legal implications that we need to start talking about.

## **Nature-related litigation**

The first legal implication is the rise in nature-related litigation.<sup>[14]</sup> Litigants are starting to understand the link between climate change and nature degradation and are using the legal system to drive policy change.

Building on their successes in the field of climate litigation,<sup>[15]</sup> litigants are taking court cases to address the biodiversity crisis, protect carbon sinks, limit deforestation and loss of ocean habitats, and prevent ecosystem degradation.<sup>[16]</sup>

In July of this year the NGFS published a report on this new trend to raise awareness among financial institutions, central banks and supervisors.<sup>[17]</sup> The report highlighted that while nature-related litigation is still in its infancy, the number of cases is expected to grow rapidly.

The report reiterated that litigation can affect financial institutions, not only where they are directly challenged, but also indirectly, when their counterparties, or the states in which they operate, are subject to such claims.<sup>[18]</sup>

The report identified two key categories of nature-related litigation as well as two key drivers.

## **Categories of nature-related litigation**

In terms of categories of litigation, most nature-related cases are being brought against states and public entities, using arguments based on fundamental rights.<sup>[19]</sup> This is not surprising given how effective such arguments have been in climate litigation.

Interestingly, however, corporates and banks, too, are already being directly targeted in nature-related litigation. This contrasts to the trends we saw under climate litigation, where cases against the private sector were much slower to start.

First, this may be because climate litigation has offered a blueprint for action for litigants who are seeking innovative ways to protect nature. Second, it may be because nature-related litigation can identify a closer causal connection between the impact of economic activities on local ecosystems and people. It is often easier to pinpoint the damage and attribute responsibility to specific actors. Thanks to new legislation, it is also becoming easier to hold multinational companies liable for harm occurring in remote parts of their global supply chains. And we can even see that litigants are already challenging banks that are alleged to finance such companies.<sup>[20]</sup>

Indeed, we can observe a close nexus between corporate litigation and legislation. Litigants are already relying on new corporate sustainability due diligence legislation,<sup>[21]</sup> on tort law, anti-money laundering laws<sup>[22]</sup> and shareholder rights to bring nature-related claims. The number of such cases is likely to grow as further legislation – such as the EU Directive on corporate sustainability due diligence and the EU Deforestation Regulation – enters into force.

## **Drivers of nature-related litigation**

Looking now at the drivers behind the trend in nature-related litigation, the first is that scientists – and litigants – are developing a much better understanding of the climate-nature nexus. Protecting nature is crucial to mitigating climate change and vice versa. The climate crisis deepens the nature crisis, thus diminishing nature's ability to mitigate what the UN Secretary General has called “the era of global boiling”.<sup>[23]</sup> The scientific consensus on this point may help litigants to strengthen their cases.<sup>[24]</sup>

The second driver is that courts are taking, as a given, the findings of climate and environmental science, in the same manner as any other area of technical expertise. Court assessments and rulings are taking into account advanced scientific concepts and sources. We saw this quite clearly in the recent ruling of the European Court of Human Rights, in the case brought by a group of Swiss grandmothers.<sup>[25]</sup> There, the Court based its ruling on the IPCC reports, and took it as a matter of fact that climate change exists, that it poses a serious threat to human rights, and that states are aware and capable of doing something about it. Moreover, the Court held that states have a positive

obligation to act, regardless of whether their individual contribution might be a “drop in the ocean” in terms of its ability to affect climate change.<sup>[26]</sup>

## **Relevance of nature degradation for the mandates of central banks and supervisors**

This leads me to the next key legal implication of the nature crisis: how will it affect the mandates of central banks and supervisors?

It goes without saying that addressing the nature crisis is primarily up to governments and legislators. However, as I mentioned at the outset, central banks and supervisors also need to consider the nature crisis as a source of risk to the economy, financial system and the individual banks they supervise.

### **Nature-related risk and banking supervision**

A very clear example of this is the way banking supervision is looking at nature-related risks. Back in 2020, the ECB’s guide on supervisory expectations for the risk management of climate-related and environmental<sup>[27]</sup> (C&E) risks already highlighted the need for banks to identify, measure and – most importantly – manage nature-related risks, such as water stress and pollution.<sup>[28]</sup>

We have been actively following up with banks regarding these supervisory expectations since then.

<sup>[29]</sup> The first interim deadline fell due in March 2023, when banks were expected to have in place a sound and comprehensive materiality assessment of both climate and nature risks. Since then, we have issued binding supervisory decisions against 28 banks that failed to meet this first interim deadline – with the possibility of imposing periodic penalty payments in the 22 most relevant cases, if the banks don’t remedy this shortcoming in time.

