



SUSTAINABILITY ASPECTS IN FOREIGN

EXCHANGE RESERVES MANAGEMENT

# THE MAGYAR NEMZETI BANK'S CHARTER OF SUSTAINABLE AND RESPONSIBLE INVESTMENT

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## 1. FOREWORD

As a central bank committed to sustainable development, the Magyar Nemzeti Bank (MNB), the central bank of Hungary attaches great importance to using its available instruments to support the management of climate change challenges and to integrate environmental considerations in the broadest possible range of its activities without compromising its primary objective of achieving and maintaining price stability. The MNB's statutory objectives include the promotion of environmental sustainability, both directly and indirectly. The traditional mandates of the Bank also provide an opportunity to address climate change, and since the amendment of the Central Bank Act in 2021, environmental sustainability aspects have been explicitly reflected in the MNB's mandate. The MNB's strategy on environmental sustainability has been developed in line with its mandates and organisational structure as set out in the Central Bank Act.

The MNB has already taken a number of steps to integrate environmental aspects into its operational framework in accordance with its statutory tasks. Environmental sustainability aspects are also strongly reflected in the supervisory strategy. In 2019, the MNB launched its [Green Program](#), which aims to mitigate the risks related to climate change and other environmental issues, to expand the supply of domestic green financial services, to enhance the related knowledge base and to further reduce the ecological footprint of financial actors and the MNB itself. In recent years, the Green Programme has become an important benchmark for the institutions supervised and has been further strengthened by the steps taken since its launch.

Recently, environmental aspects have also come to the fore in monetary policy. The MNB's [Green Monetary Policy Toolkit Strategy](#) announced in 2021 sets out the main directions for the mainstreaming of long-term environmental sustainability criteria through central bank instruments, thereby contributing to Hungary's sustainable convergence. In the Green Monetary Policy Toolkit strategy, the MNB identifies a number of risks stemming from climate change that could have an impact on price stability and financial stability.

One of the MNB's basic statutory tasks is the management of the country's international reserves. In recent years, environmental considerations have also played a key role in reserves management, accordingly in 2019 the MNB was one of the first central banks decided to create a dedicated green bond portfolio within its international reserves. However, addressing climate risks is a long-term process that will warrant further steps in the future, including in the area of foreign exchange reserves management.

## **2. MOTIVATION**

By integrating environmental considerations into reserve management, the MNB seeks to set a good example to financial market participants, to contribute to the optimal allocation of capital, which is key for climate risk projects, managing climate change risks and supporting the development of best market practices. As a first step, a dedicated green bond portfolio was built in 2019.

In addition to green bond investments, there are a number of other instruments of sustainable investment strategies available, the usefulness of which are constantly monitored by central banks, including the MNB. The MNB is an active member of the Network for Greening the Financial System (NGFS) international cooperation, which treats the sustainability shift in central bank investment portfolios a priority.

In consideration of the above, the MNB has decided to issue the Sustainable and Responsible Investment Charter (hereinafter referred to as the 'Charter').

## **3. GOALS**

- By publishing this Charter, the MNB expresses its commitment to incorporate environmental sustainability aspects in reserves management and sets out the main directions for integrating a sustainability approach into the foreign reserves investment strategy.
- The Charter aims to increase transparency and traceability, which are essential for the effective integration of green criteria and serves as a compass for making the investment strategy more sustainable.
- With this Charter, the MNB wants to set a good example to financial market participants, which can contribute to the promotion of sustainable investment practices and, in the long run, the development of the market.

## **4. SCOPE**

The Charter sets out objectives and guidelines for the Bank's foreign reserves investment strategy. Primarily, the Sustainable Investment Guidelines can be integrated efficiently into the management of bond portfolios, therefore, the Charter does not apply to other reserve assets and the central bank's monetary policy portfolios. They can only be applied to bond portfolios in accordance with the primary objectives of reserve holding, by meeting risk and liquidity requirements.

