Central Banks: leading the path towards Impact Investing

Frédéric Samama
Chief Responsible Investment Officer at CPR AM

Central Banks are right now accelerating a tectonic shift. This summer at Jackson Hole, Fed Chairman, Mr. Powell has set-up the new objectives of the FED: inclusive employment is now key. As stated, “Inflation that is persistently too low can pose serious risks to the economy”[1] and an inclusive employment[2] is one way to solve it; it leads the FED to “a focus on inequality”[3] with an attention paid on education as “people who don’t have advanced skills now have less ability to profit from the technology that is everywhere in our economy”[4].

In parallel, 65 Central Banks and supervisors have joined the network for ‘greening’ the financial system[5] over the past three years. All participants are recognizing that climate change is threatening the financial stability in a massive way. Earlier this year, on this topic, the Bank of International Settlement released “The Green Swan”[6], a book, underscoring that, with climate change, we are all facing with a new type of risk characterised by three main features: first, climate change is certain. Second, climate change carries a variety of non-linear and interacting risks: physical, regulatory, and societal. And all the forces are interacting with each other. It is thus very challenging to make such a complex model. Third, climate change impacts human lives and could even to the possible extinction of part of humanity in the long term.

So, in the central banks’ perspective, this is less about inflation, price stability, etc. and now about inequalities, education and climate change.

Just three years ago, these issues could have been perceived as belonging to the NGO terminology and only a very limited number of players in the financial sector were paying attention to it.

The fact that Central Banks are putting these issues on their agenda sends a signal that all corporates are increasingly evolving into an environment in which these themes are becoming central.

How does this new environment translate for the investors?

The question has been for a while to assess if corporates were managed in a sustainable way. Indicators like the attention paid to the employees, the pay gap ratio, etc. were a way to identify such companies. It still matters, and notably as the accounting rules were established in a period where only the financial capital was a scarce resource, thus they do not capture the other forms of capital of the firms.

> **“the issue becomes to know if the corporates are behaving like predators within society and extract some public good for the benefit of shareholders”**

Now, increasingly and in addition, the issue becomes to know if the corporates are behaving like predators within society and extract some public good for the benefit of shareholders.

Alternatively, through their activities, do the corporates contribute to some public good (both in the private markets or in the listed world)? In other words, are their business aligned with a fight against climate change, are they addressing a lack of education that is the root of inequalities, are they producing some food with a limited use of water as the planet does not have the resources enough to feed all the people properly at a time we make a lot of progress on the fight against extreme poverty, etc.

The SDGs and impact investing, that are combining returns and producing some positive externalities, are a way to align portfolios with all the dimensions of pension funds’ beneficiaries: as an investor, as a citizen, as a human being. This is what we have enjoyed at CPR with a vast range of impact investing products launched over the years, and dealing with climate, education, sustainable food, etc.

Corporates are not to replace governments in their mission to regulate societies, but they have massively grown over the past 50 years. Shifted towards immaterial assets and facing some limits related to the natural resources of the planet; they are now facing a need to secure some societal, human and natural capital while, at the same time, the financial capital has become a commodity. A cooperative approach with society is therefore increasingly becoming the only option on the table - it translates into a societal alpha.

In conclusion, Central Banks are sending a clear and loud signal to all investors. It is our collective responsibility to listen and accelerate our efforts to invent the finance for today; the one that translates this new normal into financial innovation, new partnerships to leverage on each other skills and new dimensions in our investment process. Mindsets have shifted. This is a call for action for all of us.

FOOTNOTE

1 With interest rates generally running closer to their effective lower bound even in good times, the Fed has less scope to support the economy during an economic downturn by simply cutting the federal funds rate” in New Economic Challenges and the Fed’s Monetary Policy Review, Aug 27, 2020

2 “our revised statement emphasizes that maximum employment is a broad-based and inclusive goal. This change reflects our appreciation for the benefits of a strong labor market, particularly for many in low- and moderate-income communities” ibid

3 Interview with NPR, Sept 4, 2020

4 ibid

5 https://www.ngfs.net/en

6 Available at https://www.bis.org/publ/othp31.htm