Financial and Economic Review, Vol. 21 Issue 4, December 2022, 228–236.

Report on the Fourth Green Finance Conference of the Magyar Nemzeti Bank*

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On 6 October 2022, the Central Bank of Hungary (Magyar Nemzeti Bank, MNB) organised its 4th Green Finance Conference, which was held at the MNB's Buda Centre. This year, the main focus of the conference was on the changing economic environment: at the event, the participants discussed and explored how to maintain the recent momentum in green finance during a time of rising inflation, recessionary concerns and geopolitical turbulence.

Csaba Kandrács, Deputy Governor of the Magyar Nemzeti Bank, opened the event. In his speech, he pointed out that despite the many geopolitical, social and economic challenges, we should not forget about the impending catastrophe caused by climate change and the reduction of biodiversity. China and Europe have been hit by extreme droughts, while Pakistan and the Death Valley in California, which is one of the hottest places on Earth, have suffered massive flooding. He finds it concerning that since the United Nations (UN) Climate Change Conference (COP26) in Glasgow, many of the main emitters have withdrawn from their commitment, while others are reluctant to make steps in accordance with their commitments in the Paris Agreement. It is important to emphasise that not only countries but also corporations have backed out: within the span of one year, several US banks left the Glasgow Financial Alliance for Net Zero (GFANZ), which sends a negative message. In his speech, Kandrács highlighted that Hungary is strongly committed to putting its financial system on a sustainable path. To this end, on 28 May 2021, the Hungarian Parliament decided to extend the mandate of the central bank to promote environmental sustainability as the first central bank in Europe. In accordance with its mandate, the MNB has supported the green transition of the Hungarian economy through several programmes over the last three years. As a result, amongst other things, it published its long-term climate stress test, issued a Green Recommendation for credit institutions, launched its Green Capital Requirement Relief Programme, announced a green mortgage purchase programme, launched its Green Home Programme, announced the Family

* The papers in this issue contain the views of the authors which are not necessarily the same as the official views of the Magyar Nemzeti Bank.

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Green Finance Programme, and concluded educational and research cooperation agreements with several universities and institutional partners. Moreover, it has recently been cooperating with the Organisation for Economic Co-operation and Development (OECD) and the European Commission to evaluate financial risks in Hungary due to the reduction of biodiversity. In addition, the MNB is also neutralising its own carbon footprint, to set an example for the financial sector as well, and as such, it also offsets the carbon footprint of this conference.[1]

Following the opening speech, the participants could watch a video message from *Frank Elderson*, Member of the Executive Board of the European Central Bank, in which he emphasised that the governments of EU member states remain committed to the targets set in the Paris Agreement. He added that central banks and supervisors need to pay special attention to these goals and measures, as well as the scenarios revealing climate risks when complying with their statutory mandates.

How to maintain momentum in green finance in a year of unprecedented challenges?

The first keynote speaker of the conference, *Thomas Steiner*, Executive Director of the Oesterreichische Nationalbank (OeNB), thanked the MNB for its work in the field of green finance so far, which sets a good example for the Austrian central bank as well. In his presentation, he explained that the ongoing Russian-Ukrainian war not only jeopardises the achievement of the UN Sustainable Development Goals, but also further aggravates other crises, such as the energy or food crises, not to mention its adverse effects on the inflationary environment. Due to the war, resources that are badly needed for tackling global challenges are being wasted, while at the same time it also hinders cooperation initiatives targeting the funding of sustainable investments at an international level. In his view, the European sustainable financial strategy (EU taxonomy, disclosure requirements, standards, etc.) is on the right path, but the transparency of the criteria for Environmental, Social and Governance should be promoted in order to increase business confidence and avoid "greenwashing". In his opinion, carbon pricing is the most effective incentive for real economic and financial changes, which may increase inflation at present, but in the long run, the tendency may reverse. Steiner also commented on the greening of the OeNB's own operations: they are currently working on the sustainability strategy of OeNB, which will set a target for the Austrian central bank to reach carbon neutrality by 2040. At the same time, the OeNB intends to increase

[1] With respect to the offsetting programme of 2021, a short movie on the afforestation project of the Körös-Maros National Park next to the village of Geszt was also presented at the conference. The links of the short video is as follows: https://www.youtube.com/watch?v=cKJOgkcXibY

the number of investments in green/sustainable bonds, focusing on the reduction of greenhouse gas (GHG) emissions, instead of their compensation.

Green transition challenges in the corporate sector

The other keynote speaker in the morning programme was *Pepijn Rijvers*, Executive Vice President of World Business Council for Sustainable Development (WBCSD). In his view, similarly to the digital revolution starting in the 1970s, we are once again in the middle of a large-scale transition process, which affects all sectors and countries. This time, however, the transition is not driven by innovations, but by a "perfect storm" of challenges, which is centred around the climate emergency and growing inequalities. He also added that, in terms of companies' operations, the scenario of "business as usual" is no longer a viable path as this perspective is becoming riskier with respect to the economy, is dangerous for the environment, and is socially and legally questionable as well. Furthermore, it is important to see that the adaptability of a business has a significant impact on its long-term value potential, which is why businesses need to develop competency in relation to sustainability issues in their business models in order to implement integrated decision-making. It is certainly positive that credit institutions and investors are increasingly focusing on the transition plans of a low-carbon and climate-resilient future. However, this transition requires significant funding and cooperation. At the same time, it is important for the financial sector to assign real value and appropriate incentives to business products and services that accelerate the transition to a carbon-neutral and fairer world. According to Rijvers, it is very likely that within three years, more than 50 countries will apply the framework of climate-related financial disclosures.

