

THE INCORPORATION OF ESG CRITERIA IN EUROSYSTEM CENTRAL BANKS' RESERVE MANAGEMENT: THE EXPERIENCE OF THE BANCO DE ESPAÑA

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OPERATIONS DEPARTMENT



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- 2. Central Banks lead by example**
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- 4. The risk of going too fast**
- 5. Rome wasn't built in a day**

Climate change has become one of society's main concerns in recent years. Also because of its implications for the financial system

The **financial system will play an extremely important** part in the transition to a low carbon economy:

- channelling the financing needed and
- developing sustainable financing instruments that are sufficiently standardised and transparent to permit an efficient allocation of funds.

Bank Of Spain's Iconic Clock Stops For First Time In 130 Years From Filomena Freeze

January 14, 2021 madrid news, spain news, storm filomena

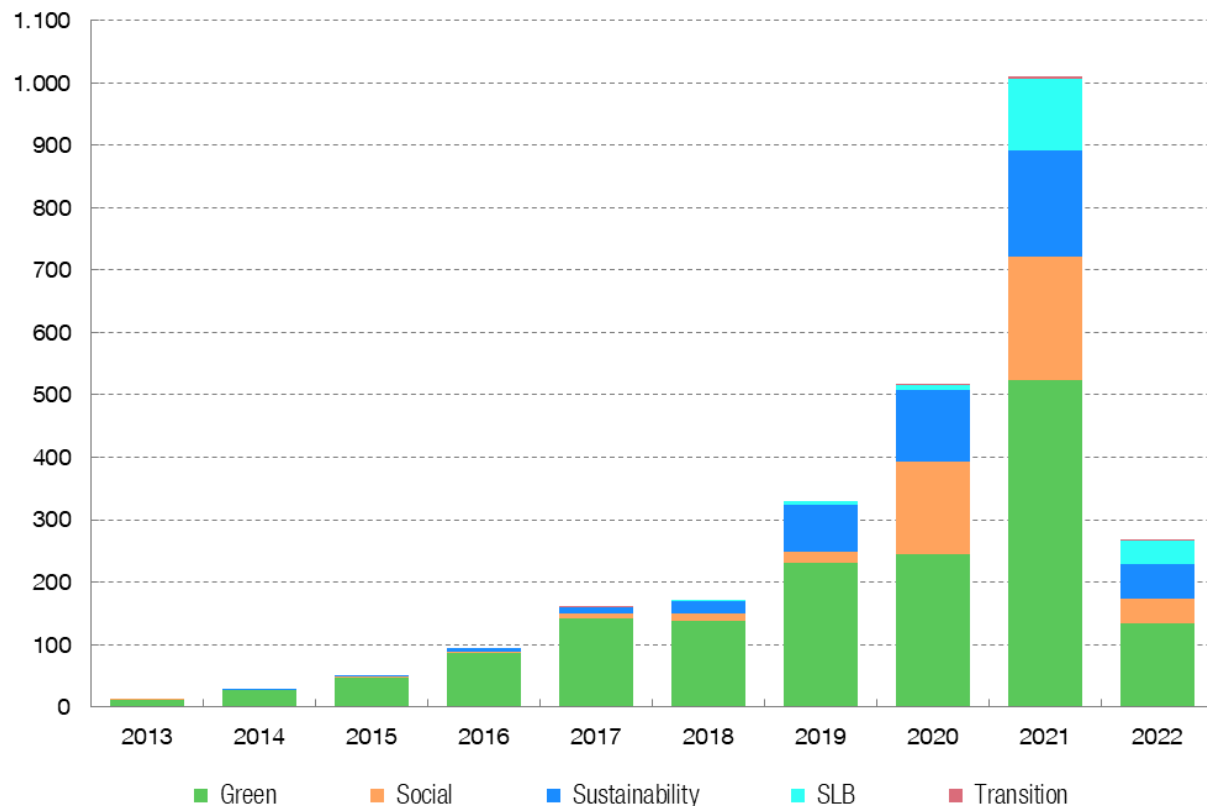


Source: Cinco Días and Madrid Metropolitan

Sustainable Finance is increasing

ESG BOND ISSUANCE EVOLUTION

EUR bn