Banks were also expected to meet a second interim deadline in December 2023, and by the end of this year, we expect all banks under our supervision to be fully aligned with all our supervisory expectations on the sound management of C&E risks.

In that respect, nature degradation is already integrated in ECB supervisory work as a risk driver that banks are expected to manage. Rather than considering nature-related risk as a standalone category of risk, we see it as a driver for each traditional type of risk reflected in the Capital Requirements Directive, from credit risk, reputational and operational risk including legal risk, to market and liquidity risk.

### **Nature-related risk and monetary policy**

We must also properly consider nature-related risk in the context of our monetary policy mandate.

First, the nature crisis could have direct implications for price stability – the primary objective of the ECB. One of the papers presented at the annual ECB Forum on Central Banking in Sintra, Portugal, in July shows how loss of biodiversity can cause losses to economic output while at the same time decreasing the resilience of output to future biodiversity losses.<sup>[30]</sup>

As part of its Climate and Nature Plan 2024-2025, the ECB is conducting further work on the risk posed to the economy by nature loss and degradation.<sup>[31]</sup> This will inform our understanding of risks to

price stability and financial stability.

Second, it is clear from the Treaties that the ECB must take into account the EU's policies to address nature degradation when carrying out its mandate.<sup>[32]</sup> There are two key legal bases for this: the ECB's secondary objective in Article 127(1), second sentence, and the transversal Treaty provisions of Articles 11 and 7 of the Treaty on the Functioning of the European Union (TFEU).

The ECB's secondary objective states that, without prejudice to price stability, the ECB shall support the general economic policies in the EU, with a view to contributing to the objectives of the EU. These objectives include "the sustainable development of Europe" and "a high level of protection and improvement of the quality of the environment". It is irrefutable that the EU's climate policy constitutes part of the general economic policies in the EU. As reiterated in the European Climate Law, the transition to net zero affects every aspect of economic life, in all sectors. Thus, to the extent that nature protection directly contributes to climate crisis mitigation and adaptation – which it often does – the ECB must support the EU's efforts in this field. In this context it is notable that the EU adopted the groundbreaking Nature Restoration Law earlier this year<sup>[33]</sup> and signed up to the Kunming-Montreal Global Biodiversity Framework (the "Paris Agreement for nature") in 2022<sup>[34]</sup> – significant developments that could be invoked to argue that nature protection, just like climate policy, constitutes an independent general economic policy. As lawyers, we need to watch this space.

Beyond the secondary objective, the ECB has to comply with two key transversal principles of the Treaties. Article 11 of the TFEU provides that the EU's environmental protection requirements must be "integrated into the definition and implementation of the Union's policies and activities".<sup>[35]</sup> This imposes an obligation on the ECB to take into account the EU's policies to protect nature when shaping its own policies and performing its tasks. In addition, under Article 7 of the TFEU, the activities and policies of the ECB need to be consistent with EU law – including EU law on nature and biodiversity.

This does not mean economists should start counting ants in Aragon, butterflies in Bavaria or worms in Wallonia. Instead, economists must develop means to transpose insights from nature science into variables of economic interest like growth, inflation and financial risks.

In developing tools for policy analysis of nature-related risks, the growing availability of data from sustainability disclosures will make it easier for central banks to identify how they need to incorporate nature into their work. Recently adopted legislation, in particular the sustainable finance framework<sup>[36]</sup>, creates an entire "ecosystem" of EU legislation that makes the link between nature degradation, the economy and the financial sector – and thus central banks and supervisors – clear and apparent. It leaves us in no doubt that we have the duty and the tools at our disposal to take nature-related risk into account when we exercise our mandate.

## Conclusion

Let me conclude.

The economy and the financial sector are vulnerable to nature-related risks. This vulnerability is all the more relevant given the importance of nature in mitigating and adapting to climate change.

Time is running out to prepare for the materialisation of nature-related risks. We need to be ready for the impact of these risks, just like we are for climate-related risks – or indeed for any other risk driver. For that reason, we need to properly consider the legal implications of nature-related risks for the financial sector, and for the mandates of central banks and supervisors.

Thank you for your attention.

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1.

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2.

Elderson, F. (2023), “[Climate-related and environmental risks – a vital part of the ECB’s supervisory agenda to keep banks safe and sound](#)”, introductory remarks at the panel on green finance policy and the role of Europe organised by the Federal Working Group Europe of the German Greens, 23 June.

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5.

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6.

