

Environmental risk analysis (ERA) in the strategic asset allocation (SAA) of the international reserves (IRs) managed by central banks (CBs)

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CEMLA's XXVI Meeting of the Central Bank Researchers Network
November 11, 2021

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CB, ERA, IR, SRI, SAA, SSA, NGFS, ESG, WEF, WWF, TIP, TPI, PRI, MPT, DCF, SWF, MVO, IO, O&G, DCF, BISIP, SDR, TCFD, MBRA, GFSG, DNS, ABS, MBS, MSCI, PACTA and many more.

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Motivation

- International Reserves (IRs) serve a wide range of functions for CBs in emerging markets.
- Environmental risks are starting to be understood as sources of financial risks.
The exposure of the IRs to environmental risks is important for CBs.
- In fact, the Network for Greening the Financial System (NGFS) was established among central banks (CBs) in 2017.

Summary

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- Lengthy but much needed literature review
 - ▶ Discusses environmental risk analysis (ERA)
 - ▶ IR management
 - ▶ ERA as input on the SAA of the IRs
- Multicriteria analytical (conceptual) framework
 - ▶ ERA is based on the analysis of scenarios of the environmental risk factors
Think of physical and transitional risks
 - ▶ Knock-on effects of the environmental risk factors on financial and systemic risks
Use measures for assessing value and risk: VaR, OpVaR, etc.
 - ▶ The results from this analysis could be considered alongside IRs' objectives and guidelines.
 - ▶ ERA would be the forth investment pillar of IR
Alongside security, liquidity and profitability.

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62.7% do not include sustainability considerations.
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 - ▶ BIS surveyed 67 CBs on their ESG investing practices:
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 - ▶ UBS surveyed 30 IR managers,
36% did not consider sustainability aspects in the IR investment process.
32% had considered but not implemented any.
5% had considered and allocated certain assets accordingly.

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- ▶ BdF significantly modified its SAA as a result of its socially responsible investing (SRI) strategy.
- ▶ DNB signed the Principles of Responsible Investment (PRI).
- ▶ Swedish CB divested from bonds issued by the Canadian province of Alberta and the Australian states of Queensland and Western Australia due to their large climate footprint.

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- There is something clearly in the making!
- This paper takes a step forward in the right direction
I look forward to see practical applications of ERA in macro models.