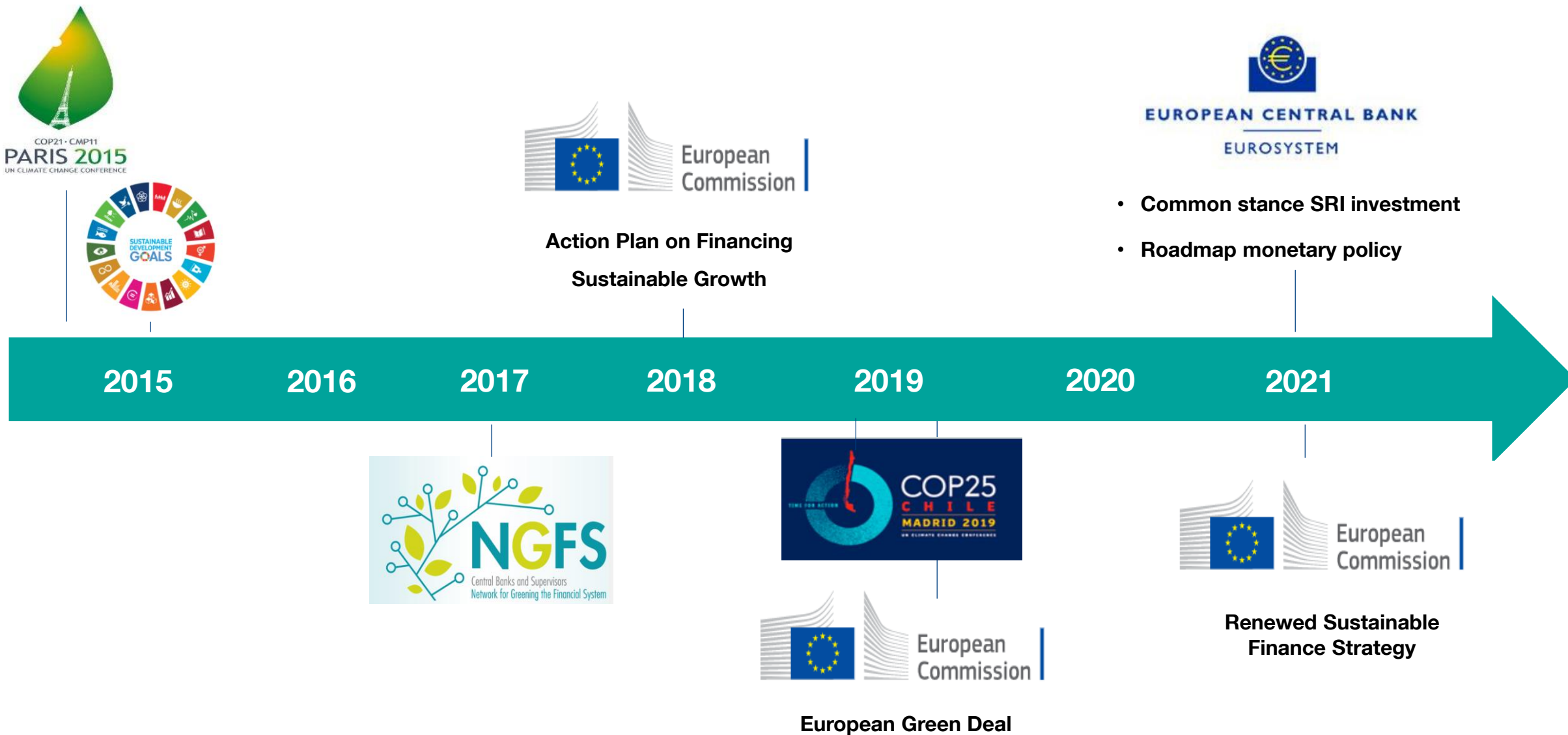
Issuance as of Q1 2022

Source: Bloomberg and own calculations

- Cumulative **sustainable debt** (green, social, sustainability, SLB, transition) has reached more than **2,5bn EUR**.
- Cumulative **green labelled debt** reached **1,5bn EUR**.
- **Global market trends** have **not** been particularly **favourable** in the **first quarter** of **2022**, ie: rise of interest rates, war in Ukraine, sell-off in the bond market and resulting volatility.
- Although it is expected that ESG debt issuance in 2022 will exceed those in 2021.

1. SUSTAINABLE AND RESPONSIBLE INVESTMENT IS HERE TO STAY

Large number of initiatives in sustainable finance since Paris Agreement in 2015







2. CENTRAL BANKS LEAD BY EXAMPLE

Network for Greening the Financial System

Central banks and supervisors

Recommendations

1.  Integrating climate-related risks into financial stability monitoring and micro-supervision.
2.  Integrating sustainability factors into own-portfolio management.
3.  Bridging the data gaps.
4.  Building awareness and intellectual capacity and encouraging technical assistance and knowledge-sharing.

