Blog

Responsible fixed income investments in the Bank of Finland

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Bank of Finland invests in green bonds, but expects, that the market would be more transparent and follow a universally agreed set of standards.

Central banks are large investors in the fixed income market and typically they invest in government bonds and government related bonds. Table below presents the Bank of Finland's fixed income allocation (see Deputy Governor Olli Rehn speech Olli Rehn: Climate Change and Green Finance).

Table.

Bank of Finland's fixed income allocation 31.12.2017

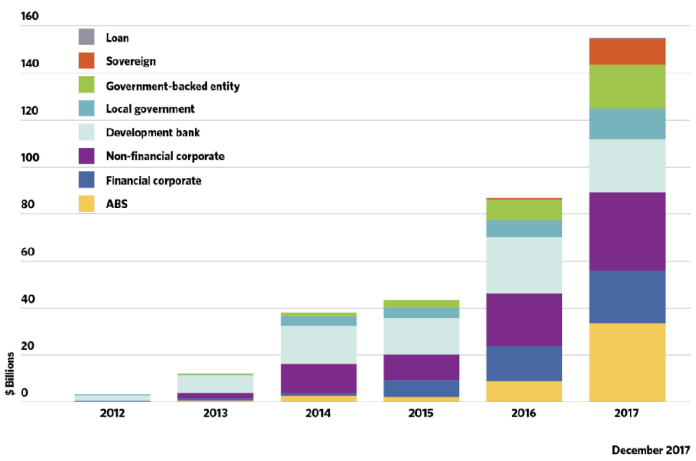
Government bonds	58%
Government related bonds	20%
Covered bonds	7%
Corporate bonds	7%
Cash	8%
Total, fixed income	**100 %**

Responsible investing methods and techniques have been developed mostly from the viewpoint of equity investors. The same techniques can be used for fixed income investments, but they include instruments and issuers such as government bonds that ESG-screening models don't cover.

The fixed income market has developed responsible products, mainly green bonds, which finance projects related to improving the environment. Demand for green bonds is growing. The chart below presents growth of green bond markets in the last few years. Government (mainly France) and government related issuers have become major issuers recently.

Chart 1.

The labelled green bond market is growing rapidly



2017 in numbers

USD155.5bn – total green bond issuance

78% growth on 2016[iii]

1500+ issues

37 countries of issuance on all **6** continents

239 different issuers

146 new issuers

USD10.7bn – largest single green bond

3 sovereign green bonds

Source: Climate Bonds Initiative, January 2018.
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Green bonds are facing many challenges, which is why they have not yet received the full support of all investors. The European Commission is currently exploring possible actions and standards that could clarify and improve the green bond market and the whole framework of responsible financing (see the European Commission action plan of Financing Sustainable Growth).

Nevertheless, green bonds allow companies whose business is not primarily focused on environmental projects to promote environmental responsibility. By investing in green bonds fixed income investors can support responsible projects and promote themselves as responsible investors. Bank of Finland invests in green bonds, but hopes, and expects, that the market would

be more transparent and follow a universally agreed set of standards.

Table above presents the large share of government related bonds in Bank of Finland's portfolio. A major part of this asset class is bonds issued by international and national development banks. Development banks are central or local government supported institutions providing financing for development projects. They include World Bank and African Development Bank. Development banks are engaged in activities that improve the environment and work against poverty and social injustice. In general, all of development banks' activities should be responsible. Therefore, Bank of Finland considers bonds issued by development banks as responsible investments. They issue green bonds too, but these instruments are specifically environment friendly bonds, whereas responsible investing is generally understood as a broader concept. Building a school in a developing country is very responsible, but it won't get one a green bond label.

Bank of Finland's responsible fixed income investment policy is constructed around two pillars. While green bonds, social bonds and development bank bonds are considered as responsible investments by design, investments in covered and corporate bonds must meet the Bank's responsible investment criteria in which issuers are required to comply with the UN Global Compact.

Keywords

asset management , environmental responsibility, green bonds, investment, responsible investment