## 5. THE MAIN PILLARS OF THE SUSTAINABLE AND RESPONSIBLE INVESTMENT CHARTER

In line with the above, the MNB pays particular attention to the environmental impact of its investments. It is an important prerequisite to be able to measure this impact, which requires the availability, standardisation and transparency of reliable data, an area where both market participants and the Bank still face challenges. This has an impact on current best practices and procedures in the market where there is also considerable room for improvement. Regular measurement and monitoring are also a model for financial actors to follow, and this Charter represents an endeavour for and a commitment to continuous improvement.

### 5.1. Measurement

Without measurement, there is no green transition. One of the pillars of the sustainable investment strategy is to understand and quantify climate risks in asset portfolios as widely and accurately as possible, which is essential in managing the relevant risks and making asset allocation more sustainable. Consequently, the MNB regularly analyses and, since 2021, in its [Climate Related Financial Disclosure](#), annually publishes the climate risk exposure of its asset portfolios following the relevant international recommendations and best practices; this way, it supports the implementation of green investment strategies and the back-testing of their impact. In addition, the MNB has also introduced the quantification of climate risk aspects into the internal risk measurement system of reserves management, which is an important element in the efficient preparation of decision-making and assessment.

In parallel with the expected improvement in the quality and accessibility of data, the Bank strives for a more comprehensive analysis and reporting of the climate impacts of its investments. As part of this, it seeks to use forward-looking indicators besides retrospective indicators, to quantify physical and transition risks, and to cover as broad range of bond portfolio exposures as possible. In the case of the green bond portfolio, it is also key to monitor positive environmental impacts brought about by the investments.

## 5.2. Investment strategy

The medium-term elements of the sustainable investment strategy are the following:

- The MNB monitors the relevant environmental sustainability factors and criteria, and integrates them into the investment process where possible, keeping in mind the triple bottom line (liquidity-security-return) of reserve management.
  - The Bank supports projects with a positive environmental impact through its dedicated green bond portfolio.
  - In parallel with monitoring the evolution of the relevant data, the Bank will assess the possibility, the benefits and the risks of sustainable investment strategies, including screening the investment universe according to sustainability criteria, under- or overweighting investments in terms of their environmental performance, and the use of climate risk benchmarks.
- The Bank will analyse the climate impact of its investments more comprehensively as data quality and availability are expected to improve.
- In addition to backward looking indicators, the Bank also seeks to use forward looking indicators in its investment processes whenever possible.
- The Bank is committed to the continuous development of a responsible and sustainable investment approach.
- As the green investment market develops, the Bank will monitor and consider the possibilities of setting specific decarbonisation targets in line with the traditional central bank investment objectives.

The long-term elements of the sustainable investment strategy are the following:

- The MNB's long-term objective is to decarbonise reserve portfolios as much as possible without compromising the priority targets and requirements of reserve holding.
- The Bank also aims to contribute to the development of a sustainable investment market through its Sustainable Investment Guidelines by encouraging and supporting market participants.

## 5.3. Transparency, active engagement

Transparency is of key importance in the green transition process, and the MNB regularly analyses and, since 2021, annually publishes the evolution of its climate risk and green exposure indicators in accordance with best international practices and recommendations. In this context, the MNB will also report on the progress of the Charter's implementation.

The MNB actively participates in the relevant national and international professional fora with a view to the integration of green aspects, thus facilitating the exchange of knowledge which is essential for market development. Since 2019, the MNB has been a member of the NGFS, a collaborative network of central banks, and promotes active dialogue by attending national and international conferences and organising professional events in this field.

#### **5.4. Monitoring**

The MNB will closely monitor the development of sustainable and responsible investment practices and the emergence of new practices, and will consider their adoption in its own operations.

The way the elements of the Charter will be implemented depends largely on the evolution of the quality and availability of the relevant data and best market practices. In line with the principles set out in this Charter, the MNB will regularly review reserve asset allocation and the procedures applied.

#### **6. CLOSING PROVISIONS**

The Bank will regularly review the Sustainable and Responsible Investment Charter, and will update, supplement and amend its elements as necessary, in light of the changing market environment.