Policy makers

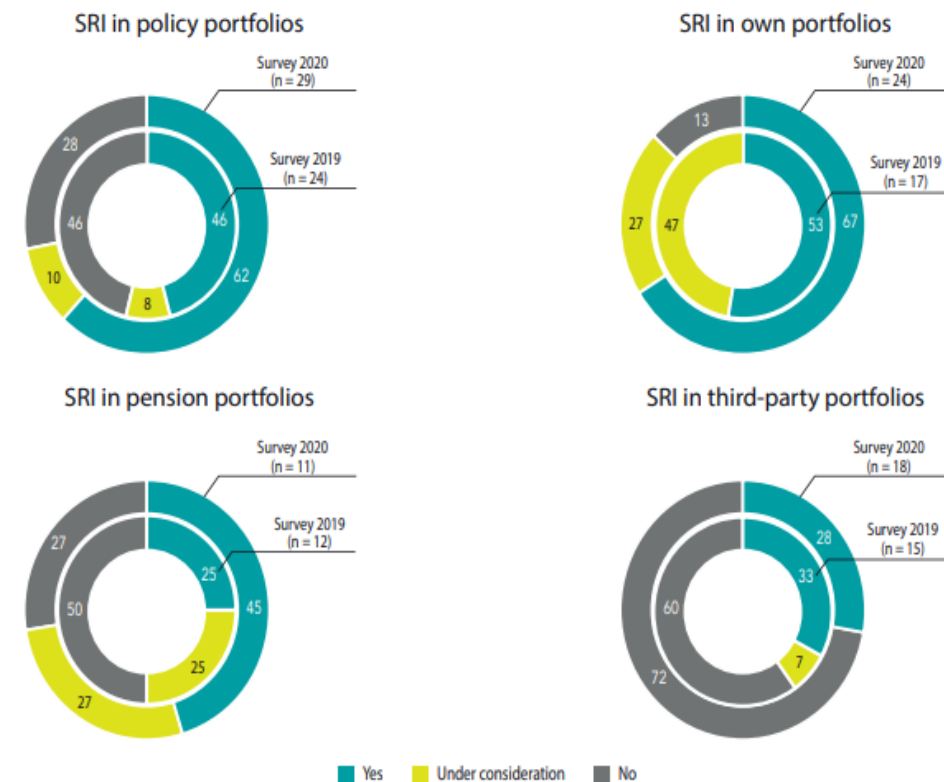
Recommendations

5.  Achieving robust and internationally consistent climate and environment-related disclosure.
6.  Supporting the development of a taxonomy of economic activities.

Source: NGFS (2019). A call for action. Climate change as a source of financial risk. Comprehensive Report.

C2 SRI practices in central banks' portfolios

(%)



Source: NGFS portfolio management survey 2020.

Note: The number of respondents varies by portfolio type and year (as indicated above).

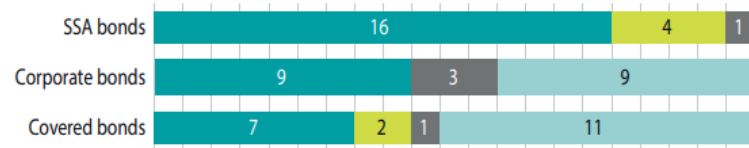
Source: NGFS (2020) Progress report on the implementation of sustainable and responsible investment practices in central banks' portfolio management

2. CENTRAL BANKS LEAD BY EXAMPLE

Network for Greening the Financial System

C9.1 Green bond investments per portfolio type

Policy portfolio (foreign currency) (n = 21): Green (or thematic) bonds

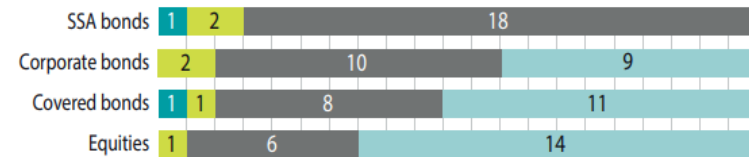


Pension portfolios (n = 8): Green (or thematic) bonds

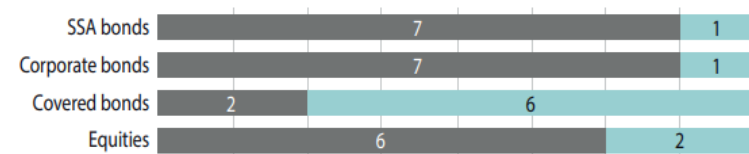


C9.2 Impact investments per portfolio type

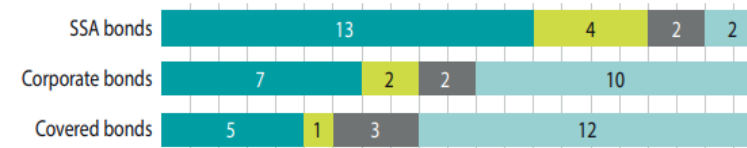
Policy portfolio (foreign currency) (n = 21):
Impact investing (beyond green bonds)



Pension portfolios (n = 8): Impact investing (beyond green bonds)



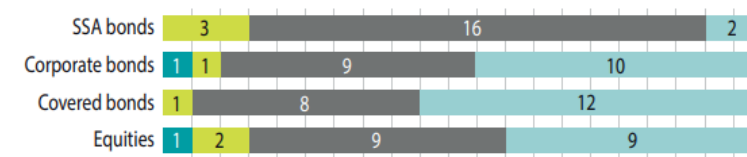
Own portfolios (n = 21): Green (or thematic) bonds



