INSIGHT

How Central Banks Can Promote Sustainable and Responsible Investment

Sustainable and responsible investment puts a premium on projects with positive social and environmental impacts. Photo credit: ADB.

This piece discusses how central banks can take the lead in addressing climate-related risks in the finance sector.

Introduction

Sustainable and responsible investment has generated a lot of attention nowadays as the impacts of climate change continue to expose humanity to various risks. This kind of investment takes sustainable development priorities into account, making sure that the needs of the current generation are met without compromising the ability of future generations to meet their own.

In recent years, central banks and sovereign wealth funds in major economies began to adopt the principle of sustainable and responsible investment in portfolio management.

Analysis

According to the 2018 Intergovernmental Panel on Climate Change (IPCC) report, the global temperature is expected to rise by 1.5? between 2030 and 2052 if greenhouse gas emissions continue at the current rate. Coronese et al. (2019) argued that the magnitude of property loss stemming from environmental disaster is growing larger even when accounting for inflations and the scope of the damaged area, and warned that insurance firms' financial loss could increase exponentially.

In response, the Republic of Korea's National Pension Service?which oversees funds worth over 700 trillion won (more than $500 billion)?plans to require asset management firms that manage pension funds to report on the status of their responsible investment starting 2020.

In March 2019, De Nederlandsche Bank signed the Principles for Responsible Investment and subsequently began to adopt environmental, social, and governance elements to investment. The bank's new corporate social responsibility strategy now focuses on achieving sustainable economic growth that has no harmful effects on the environment and an inclusive financial and economic system. It targets to invest its assets in a responsible manner by screening investment portfolios based on environmental, social, and governance criteria and by developing a responsible investment approach.

In November 2019, Riksbank of Sweden announced that it disposed of the bonds issued by the state of Alberta in Canada and the state of Queensland in Australia, citing their high level of greenhouse gas emissions as the reason. Alberta emits greenhouse gas three times more than Ontario or Quebec due to oil production. Meanwhile, Queensland is known to be the largest greenhouse gas-emitting state in Australia.

The Network for Greening the Financial System (NGFS)?launched in 2017 as a committee among eight central banks and supervisory authorities?recently published a report to guide central banks on how to leverage sustainable and responsible investment in their portfolios. Central banks can set financially sustainable and responsible investment goals in consideration of how climate change and related risks affect an investment portfolio. Meanwhile, they can also set non-financial goals based on how an investment portfolio affects the environment or the larger society.

NGFS emphasized that investors, other than central banks, can also reduce reputational as well as environmental, social, and governance-related risks by practicing this kind of responsible investment.

Implication

Central banks can take several strategies in applying responsible and sustainable investment.

- **Excluding regions, countries, or companies that go against the ethos of sustainable or responsible investment through negative screening.**
  In Norway, Norges Bank organized an independent ethical committee and stopped investing in 30 companies that have problems relating to governance and sustainability, and an additional 15

companies related to climate change.

- **Putting a premium on the environment, social, and governance elements of traditional financial performance.**
  Bank of Italy no longer invests in companies whose environmental, social, and governance score falls below the acceptable level.
- **Investing in projects that have a direct social and environmental impact**.
  Banque de France adopted an investment strategy to implement the Paris Climate Change Agreement. The bank also selects investment projects based on the impact to energy and environment.
- **Guiding companies to behave in a certain way by exercising voting rights or making management proposals.**
  Swiss National Bank has been influencing shareholder behaviors at shareholder meetings since 2015 to enhance corporate governance. In November 2019, Bank of Korea joined NGFS to actively participate in global discussions on environmental issues, strengthening efforts for sustainable and responsible investment.

Meanwhile, more attention is needed to encourage the private sector to apply these strategies and establish concrete implementation plans.

Resources

DeNederlandscheBank. 2019. *DND First Central Bank to Sign the Principles for Responsible Investment.*

DeNederlandscheBank. *Responsible Investment Charter.*

IPCC. Global Warming of 1.5 °C – A Special Report.

Network for Greening the Financial System. 2019. *A Sustainable and Responsible Investment Guide for Central Bank's Portfolio Management.*

SRI-Connect. Sustainable & Responsible Investment - A Basic Definition.

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The Korea Institute of Finance provides expert analysis for the development of the Republic of Korea's financial sector and financial policy.

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