Marsden, L. et al. (2024), “[Ecosystem tipping points: Understanding risks to the economy and financial system](#)”, UCL Institute for Innovation and Public Purpose, Policy Report, April.

7.

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9.

Boldrini, S. et al. (2023), "[Living in a world of disappearing nature: physical risk and the implications for financial stability](#)", *Occasional Paper Series*, No 333, ECB, Frankfurt am Main, November.

10.

Cziesielski, M. et al. (2024), "[Study for a methodological framework and assessment of potential financial risks associated with biodiversity loss and ecosystem degradation – Final Report](#)", European Commission, Brussels, March. These sectors are vulnerable to risks such as water scarcity, floods, storms, soil erosion, pests and invasive species, loss of pollinators and disease (including microbial resistance).

11.

FSB (2024), "[Stocktake on nature-related risks: Supervisory and regulatory approaches and perspectives on financial risk](#)", 18 July.

12.

NGFS (2022), "[Statement on nature-related financial risks](#)", 24 March.

13.

NGFS (2024), "[Nature-related Financial Risks: a Conceptual Framework to guide Action by Central Banks and Supervisors](#)", July.

14.

The NGFS defines nature-related litigation as encompassing all strategic claims brought before judicial bodies, focusing on climate, biodiversity loss and ecosystem services degradation.

15.

NGFS (2023), "[Climate-related litigation: recent trends and developments](#)", September.

16.

Setzer, J. and Higham, C. (2024), "[Global trends in climate change litigation: 2024 snapshot](#)", London, June.

17.

NGFS (2024), "[Nature-related litigation: emerging trends and lessons learned from climate-related litigation](#)", 2 July.

18.

See also Solana, J. (2020), "[Climate change litigation as financial risk](#)", *Green Finance*, Vol. 2, Issue 4, p. 344.

19.

Rodríguez-Garavito, C. and Boyd, D. (2023), "[A Rights Turn in Biodiversity Litigation?](#)" *Transnational Environmental Law*, Vol.12, No 3, p. 498.

20.

See for example [Comissão Pastoral da Terra and Notre Affaire à Tous v. BNP Paribas](#). This case is still pending.

21.

For example, cases have been brought against corporates under the French “duty of vigilance” law, such as [ClientEarth, Surfrider Foundation Europe, and Zero Waste France v. Danone](#) and [Envol Vert v. Casino](#). These cases are still pending.

22.

For instance, a complaint has been brought against banks in France, citing financial support to companies implicated in alleged illegal deforestation in the Amazon. A different application has also been filed before the UK courts against an exchange operator, in connection with the trading of metals which are allegedly the proceeds of environmental crimes.

23.

The Secretary-General noted: “The era of global warming has ended; the era of global boiling has arrived.”, see Guterres, A. (2023), “[Press conference by Secretary-General António Guterres on climate](#)”, 27 July.

24.

For instance, the Intergovernmental Panel on Climate Change (IPCC) has emphasised that safeguarding biodiversity and ecosystems is fundamental to climate resilient development, in the light of the threats posed by climate change to nature and its roles in adaptation and mitigation.

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26.

See also Kotze, L. et al. (2024), “[Courts, climate litigation and the evolution of earth system law](#)”, *Global Policy*, 15, 5–22.

27.

Here, I use the terms “environmental” and “nature-related” risk interchangeably.

28.



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30.

Kuchler, T. et al. (2024), [The economics of biodiversity loss](#), ECB Forum on Central Banking, June.

31.

ECB (2024), [Climate and nature plan 2024-2025 at a glance](#).

32.

O’Connell, M. (2024), [“Birth of a naturalist? Nature-related risks and biodiversity loss: legal implications for the ECB”](#), *ECB Legal Working Paper Series*, No 22, Frankfurt am Main, June.

33.

[Regulation \(EU\) 2024/1991 of the European Parliament and of the Council of 24 June 2024 on nature restoration and amending Regulation \(EU\) 2022/869](#) (OJ L, 2024/1991, 29.7.2024).

34.

Kunming-Montreal Global Biodiversity Framework (GBF) was agreed on 18 December 2022.

35.

This “principle of integration” is also reflected in Article 37 of the Charter of Fundamental Rights.

36.

In particular, the [Taxonomy Regulation](#) targets not only climate mitigation and adaptation, but also four further environmental objectives relevant to nature; the [Sustainable Finance Disclosure Regulation](#) (SFDR) defines “sustainable investments” with reference to the impact on biodiversity and nature; and perhaps most importantly, the [Corporate Sustainability Reporting Directive](#) (CSRD) imposes substantial disclosure requirements related to nature.

CONTACT

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