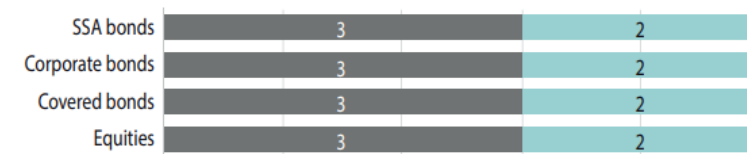
Third party portfolios (n = 5): Green (or thematic) bonds



Own portfolios (n = 21): Impact investing (beyond green bonds)



Third party portfolios (n = 5):
Impact investing (beyond green bonds)



■ Yes ■ Under consideration ■ No ■ Not invested

Source: NGFS portfolio management survey 2020.

Note: The number of respondents varies by portfolio type (as indicated above), and only reflects those central banks that have adopted some form of SRI practices in the respective portfolio.

2. CENTRAL BANKS LEAD BY EXAMPLE

Why Central Banks (Eurosystem) consider SRI strategies?

Maintain price stability



Taking the impact of climate change into consideration and promote a low-carbon economy transition

Supporting Europe's economic policies



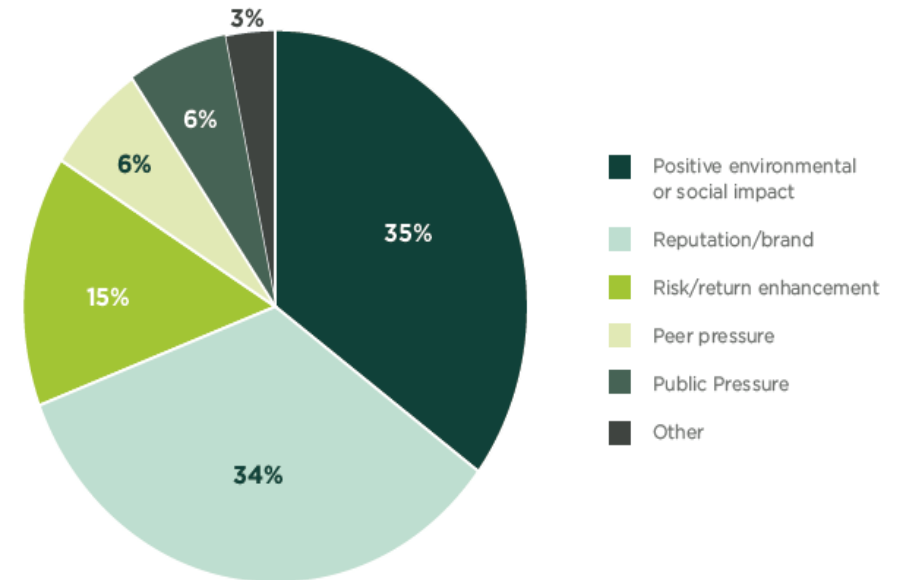
Sustainable development of Europe

Climate risk management related to the investments



Direct impact on the risk profile and performance of the reserves

Figure 1. Motivations of Central Banks That Consider ESG



N=33.

Source: World Bank Treasury.

