Sabine Mauderer: Scaling up green finance - the role of central banks

Speech by Dr Sabine Mauderer, Member of the Executive Board of the Deutsche Bundesbank, at the 2019 Green Bond Principles and Social Bond Principles Annual General Meeting and Conference, Frankfurt am Main, 13 June 2019.

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Ladies and gentlemen,

I am delighted to speak to you right here in the middle of Frankfurt's famous Palmengarten. The Palmengarten was opened in 1871, and, like many sights in Frankfurt at that time, was financed by a private civic initiative. To raise the necessary funds, several citizens founded the Palmengarten stock company. The Palmengarten is an early example of a fruitful combination: of green and finance. Even now, the Palmengarten is close to green finance: KfW, the biggest German Green Bond issuer is located close to the Palmengarten. And the Bundesbank, which is also closely involved in Green Finance, is located just north of the Palmengarten.

A "Green Week" is currently taking place in Frankfurt, with all ICMA and sideline meetings. The "Green Week" originally was, and still is, a large and famous agricultural fair in Berlin. As Frankfurt is the financial centre of Germany, it is the perfect place for the "Green Finance Week".

In my speech, I wish to focus on three topics:

First, the Green Finance activities of the international Central Banks and Supervisors Network on Greening the Financial System, or NGFS, of which the Bundesbank is a founding member. Second, let me provide some insights into the Bundesbank's activities on Green Finance in our different business areas. Third, I will briefly take stock of current German political initiatives on Green Finance.

1 NGFS Activities

Beginning with the NGFS, let me first point out the key message of our network: Central banks all over the world acknowledge that climate change is a source of financial risks. Therefore, green finance is a field of work for central banks and the whole financial sector. Combating climate change and preserving the environment: this is no longer a hobby-horse of eco-activists, but a key factor for economic and financial systems. This awareness can be seen in the growing support for NGFS: We started with central banks and supervisors from eight jurisdictions and have grown to 40 members and six observers, representing all five continents and overseeing two-thirds of the globally systemically important financial sector. We are, so-to-say, a "coalition of the willing".

Central banks always play a key role in the financial system, and this is also the case for green finance. In many ways, the market for green assets can be compared to the early stages of other relatively new market segments. For market dynamics to fully unfold, investors need a stable investment framework, including reliable market standards, market indices and transparency. And central banks are trusted parties. Given our advisory role in politics and our perceived role as anchor investors, we can serve as catalysts for further market growth. But given our enormous market power and our independence, we have to act responsibly and be accountable. To address central banks' crucial role, the NGFS sees itself as a platform for best practices and for the exchange of views and experience between central bankers and supervisors.

In our first comprehensive report, published in mid-April, we put forward six practical recommendations.

The four recommendations addressed to central banks and supervisors are:

1. Integrating climate-related risks into financial stability monitoring and micro-supervision. This includes assessing climate-related risks in the financial system and integrating them into prudential supervision.
2. Integrating sustainability factors into own portfolio management. The NGFS encourages central banks to lead by example in their own operations.
3. Bridging data gaps. Public authorities are asked to share data relevant to Climate Risk Assessment and make these data publicly available.
4. Building awareness and intellectual capacity and encouraging technical assistance and knowledge-sharing. The NGFS encourages all financial institutions to build in-house capacity and to collaborate to improve their understanding of how climate-related factors translate into financial risks and opportunities.

Two NGFS recommendations are addressed to policymakers:

Achieving robust and internationally consistent climate and environment-related disclosure. Investors need to know about the climate risks in their investments.

And supporting the development of a taxonomy of economic activities. A taxonomy makes investing green easier and prevents “green washing”. It creates more market transparency on which activities are really green and which are not.

The NGFS is tackling these challenges in three workstreams: on banking supervision, on macrofinancial supervision and on scaling up green finance. I am a member of the NGFS steering committee and, as of April, I have also taken over the chair of workstream 3. Tomorrow, workstream 3, hosted by the Bundesbank, will convene here in Frankfurt. As a deliverable for this year, we are working on a handbook of best practices for incorporating sustainability criteria into central banks’ portfolio management, with a particular focus on climate-friendly investments. We plan to publish the handbook by October this year.

2 Bundesbank Activities

As you can see: the Bundesbank is an active member of the NGFS. And to confirm our strong commitment to the issue, we have also integrated green finance into our own business areas.

