Harvesh Seegolam: Current challenges and the pathway to the greening of Reserves Management

Keynote speech by Mr Harvesh Seegolam, Governor of the Bank of Mauritius, at the Pan African Central Bank Conference on Risk and Reserve Management, Port Louis, 22 June 2023.

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- Governor
- Deputy Governors
- Distinguished Guests
- Members of the press
- Ladies and Gentlemen
- All protocol observed

A very good morning to all of you. Let me join my Deputy Governors in extending a very warm welcome to the Governor, Deputy Governors and representatives of central banks to Mauritius. It is with pleasure that the Bank of Mauritius is hosting this Pan African Central Bank Conference on risk and reserve management. I am sure that the last two days have broadened your perspective and equipped you with the requisite knowledge to enhance your skills in the subject matter.

I would also want to laud the German Agency Cooperation (GIZ) and Allianz Global Investors for this initiative across the SADC region, as well as acknowledge the continuous support of the Wits Business School, University of Witswatersrand from South Africa.

My address today will be on a highly topical issue which is increasingly hogging the limelight of sustainable central banking.

Ladies and gentlemen,
According to the World Economic Forum, around 50% of global GDP is moderately or highly dependent on nature. Weather-related disturbances around the world are becoming more frequent and chaotic. Climate-related disasters and their unpredictable patterns have been detrimental to many economies. What is striking with these disturbances is that a localized weather-related shock can unsettle the entire climate pattern throughout the world and generate weather-related hazards in other parts of the world. Examples abound, like wildfires in Australia, droughts in Africa, and floods in Haiti. The list goes on. We have already reached the tipping point regarding the climate issue and the sustainability agenda needs to be at the forefront for us to stand at least a fighting chance. Failure to do so will irremediably move us from the COVID frying pan into the climate fire.

Due to the negative externalities that a weather hazard can pose across countries, efforts spearheaded to address those cannot be limited at the individual country level. Rather, it has become increasingly conspicuous that a global coordinated effort is required to mitigate the problem and adapt to it so that we may protect the planet and preserve inter-generational legacy.

With this in mind, leaders of nations signed the Paris Agreement in 2015 which was, in its own ways, unique compared to previous multilateral agreements that have been signed on climate change. The Paris
Agreement is a major catalyst to raise awareness against global warming and directed the world to the path of low-carbon emissions. However, we still have a long journey ahead of us to limit global warming below the targeted 2 degrees Celsius by 2050. This is not an easy task but I still believe is still achievable.
Progress toward this target demands a multilateral approach topped up with appropriate incentive mechanisms and requiring a common effort from each and every one of us to achieve a 'global public good' that we would not otherwise be able to achieve. This is what environmental economists would call avoiding a collective action problem. To this end, multiple initiatives have been launched: the UN-convened Financial Centers for Sustainability (FC4S), the Network of Central Banks and Supervisors for Greening the Financial System (NGFS), and the G20 Sustainable Finance Working Group (SFWG), to name a few.

Ladies and gentlemen,
Central banks played an active part in this journey towards a greener and more sustainable global economy. Launching the NGFS in 2017 was a milestone in that direction.

Central banks can support the greening of the financial system in various ways. These include: the integration of climate-related risks data into financial stability assessments; usage of adequate taxonomy; proper disclosure requirements; and most importantly, the management of foreign exchange reserves in a more sustainable way.

Traditionally, reserves have been managed under the three main objectives of security, liquidity, and return. With a growing number of central banks becoming more 'climate-change conscious' or rather building an aversion to climate-change, Environmental, Social, and Governance – the so-called ESG - considerations have recently been frontloaded into policy decision-making processes. As a result, they are now emerging as an essential artefact of reserves management objectives.

Central banks that seek to integrate ESG factors into their reserves management decision-making process face somewhat distinct challenges. This is reflective of the diversity among central banks' balance sheet structures and portfolio management philosophies and processes. Much also depends on the level of financial market development, as well as the macroeconomic topography and the degree of monetary policy sophistication. Some central banks which hold insufficient levels of reserves or which pre-dominantly hold reserves as insurance mechanism against external economic shocks, face constrained choices regarding the composition of their reserves portfolio. As a result, they remain committed to liquidity and security constraints and their Strategic Asset Allocation (SAA) allows little room for ESG-based holdings. Other central banks with adequate levels of reserves may have more flexibility in diversifying their portfolio composition to ensure a reasonable dosage of ESG-compliant holdings.
Usually, the incorporation of ESG criteria by central banks falls under three categories:
The first is negative screening which is the most widely used. It simply consists of excluding sectors or companies from the investment universe based on ethical, moral or scientific grounds, e.g., companies with poor environmental credentials. In our case,

we have invested in an ESG fund denominated in Euro. As part of our internally-managed corporate bond portfolio, we have adopted the negative screening and exclusion (UN sanction list). The second category is thematic investing. This directs investment towards specific themes which are expected to improve risk-adjusted return and as well as bring along ancillary societal benefits. The third category is impact investing which is more results-oriented and which looks at policy outcomes alongside financial outcomes.