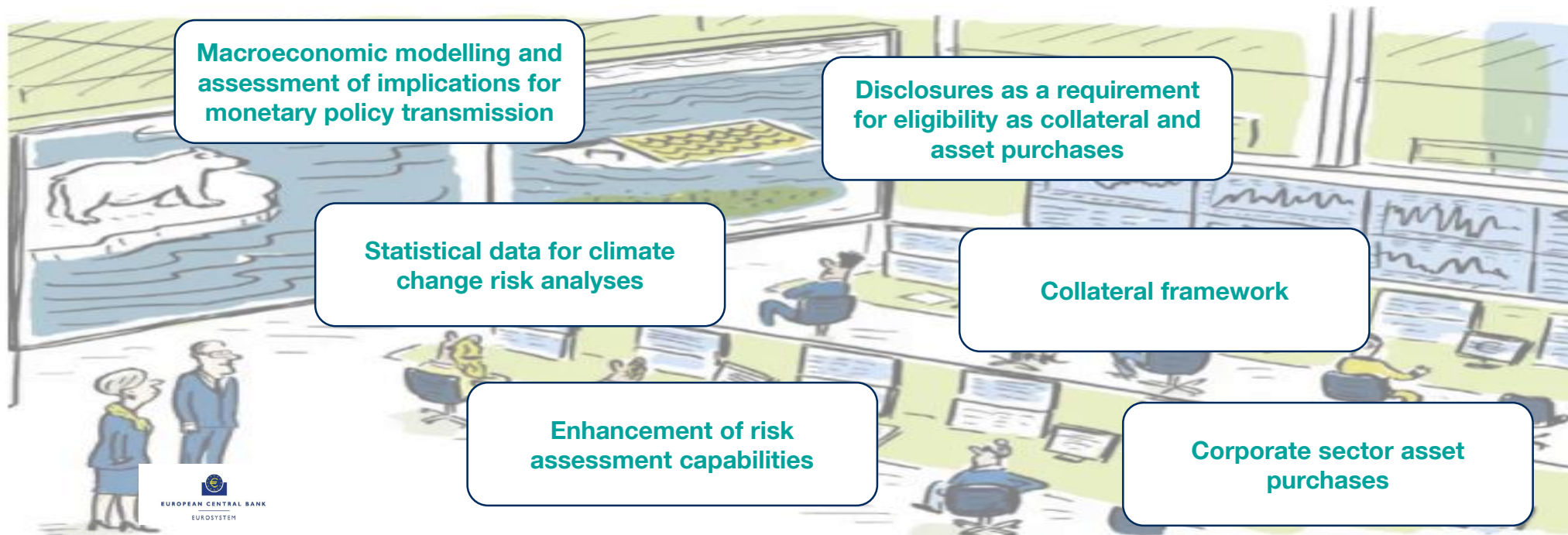


PRESS RELEASE

ECB presents action plan to include climate change considerations in its monetary policy strategy

8 July 2021

Roadmap 2021 – 2024





PRESS RELEASE

Eurosystem agrees on common stance for climate change-related sustainable investments in non-monetary policy portfolios (euro-denominated)

4 February 2021



- **The common stance will help all Eurosystem members to contribute to the transition to a low-carbon economy and to EU climate goals.** It will increase the awareness and understanding of climate risks while promoting climate-related disclosures.
- **It is aligned with NGFS recommendations.**
- **Eurosystem aims to start climate-related disclosures for these types of portfolios within two years using the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD) as the initial framework and reporting, as a minimum, in the category of metrics and targets.**

2. CENTRAL BANKS LEAD BY EXAMPLE

Eurosystem's peers



- Responsible investment (RI) approach for **own funds** and **pension liabilities investment portfolios**.
- EUR **1.6 billion** invested in **green bonds**.
- EUR **355 million** invested in Energy and Ecological Transition **thematic funds**.

Responsible Investment Report 2021



- **Socially responsible investment policy** for **own reserves**.
- **Filter** for **investment** and (potential) **counterparties** to ensure that they meet ESG criteria.
- Investment in **green bonds**. At the beginning of 2022, DNB had approximately € **460 million** in green bonds. They expected to invest a **further € 80 million** in green bonds **this year**.

DNB Website - Sustainable investment



- The Bank of Finland considers **ESG factors** on **all phases** of the **investment process**.
- **Investment** in **green, social** and **sustainable** instruments.

Annual Report 2021



- **Sustainable investment strategy** for its **euro-denominated portfolio**, consisting of **two steps**: (1) “**negative screening**”; (2) issuers are grouped according to their **sustainability profile**. The **best** issuers are then weighted **higher** and the worst weighted lower in the benchmark portfolio.

Annual Report 2021



- Since 2019, the Bank of Italy has begun to **integrate ESG criteria** in the management of its **non-monetary policy portfolios**.
- The **share of green bonds** of **sovereign issuers** in the euro area and of supranational institutions is destined to **grow** over time.

