



Responsible investment: an issue of growing importance for the Banque de France and the central banking community

Over recent years, responsible investment has come to the fore as a major focus of work by central banks.

The Central Banks and Supervisors Network for Greening the Financial System (NGFS), whose secretariat is provided by the Banque de France and based in Paris, has played a driving role in encouraging NGFS member central banks to integrate sustainability factors into own-portfolio management and thus set an example for other financial participants.

The Banque de France is a pioneering presence within this community. In 2018, it adopted a responsible investment charter, which it implements operationally through the responsible investment strategy applied to its own investments (EUR 23 billion). Recently, the Banque de France announced that it was stepping up its fossil fuel exclusions and aims to exit coal completely in 2024.

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JEL codes
G11
and G23

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EUR **23** billion

total assets in portfolios to which the Banque de France applies its responsible investment strategy

2024

target date for completely exiting coal and capping oil and gas;
2021 for unconventional hydrocarbons

The Banque de France's responsible investment strategy in 2021

3 PILLARS

Pillar 1

ALIGN INVESTMENTS WITH FRANCE'S CLIMATE COMMITMENTS

Pillar 2

INCLUDE ENVIRONMENTAL, SOCIAL AND GOVERNANCE (ESG) CRITERIA IN ASSET MANAGEMENT

Pillar 3

EXERCISE VOTING RIGHTS AND ENGAGE WITH ISSUERS

Source: Banque de France.



1 Sustainable and responsible investment: one of the NGFS's work priorities

Since its inception, the NGFS has prioritised sustainable and responsible investment

In December 2017, at the One Planet Summit in Paris, the Banque de France took the initiative to create the Central Banks and Supervisors Network for Greening the Financial System (NGFS)¹ alongside seven other central banks and supervisory authorities.^{2,3} It has acted as the secretariat for the network since that time. The NGFS is a "coalition of the willing": it is a voluntary forum with three key purposes: to share best practices, contribute to the development of climate and environment-related risk management in the financial sector and mobilise mainstream finance to support the transition towards a sustainable economy. Climate change is one of many sources of structural change affecting the financial system. Because of its distinctive characteristics, including its irreversibility, its non linearity and its medium/long-term time horizon, climate change needs to be considered and managed differently and addressed through specific work projects.

In April 2019, the NGFS published its first comprehensive report⁴ during a conference at the Banque de France's headquarters.⁵ The report presented four non-binding recommendations to be implemented by member central banks and supervisors:⁶

- No. 1: integrating climate-related risks into financial stability monitoring and micro-supervision;
- No. 2: integrating sustainability factors into own-portfolio management;
- No. 3: bridging the data gaps;
- No. 4: building awareness and intellectual capacity and encouraging technical assistance and knowledge sharing.

Recommendation No. 2 deals specifically with the topic of sustainable and responsible investment. The NGFS encourages central banks to lead by example in their own operations. Without prejudice to their mandates and status (as institutional configurations may vary between jurisdictions), this includes integrating sustainability factors into the management of some portfolios (own funds, pension funds and foreign reserves to the extent possible).

In its report, the NGFS identified several potential benefits to this approach:

- the assessment of sustainability factors, in addition to traditional financial factors, can help central banks, in their capacity as investors, to improve their understanding of long-term risks and opportunities and thereby enhance the risk-return profile of their long-term investments. This approach may also be taken to show an example to other financial participants;
- central banks can reduce reputational risks by acknowledging financial risks related to the transition towards a carbon-neutral economy and by addressing these risks proactively in their own (risk) frameworks;
- central banks may decide to employ part of their investments to pursue non-financial sustainability goals in order to generate positive (societal) impacts, in addition to traditional financial return goals. In this way, central banks can also actively support the development of the market for green and sustainable assets.

