**World-first stress test shows African financial institutions are unprepared for nature-related risk**

*Modelling by Vivid Economics by McKinsey and FSD Africa shows impact of nature-loss could double losses on lending to some sectors and underlines need for action now.*

**23 June 2022: Nairobi –** A new report from Vivid Economics by McKinsey and the UK-funded financial sector development agency FSD Africa underlines the importance for financial institutions to unlock the potential benefits of investing in businesses that protect and grow nature.

Applying first-of-its-kind analysis to three private banks and the financial systems of Zambia, Egypt, Ghana, Mauritius, Kenya, and South Africa, the report shows that for the most exposed lending portfolios, for example, in Zambia and Ghana, nature-related risks in agriculture and extractives could almost double expected losses by 2030, wiping $millions off the value of their loan books. These nature-related risks are comparable with climate-related risks seen in similar sectors.

The report shows that financial institutions could benefit by adjusting investment strategies towards nature-positive outcomes. For example, action to protect and grow nature and changes in consumer demand could likely create high-growth opportunities in agricultural commodities such as alternative proteins. The report estimates that demand for crops relevant to alternative proteins cultivated in Africa, such as sugar cane and pulses, could be 15 to 36 percent higher by 2030.

The fast pace at which nature is degrading and the severe consequence of environmental tipping points make ambitious global consumer and policy action to address the nature crisis more likely.

In the scenario of ambitious policy action, nature-related impacts are material especially for the agriculture and extractives sectors and thus require immediate attention. Equity portfolios could see changes in value between -2 percent and -5 percent for agriculture in most countries, and between +1 percent and -4 percent for extractives.

On current trends, Africa is moving closer to environmental tipping points such as the conversion of the Congo basin rainforest to savannah, disruption of the West African monsoon, dieback of coral reef in South Eastern Africa and the desertification of up to 45% of Africa’s land area. Such physical risks are complex and difficult to model but have the potential to make businesses unviable in sectors such as rain-fed agriculture, pharmaceutical research, and tourism. An example is that water stress in the worst affected areas of Africa could lead to the prices of essential agricultural commodities increasing by between 15% and 30% by 2030.

Given the materiality of nature-related risks that the report demonstrates, African financial institutions are encouraged to engage with global standards for managing and disclosing nature-related financial risks, such as the Taskforce on Nature-related Financial Disclosures (TNFD).

The report represents the first application in a real-world setting of the LEAP Nature Risk Assessment Approach which was released for consultation by TNFD in March this year. While it demonstrates that even at this stage in its development the framework can be used to generate actionable conclusions, financial institutions in Africa can feed into its development to reflect the particular challenges they face.

African regulators can also play a pivotal role by clearly communicating their plans regarding climate and nature risk management and a timeline for implementing recommendations on nature-related risk released by the Network for Greening the Financial System. The report suggests that to effectively and holistically address environmental risks and opportunities, regulators and financial institutions could consider nature and climate-related risk together from the start as part of an integrated framework.

**Mark Napier, CEO of FSD Africa:**

“*The impacts of shifting to a nature-positive society are material and already underway. There is significant upside to be captured but financial institutions must institute new approaches to portfolio management that get ahead of changing regulation, of consumer preferences, and of the huge economic damage threatened by tipping points in critical natural systems. Getting this right could tip the scales between growth and decline for portfolios across the continent.”*

 **Robin Smale**, **Director at Vivid Economics by McKinsey:**

*“The nature crisis is just as urgent as the climate crisis, and demands swift action. By putting the TNFD beta framework into practice for the first time, our new research with FSD Africa demonstrates the exposure of the African financial sector to material opportunities and risks from nature loss. The critical understanding of the connections between nature, climate change and business can help financial institutions to build in resilience and capture opportunities presented by a net-zero and nature-positive future.”*

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**About FSD Africa**

FSD Africa is a specialist development agency making finance work for Africa’s future. Based in Nairobi, FSD Africa’s team of financial sector experts work alongside governments, business leaders, regulators, and policymakers to design and build ambitious programmes that make financial markets work better for everyone. Established in 2012, FSD Africa is incorporated as a non-profit company limited by guarantee in Kenya. It is funded by UK aid from the UK government.

**About Vivid Economics by McKinsey**

Vivid Economics by McKinsey is a strategic economics consultancy firm with broad sustainability and macroeconomic capabilities. The firm helps clients in all sectors around the world successfully navigate the risks and opportunities presented by the economy-wide transition to a more sustainable future. It has a global footprint, delivering projects in over 60 countries, and employing more than 250 consultants, data scientists, and solution developers. Vivid Economics was acquired by the global management consulting firm, McKinsey & Company, in 2021.