Report on sustainable investments and climate-related risks 2021



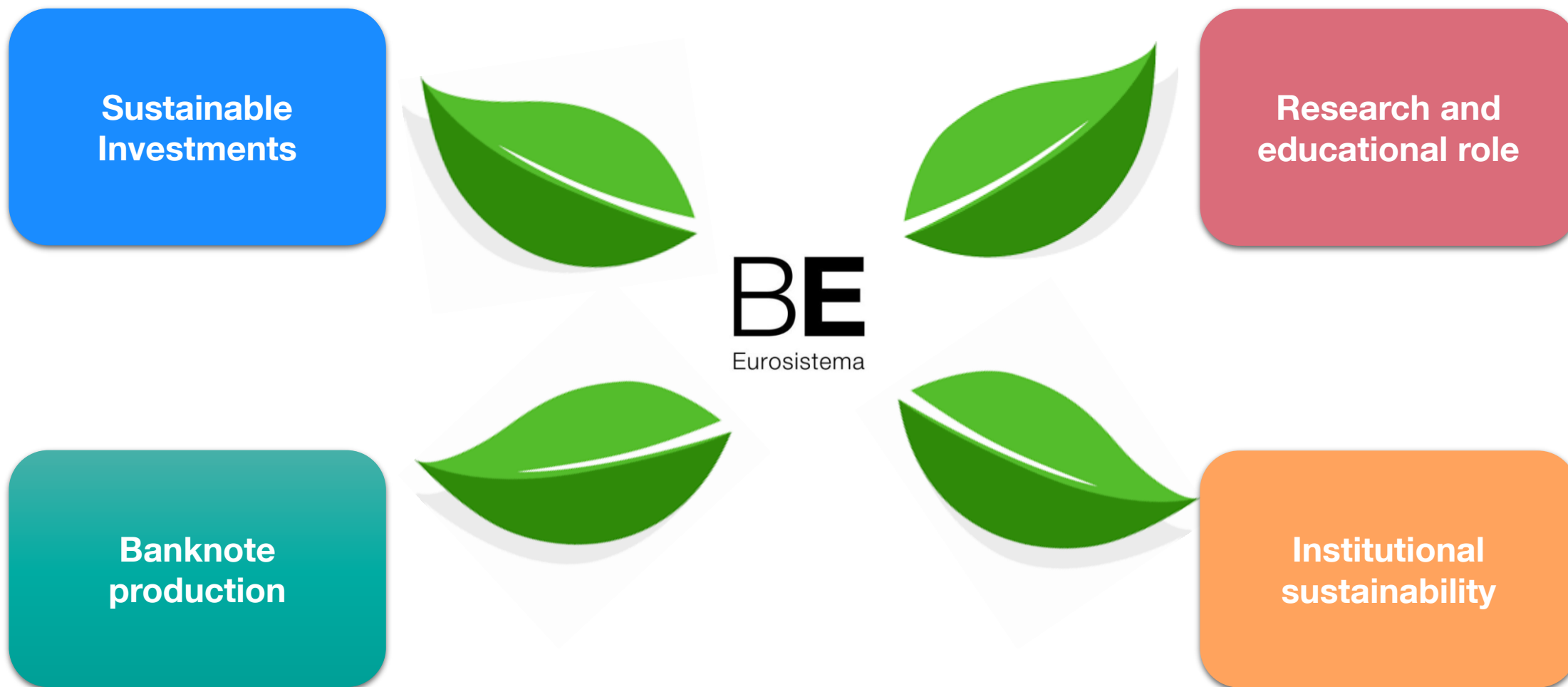
BANCO DE PORTUGAL
EUROSYSTEM

- Incorporation of **sustainability principles** for **own investment assets** in **2019**.
- Investment in the **first BIS green bond fund**.

Sustainability Report 2019-2020

2. CENTRAL BANKS LEAD BY EXAMPLE

Banco de España - from different perspectives



Home > About us > Environmental sustainability > General information > Monetary policy and investment portfolio

Monetary policy and investment portfolio

The fight against climate change and the transition to a carbon-neutral economy requires the mobilisation of a large volume of resources to fund the necessary investments. The financial system has a very important role to play in channelling these resources. Numerous initiatives have been launched by public and private institutions in recent years, to mobilise funding for a transition that will enable climate change to be addressed. At the European level, the work of the European Commission to develop an EU strategy on sustainable finances is notable. An example of this is the creation of an environmental taxonomy.

While, given its nature, the main role in this area corresponds to governments, central banks can play an important role as catalysts and lead by example, to help achieve the Paris Agreement objectives. In particular, the areas central banks are working on include the incorporation of climate change into the implementation of monetary policy and the incorporation of sustainable and responsible investment criteria in the management of their own asset portfolios.

- › Monetary policy implementation
- › Own-portfolio management

Sustainable finance and development of financial markets



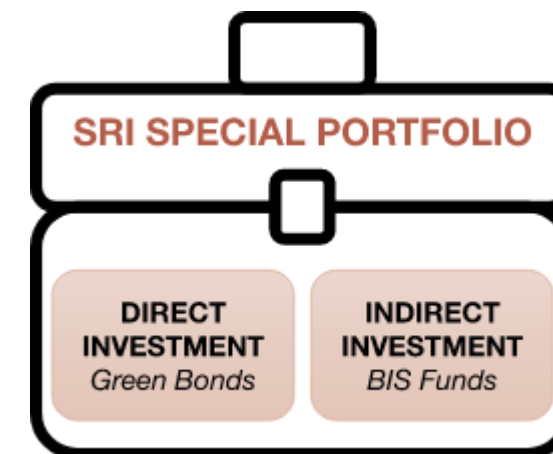
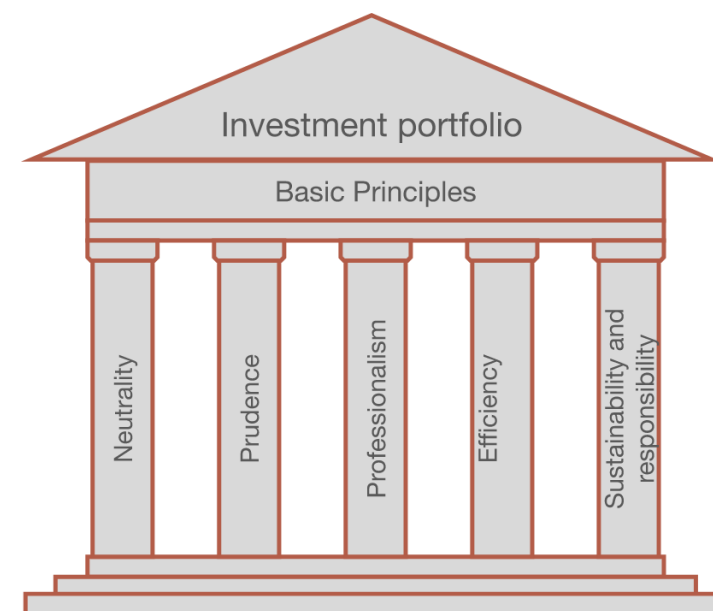
Green factor in financial markets