To illustrate, some central banks have already taken steps to incorporate environmental sustainability considerations within their reserve management framework. Progress on this front is varied. Banque de France, Banco de Mexico, Norges Bank are pioneers in the fields. Others are still at the beginning of the journey, as challenges persist.

In the case of the Bank of Mauritius, in June 2021, the Bank came up with a Guide for the Issue of Sustainable Bonds. The document provides an overview of the requirements and process for the issuance of Sustainable Bonds and the listing of these Bonds on Exchanges licensed in Mauritius. It also seeks to ensure the integrity of the sustainable financing ecosystem in Mauritius and to prevent inter alia "green washing".

According to the World Bank, challenges are four-fold. First, a uniform definition of ESG is still lacking. Second, there is a lack of coherent and consistent accounting and reporting framework and disclosure requirements across jurisdictions. Third, measuring the impact of ESG considerations on financial returns is still inconclusive. Fourth, monitoring progress and appraising performance is difficult in view of lack of availability of proper benchmarks. Challenges tied to the process of gathering and analyzing data may also inhibit the smooth incorporation of ESG considerations into an investment and asset allocation framework.
Ladies and gentlemen

You will concur with me that building internal expertise amongst reserve managers is paramount, given the esoteric and erudite nature of reserves management. According to the NGFS capacity-building is a real challenge across all its members. I am pleased to note that, as indicated in surveys conducted by the Institute of International Finance (IIF) in 2022, central banks are rolling out their plans to upskill their workforce in a myriad of areas surrounding reserve management.

At the height of the pandemic, the Bank came up with the novel idea of setting up of the Mauritius Investment Corporation as a subsidiary. The MIC as it is known in short has been provided with an amount of USD 2 billion out of our reserves to build up the domestic portfolio for generation of wealth for future generations. I must say that the decision has contributed to improve the profitability of the Bank by generating satisfactory returns.

The Gross Official International Reserves (GOIR) remain comfortable, providing adequate buffer against potential adverse external shocks. The GOIR stood at US$6.4 billion as at end-May 2023, representing around 10 months of imports. As our economy continues to recover, the Bank has set as objective the consolidation of its reserves.

The more so that reserve management practices in central banks lag behind the sophistication of other asset managers in institutions which take a more long-term view towards asset management, e.g. pension funds, life insurance companies, endowments and intra-generational Sovereign Wealth Funds (SWFs).

Reserve management activities in central banks tends to be more geared towards establishing a pedestal between short- and long-term considerations. The peculiar nature of central banking in that front means that it is crucial for us to get together and to peer learn from each other's experiences. Collaborating with more experienced asset managers to help transform the reserves portfolio is also an option that may be explored.

Ladies and gentlemen

Sustainability as a reserve management objective needs to be in line with the traditional tenets of safety, liquidity, and return. Being predominantly fixed-income traders, a simple investment avenue that reserves managers may consider is green bonds.

In general, the safety and return aspects of green bonds support their incorporation into reserve portfolios. Adding these bonds to a conventional bond portfolio may also generate diversification benefits. However, some challenges remain. These bonds' accessibility and liquidity still pose some constraints. Benchmarks on returns and risks on these asset classes still have to be developed.

Persistently high levels of inflation continue to deplete the real value of investments. Together with this, the past year has been one of the worst years for financial markets for fixed income. It has indeed not been an easy period to navigate.

Central banks of developed market countries are yet to end their monetary policy tightening cycle. There is still work to be done to bring inflation down within target. With this backdrop, further market volatility is expected over the short to medium term. The proper management of those market volatilities remains a key priority for central banks.

Nevertheless, the potential benefit of integrating sustainability elements into the investment framework should not be overlooked. After all a key objective of transitioning towards a sustainable investment and risk-based framework within reserve management is for a better management of long-term market volatility.

Ladies and gentlemen

I am aware that a graduation ceremony will take place after my remarks. Those of you who will be in that cohort would have successfully passed the test. However, as with other disciplines, reserve management is also fast evolving. It will require that you constantly update your skill set to ensure its continued relevance in a changing world. The prudent and efficient management of our country's reserves rests in your able hands and there cannot be a better motivation to the pursuit of excellence. Your hard work has eventually paid off and I congratulate you on your achievement. I am sure that down the line, there will be many more opportunities for celebration.

With these words, I thank you for your attention.