1 Link to the NGFS website: <https://www.ngfs.net>

2 See press release from the eight founding members: https://www.banque-france.fr/sites/default/files/medias/documents/joint_statement_-_greening_the_financial_system_-_final.pdf

3 See updated list of NGFS members: <https://www.ngfs.net/en/about-us/membership>

4 https://www.ngfs.net/sites/default/files/medias/documents/ngfs_first_comprehensive_report_-_17042019_0.pdf

5 For more information: <https://www.ngfs.net/node/217687>

6 Two other recommendations highlighted actions that can be taken by policymakers to facilitate the work of central banks and supervisors: Recommendation No. 5 aims to achieve robust and internationally consistent climate and environment-related disclosure; Recommendation No. 6 is designed to support the development of a taxonomy of economic activities.



Work by the NGFS has driven increasing engagement by central banks in support of responsible investment

In October 2019, the NGFS published *A sustainable and responsible investment guide for central banks*,⁷ which it updated and expanded in December 2020.⁸ These documents present the range of strategies⁹ available to central banks and are designed to be practical handbooks to guide the institutions in their approaches, for while sustainable and responsible investment is not the sole preserve of central banks, they do have to contend with specific constraints stemming from their mandates and the composition of their portfolios.

The concept of sustainable and responsible investment covers a wide range of objectives, strategies and investment practices. Objectives may include specific recognition of climate considerations – this is true for half of all central banks surveyed, a significantly higher proportion than last year –, or they may address environmental, social and governance (ESG) considerations more generally.

Noteworthy progress has been made in barely a year: 88% of central banks that responded to the questionnaire in 2020¹⁰ have begun to implement sustainable and responsible investment practices. Crucially, the shift is apparent across all portfolios. Based on the NGFS's work, a number of observations may be made, including:

- **central banks seem to be guided more by extra-financial considerations than by strictly financial considerations.** Accordingly, reputational risk and the desire to lead by example are among the main reasons given for implementing sustainable investment strategies, ahead of protecting against the risks posed by climate change to investment portfolios;
- **central banks apply sustainable and responsible investment principles mainly to portfolios held on own**

account, for which they are subject to fewer mandate-related constraints. However, a significant proportion of them also apply responsible investment principles to their foreign reserves portfolios;

- **the approaches taken vary in complexity across central banks and portfolios:** impact investments (including green bonds) and the application of exclusionary filters (exclusion of certain securities based on predefined criteria, often norm- or sector-based) are the most commonly applied approaches, followed by ESG integration. These approaches look set to grow more complex. To give an example, exclusionary filters are still fairly “neutral” for the most part, i.e. they exclude the securities of companies that breach international conventions on controversial weapons or the United Nations Global Compact. But climate criteria are starting to be added, as illustrated by the sector exclusion strategy implemented by the Banque de France (see Section 2 below). Central banks could also tap into advances in the development of methodologies and benchmarks aimed at allowing investors to align their portfolios with climate criteria;
- **overall, central banks still have work to do in terms of monitoring and disclosure tools for sustainable and responsible investment strategies, and in terms of formal arrangements for governance structures and risk management practices.** A third of participants measure the carbon footprint of their investment portfolios, with only half of these respondents making this information public. Just 10% apply the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD). To date, only four central banks have signed up to the Principles for Responsible Investment (PRI);
- **one of the main difficulties encountered is linked to inadequate quality and insufficient comparability of climate and ESG data.** Yet these data are essential to implementing investment strategies and risk management and monitoring practices.

⁷ https://www.ngfs.net/sites/default/files/medias/documents/ngfs_a_sustainable_and_responsible_investment_guide.pdf

⁸ https://www.ngfs.net/sites/default/files/medias/documents/sri_progress_report_2020.pdf

⁹ Five non-exclusive types of strategies can be implemented, namely negative screening, best in class, ESG integration, impact investing (including green bonds), voting and engagement.

¹⁰ The NGFS guides were drawn up in part from a questionnaire sent to NGFS members that drew responses from 27 central banks in 2019 and 40 in 2020.