Issues of green and other bonds associated with sustainability

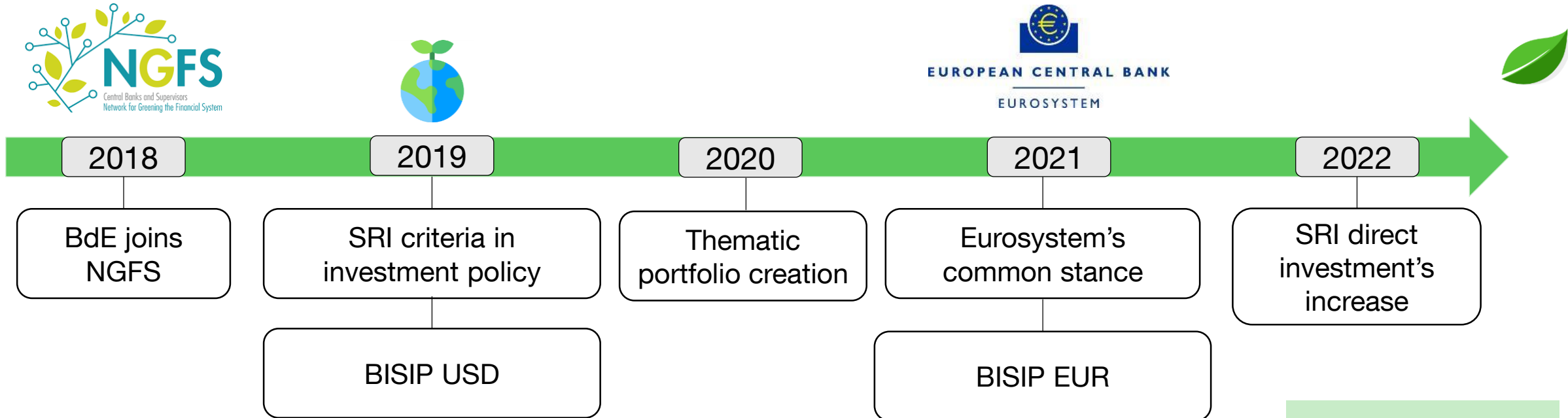


Sustainable finance initiatives



2. CENTRAL BANKS LEAD BY EXAMPLE

Banco de España. Milestones



- **2018** → Banco de España joined the **Network for Greening the Financial System (NGFS)**
- **2019** → Adding **SRI criteria** in our **own portfolios**
- **2020** → Construction of a **thematic portfolio**
- **2021** → Banco de España adopts the **Eurosystem's common stance** for sustainable investment

INVESTMENT PRINCIPLES

Neutrality
Prudence
Professionalism
Efficiency
Sustainability and
Responsibility

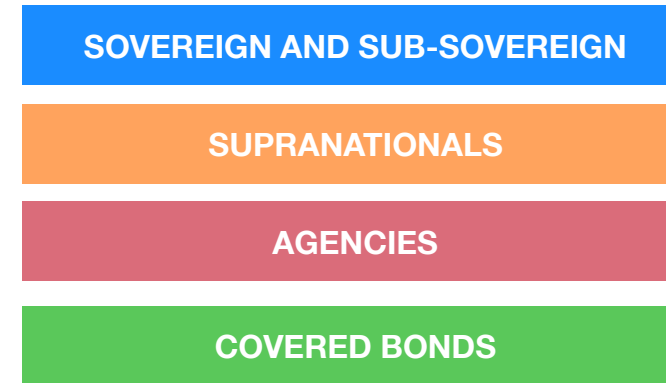
2. CENTRAL BANKS LEAD BY EXAMPLE

Banco de España. Own portfolios. Total Investment

BY CURRENCY



BY ASSET CLASS*



DISTRIBUTION BY TYPE OF MANAGEMENT



As of 06/10/2022.

Source: MAPS.

* Direct investment only.