Under my leadership as the responsible board member for the Bundesbank’s market-related operations, we manage public sector funds as well as our own funds. Looking at the public sector funds, we have a long track record in sustainable investments. As a fiscal agent, Bundesbank has been managing several large-scale public pension fund portfolios for Federal states as well as the central government for more than ten years. 4 out of 16 portfolios are already invested according to an ESG approach or invest in Green Bonds. In total, these portfolios have a volume in the range of substantial single-digit billions of euros. And we expect this number to grow in the near future. Four more fiscal clients are currently discussing introducing ESG considerations in their investment strategy, while additional two are already planning to do so. So 10 out of 16 of our fiscal clients are investing sustainable or are on their way to do so.

Our public sector clients mainly focus on the inclusion of ESG criteria in equity investments, followed by initial approaches in fixed-income portfolios. Based on a passive investment strategy, we combine various best-in-class approaches with exclusionary screening. Our experience over the past few years has shown that developing a sustainable investment strategy requires thorough preparation. There is no “one-size-fits-all” approach to ESG criteria. Moreover, when talking about sustainable investing, each investor tends to define a set of ESG criteria consistent with its individual values. Furthermore, we advise our fiscal clients, namely the states of Hesse, Baden-Wuerttemberg and North Rhine-Westphalia, to design and create tailor-made sustainability and ESG indices that we use for our benchmarking.

Moreover, the Bundesbank is also considering investments in sustainable assets in its own funds. We enjoy more freedom of choice with regard to the selection of investments in our own funds, unlike – for instance – in the FX reserve management portfolios or even with monetary policy operations. We are currently in the process of assessing ways we can enlarge the scope of assets and take sustainable investment criteria into account in our own funds. We also contribute to a Eurosystem working group on sustainability in the management of non-monetary portfolios.

As regards monetary policy, we have to be careful not to jeopardize our primary mandate of price stability by pursuing other policy objectives. However, since market neutrality is an integral principle of our monetary policy operations, sustainable assets are alongside the market within the scope of the Eurosystem's asset purchase programme. So the more the market is invested in green finance, the more the ECB and the national central banks can reflect this development in the asset purchase programme.

Besides the investments, the Bundesbank is closely looking at the risks resulting from climate change. We look at individual risks in our banking supervision and at systemic risks in our supervision of financial stability. We are making the case for individual financial institutions to disclose their climate-related financial risks and look at these risks in banking regulation and supervision. Regarding financial stability, we evaluate whether the financial system as a whole is able to deal with asset devaluations resulting from physical climate risks or from transformation risks following political decisions to address climate change, for example on energy policies.

Furthermore, the Bundesbank is intensifying the public dialogue to raise even more awareness among market participants and the general public. In the fourth quarter of 2019, we will publish a report which analyses major market trends in ESG and green finance including an outlook on the way forward. And we are organising a financial markets conference on sustainability in October.

3 Government Activities

All this comes at a time when German politics has been paying ever-closer attention to Green Finance, as climate protection commands broad support across virtually the entire political spectrum. In February, the State Secretaries' Committee for Sustainable Development declared that Germany should become a leading hub for sustainable finance. Chancellor Merkel reaffirmed this aspiration just a few weeks ago.

And just last week, the Federal Government's new Sustainable Finance Advisory Committee met for the first time. The Bundesbank is an advisory member of this committee. The committee is tasked with monitoring the European discussion on sustainable finance, improving knowledge, strengthening sustainable finance and, of course, advising the government. The government is also planning a strategy for communicating to consumers and the financial industry to promote green finance. And the government plans to further discuss greening their own pension fund portfolios.

Most important for market participants: the idea of issuing a Green Bund is gaining traction. There are different models and ideas of how to design such a Green Bund. The challenge is to establish this Green Bund on the market while neither affecting the high secondary market liquidity of conventional Bunds nor fragmenting the existing financing instruments. Gathering from recent experience of other AAA issuers, we can expect a high demand for a Green Bund.

4 Conclusion

Ladies and gentlemen, the current Frankfurt Green Finance Week is not a one-hit wonder, but an evergreen: Our work for scaling up green finance will continue – as a central bank, but also in the political arena.

Green Finance will also be an important task for the new European Parliament and European Commission. The EU action plan on sustainable finance will definitely shape our work going forward. So we will not only have “Green Weeks” in Berlin and Frankfurt, but also green months and years in Brussels.

Let us all keep the spirit up and work together to scale up green finance. Thank you for your attention.