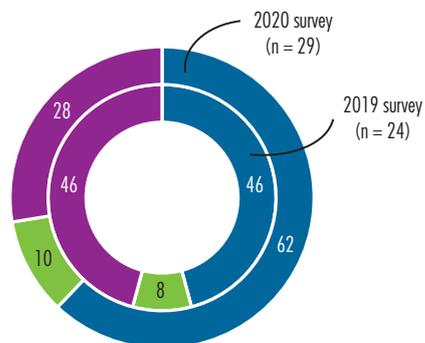


Sustainable and responsible investment practices in central bank portfolios

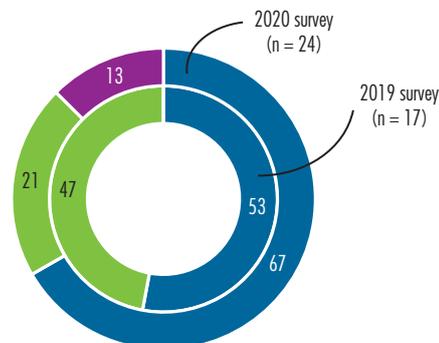
(%)

■ Yes ■ Under consideration ■ No

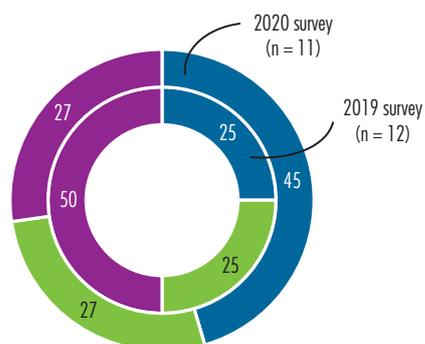
a) In policy portfolios



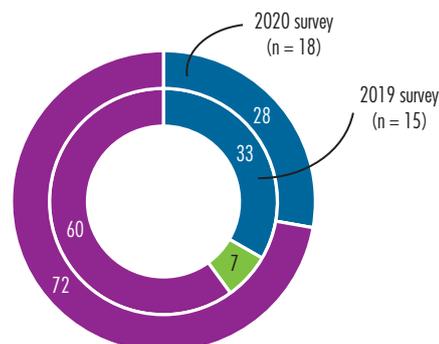
b) In own portfolios



c) In pension portfolios



d) In third party portfolios



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

Overall, the shift is under way and is set to gather momentum, not just in investment strategies and practices but also in transparency. Experience-sharing within the NGFS is precisely intended to enable a growing number of central banks to take this path and improve their approaches, drawing inspiration from more advanced colleagues.

2 After adopting a pioneering approach in 2018, the Banque de France is continuing to develop its strategy

In his foreword to the Banque de France's *Responsible Investment Report 2020*, Governor François Villeroy de Galhau said: "The Banque de France is deeply

committed to helping to achieve the goals of the Paris Agreement and to promoting the growth of sustainable finance more generally. [...] It has pursued an ambitious responsible investment approach since 2018."

Building on the 2015 Paris Agreement and the One Planet Summit in 2017, the Banque de France adopted a responsible investment charter in March 2018. The charter applies to the asset portfolios for which the Banque de France has full responsibility, namely the portfolio backed by its own funds and the portfolio backed by its pension liabilities (total assets of around EUR 23 billion at 31 December 2020), both of which are managed by the Finance Directorate.¹¹ Among other

¹¹ These assets exclude securities held for monetary policy purposes under the mission entrusted to the European System of Central Banks by the Treaty on the Functioning of the European Union (TFEU).



things, the charter states that the Banque de France will integrate ESG criteria in the management of these assets and report on its strategy in a specific annual report.