SRI implementation is not straightforward. It poses challenges for central banks



What does the impact of an SRI strategy depend on?

- the **purpose** of a Central Bank's reserves
- the **framework** for implementing the strategy
- the investment **style**
- the **size** of the investment
- the investment **horizon**
- the asset **composition**
- the level of **data development** on each asset class



Factors to consider when choosing a strategy

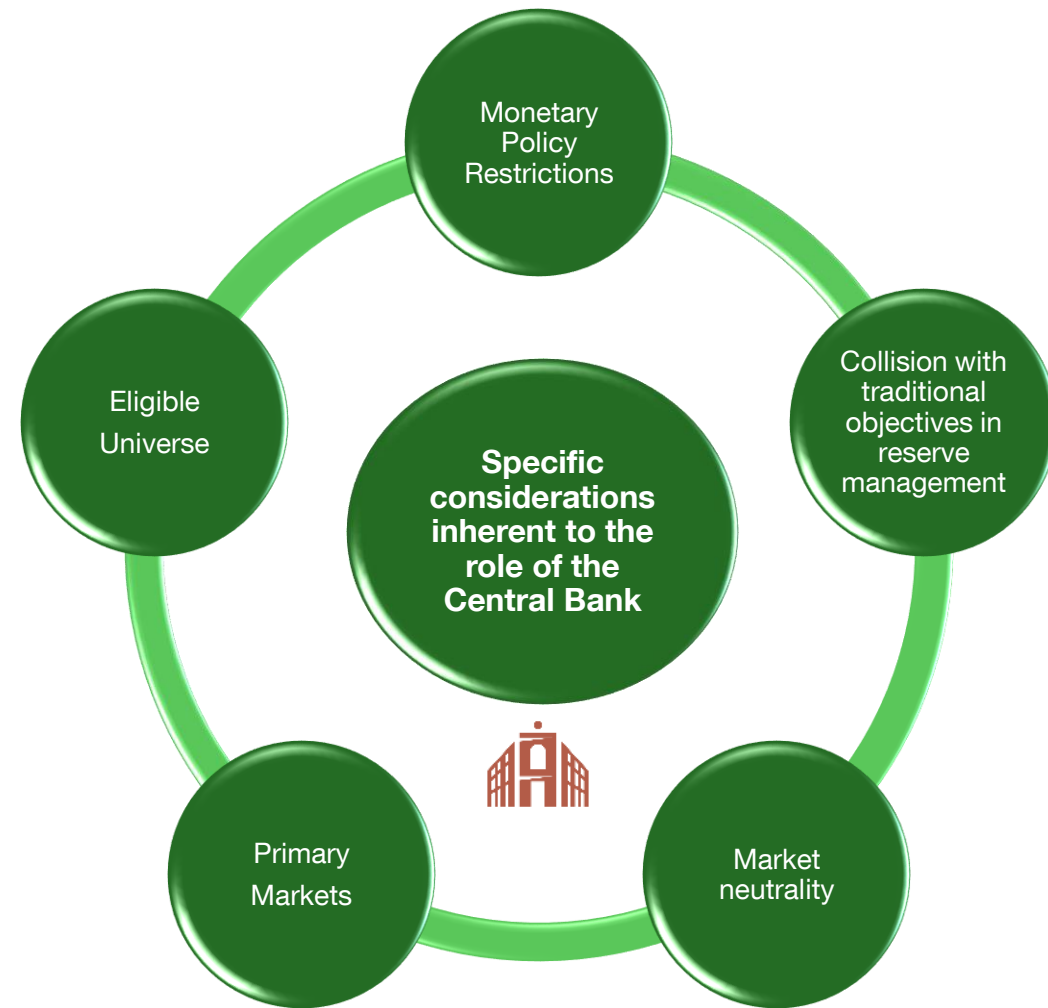


Political neutrality

Avoid that a given action can be interpreted as a judgment on governments' implementation of the Paris Agreement and EU Green Deal commitments.

Market neutrality

Any reallocation decision could affect financial markets and interfere with market price formation mechanisms.



When you try to go faster than the situations allows you (taxonomy, legislation, market developments), you risk opting for easy routes:

Sustainable is not:

- Publishing anything pretending it is sustainable.
- Recycling as SRI your old portfolio
- Demanding issuers for things that are not in the regulation.

Greenwashing!!!



You need to establish solid foundations before announcing that you are **green**.



- **Know your market: what is Green and what is not.**
- **Issuers need time to fill the regulation requirements (time that is given by the regulation!).**
- **Decide how to treat sovereign debt vs. corporate debt**
- **Decide how to treat debt vs. Equity.**
- **Move from production-centered metrics to consumption-based ones.**
- **Look for forward looking approaches rather than backward looking ones.**

THANK YOU FOR YOUR ATTENTION



GRACIAS POR SU ATENCIÓN

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