In March 2019, the Banque de France established its strategy and presented it in its first *Annual Report on Responsible Investment*. The Banque de France applies a double materiality principle, considering not only the impact of climate risks on its own assets but also the impact of its portfolios on the environment and the climate. By doing this, the Banque de France hopes to limit the physical and transition risks to which its portfolios are exposed, while simultaneously improving the overall environmental impact of the assets that it finances. In this regard, it contributes to meeting the Sustainable Development Goals (SDGs) adopted by the UN in 2015.¹²

The Banque de France's responsible investment strategy is structured around three pillars (climate, ESG and engagement), which are themselves separated into five objectives:

Pillar 1: Align investments with France's climate commitments under the 2015 Paris Agreement

Objective No. 1: Align portfolios with a global warming trajectory of below 2°C. The aim is to reduce the carbon emissions linked to assets held, i.e. the companies in the portfolio. Initial efforts were concentrated on the equity component of the own funds portfolio. As part of this, the Banque de France excluded the shares of companies whose carbon emissions were most detrimental to alignment with a 2°C trajectory. Between 2018 and 2019, it successfully moved from a trajectory of over 3°C to a trajectory of below 2°C, in accordance with the target it had set. Between now and the end of 2022, the Banque de France will align the equity component of its pension liabilities portfolio with the same target.

Objective No. 2: Contribute to financing the energy and ecological transition (EET). To this end, the Banque de France invests in green bonds and thematic funds with an EET focus. It thus finances, for example, infrastructures to produce renewable energy, energy refits for buildings,

reduction of pollution linked to marine infrastructure (blue finance) as well as small- and medium-sized enterprises that are EET innovators, i.e. in areas such as energy storage and smart cities. At end-2020, the Banque de France had invested EUR 1.5 billion in green bonds and EUR 205 million in EET funds.

Pillar 2: Include ESG criteria more generally in asset management

Objective No. 3: the Banque de France aims to exclude 20% of its equity investment universe on the basis of ESG criteria and scores. In this regard, it takes its lead from the Socially Responsible Investment (SRI) label established in 2016 by the French Ministry for the Economy and Finance. To achieve the 20% threshold, the Banque de France applies several types of exclusions:

- norm-based exclusions: these particularly concern companies involved in controversial weapons banned by the Oslo and Ottawa conventions, and companies involved in anti-money laundering and counter terrorist financing controversies;
- sector-based exclusions: until the end of 2020, the Banque de France excluded companies that derive over 20% of their revenue from coal. It lowered the threshold to 2% in 2021 and will exit coal completely by the end of 2024. It will also cap its investments in hydrocarbons, i.e. oil, gas and unconventional hydrocarbons;¹³
- ESG score-based exclusions: the Banque de France excludes companies with the worst ESG scores in their sector, as measured by a specialised data provider.

Pillar 3: As shareholder, exercise voting rights and engage with issuers

Objective No. 4: Adopt a voting policy that includes provisions on extra-financial transparency in 2019. The Banque de France has adopted a series of principles that it applies during the general meetings of companies in which it holds shares. These principles cover areas

¹² Notably Goals 7 (energy services) and 13 (climate change prevention).

¹³ See press release: https://www.banque-france.fr/sites/default/files/medias/documents/cp_politique_dinvestissement_responsable.pdf



such as company disclosures on the environmental impact of their activities, gender balance on boards and recognition of ESG performances in executive remuneration. Through its voting policy, the Banque de France also requires companies involved in the coal sector to have an exit plan. In addition, the Banque de France will oppose any new project to develop fossil fuels.

Objective No. 5: Achieve a general meeting attendance rate of over 40% in 2019 and 80% by 2020. These two targets were achieved.

In addition to these objectives, the Banque de France monitors the climate and ESG performances of its portfolios through a series of indicators, including the carbon footprint and intensity of its assets, the green share (sustainable activities as defined by the European taxonomy) and brown share (exposure to fossil fuels) of its portfolios, exposure of its assets to physical and transition risks, and average ESG scores. These indicators are tracked portfolio by portfolio, asset class by asset class (equities, sovereign bonds and corporate bonds), and compared against benchmarks. In 2020, the Banque de France strengthened these analyses further by incorporating monitoring of the biodiversity impact of its portfolios, and by adding new indicators covering the social performances of the portfolios' equity components.

As a result, since 2018, the Banque de France has significantly improved its ESG performances, without its financial results being negatively impacted. In particular, carbon emissions attributable to portfolios have been markedly reduced,¹⁴ notably owing to the strategy of aligning portfolios with a climate warming trajectory of below 2°C. Likewise, the brown share has come down significantly, while the green share has increased and portfolios' average ESG scores have improved.

All of these indicators are presented annually in the Banque de France's *Responsible Investment Report*.¹⁵

This is in compliance with:

- French legal provisions requiring institutional investors to publish information on how ESG issues are recognised in their investments (Article 173 VI of the 2015 Energy Transition for Green Growth Act).¹⁶ Although these provisions do not apply to the Banque de France, they are integrated in the report; similarly, the Banque de France will take into account European regulatory requirements that are currently under development, including Regulation EU 2019/2088 on sustainability related disclosures in the financial services sector (SDFR) and Regulation EU 2020/852 on sustainable investment (the "European Taxonomy" Regulation);
- the TCFD's 2017 recommendations. As these recommendations essentially concern financial materiality (climate-related impact on companies), the Banque de France's report supplements them in order to comply with the double materiality principle;
- Recommendation No. 2 of the first comprehensive report of the NGFS in 2019, which calls for sustainability factors to be integrated into own-portfolio management (see Section 1 above).

The Banque de France is an active member of the Eurosystem working group on responsible investment, which in February 2021 adopted a common stance¹⁷ whereby Eurosystem members committed to establishing responsible investment strategies for managing euro-denominated non-monetary policy portfolios and to publishing the results of these strategies by end-2022 or the beginning of 2023 at the latest. The Banque de France also participates in the NGFS sub-working group on sustainable and responsible investment by central banks and provided input to the two reports published in 2019 and 2020 (see Section 1). Based on these reports, it is clear that the Banque de France has an ambitious position within the central banking community, both in terms of strategy and transparency.

¹⁴ The capital carbon footprint recorded for the equity component of the own funds portfolio has been cut by 51.5% compared with 2018 to 97 tCO₂e per EUR million invested, while the footprint of the pension liabilities portfolio's equity component has been reduced by 34.7% to 94 tCO₂e per EUR million invested.

¹⁵ The report is available at: <https://www.banque-france.fr/en/banque-de-france/corporate-social-responsibility/economic-and-civic-commitment/contributing-responsible-investment>

¹⁶ In March 2021, this article was replaced by Article 29 of the Energy and Climate Act of 8 November 2019.

¹⁷ See press release: https://www.ecb.europa.eu/press/pr/date/2021/html/ecb.pr210204_1~a720bc4f03.fr.html



The Banque de France's responsible investment strategy in 2021

3 PILLARS 5 OBJECTIVES

Pillar 1

ALIGN INVESTMENTS
WITH FRANCE'S CLIMATE
COMMITMENTS

OBJECTIVE No. 1

Align with a 2°C trajectory.
Horizon set at end-2020 for the
equity component of the own funds
portfolio and end-2022 at the latest
for the pension liabilities portfolio



Equity component
of the own funds portfolio 2°C
aligned from end-2019

OBJECTIVE No. 2

Provide EUR 1.7 billion in financing
for the energy and ecological
transition (EET), including
EUR 330 million in investments in
thematic funds with an EET focus



- EUR 1.5 billion invested
in green bonds
- EUR 205 million in investments
in EET thematic funds

Pillar 2

INCLUDE ENVIRONMENTAL,
SOCIAL AND GOVERNANCE
(ESG) CRITERIA IN
ASSET MANAGEMENT

OBJECTIVE No. 3

Equity components to meet
the requirements of Pillar III
of the French SRI label from 2019



20% of equity issuers
excluded on the basis of ESG criteria
from end-2019

Pillar 3

EXERCISE VOTING RIGHTS
AND ENGAGE
WITH ISSUERS

OBJECTIVE No. 4

Adopt a voting policy
that includes provisions on
extra-financial transparency in 2019



Voting policy adopted at end-2019

OBJECTIVE No. 5

Achieve a general meeting
attendance rate of over 40%
in 2019 and 80% by 2020



Attendance rate of 90% at end-2020

Source: Banque de France.



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