Award ceremony of the MNB Green Finance Awards and the Green Finance Science Awards

Within the framework of the conference, the central bank presented the Green Finance Awards for financial institutions and the Green Finance Science Awards, honouring outstanding scientific achievements. In 2019, the MNB awarded the greenest financial institutions with the Green Finance Award for the first time. The Green Bank Award are judged primarily on the extent of green lending, the proportion of green securities held by institutions in their portfolios and the exposure of the institutions to climate change risk. Accordingly, in 2022, the *Green Bank Award* was won by *Raiffeisen Bank Zrt.*, the *Green Insurance and Pension Fund Award* was awarded to *UNION Vienna Insurance Group Biztosító Zrt.*, while the *Green Investment Fund Manager Award* was awarded to *Raiffeisen Befektetési Alapkezelő Zrt.* by the central bank.

In 2021, the MNB established the Green Finance Science Awards and the Green Finance Research Initiative to encourage the promotion of environmental sustainability and to show its appreciation for Hungarian and non-Hungarian professionals who have conducted outstanding green finance research. The Green Finance Science Awards are awarded by a panel of academics and selected members of the Monetary Council. This year, the *Green Finance Science Talent Award* was awarded to *László Vértesy* for his outstanding research work, which is justified by his excellent publications and the high number of citations received, and which can be characterised by an interdisciplinary approach. *Elvira Böcskei and her research team* won the *Special Prize* of the competition of the *Green Finance Research Initiative* for their research plan elaborated on the topic of a more competitive and at the same time sustainable real estate sector. *The first place* in the competition of the Green Finance Research Initiative was awarded to the *MATE Centre for Circular Economy Analysis and Knowledge research team* for their research design on the financial preparedness of agri-food companies related to climate stress. *Áron Horváth and his team* were awarded *second place* in the Green Finance Research Initiative competition for their research project on the statistical analysis of the relationship between building energy data and house prices in Hungary. *The third place* in the Green Finance Research Initiative competition was awarded to *Antal Ferenc Kovács* for his research plan for the feasibility study of a corporate portfolio for the management of national natural assets. The *International Green Finance Lifetime Achievement Scientific Award* was awarded to *Sean Kidney*, co-founder and CEO of the Climate Bonds Initiative and professor at the SOAS University of London Centre for Sustainable Finance, who is a member of several green finance councils and committees at an international level.

Sean Kidney placed great emphasis on the fact that in the case of a green revolution, bigger countries can learn from small economies, which is why we can see that Singapore, Hong Kong and Hungary are at the forefront of the green transition. Considering the fact that greenhouse gases (GHG) show their impact later on, the climate change we are currently experiencing is due to the emissions up to the 1980s; therefore, even if GHG emissions were to cease immediately, we would experience a growing impact on the climate for 30 more years. Climate change inherently comes with the danger of war and conflicts, and may trigger massive migration and the complete collapse of the ecosystem. The transition to a green economy is best stimulated by an increase in volumes, because costs are reduced significantly. It also offers a serious investment opportunity: according to the study published by the global management consulting firm, McKinsey, the green transition requires the investment of USD 9.2 trillion, two thirds of which would require the reallocation of existing capital investments, whereas one third of which would appear as new capital need, as green investments have high investment costs, but low operation costs. Investors are hopeful: they see the future is clear and green, but the market is quite volatile at the moment, as nobody can be certain which companies will be the front-runners. For example, it is an open question whether it is worth investing in an existing Chinese solar company or an Indian start-up subsidised by the state. In terms of the green bond market, it is clearly visible that in 10 years the outstanding stock increased a thousandfold, i.e. from USD 2 billion to USD 2 trillion. Experience shows that green bonds are more resilient and more liquid on the secondary market. According to the professor's vision, the next 30 years may bring about a boom in investments that results in a significant increase of workplaces and welfare.

Transition plans in the financial sector

In the next part of the conference, the existence of transition plans in the financial sector was discussed. The panel discussion was introduced by *James Vaccaro* (Climate Safe Lending Network). Based on the observations of climate change, countries will find themselves in a very difficult situation. Therefore, the transition plans will need to provide answers to two questions. On the one hand, how they can address micro-prudential risks, and on the other hand, how they can contribute to the management of systemic challenges. According to the suggestion of Climate Safe Lending Network, institutions should completely phase out the "harmful legacies" of the past, for example, using fossil fuels and supporting deforestation, and at the same time, they should reduce the carbon intensity of their existing, funded portfolio and find projects in line with the climate targets. A distinction must be made between those institutions that set carbon intensity ratios and those that set absolute emission targets, as only the latter can achieve an actual emissions reduction. Furthermore, Vaccaro emphasised that credit institutions have a chance to reduce carbon not only via financing channels, but as they influence the development of the regulatory environment, frequently provide business advice to borrowing companies, facilitate networking between different business partners, collect large amounts of data and create and analyse their databases, their financial relationships could be revised based on these factors as well.

After the panel introduction by Vaccaro, the first panel discussion was moderated by *Gábor Gyura* (UNEP FI) with *Mark Campanale* (Carbon Tracker Initiative), *Robert Spruijt* (ING) and *Beáta Paróczai* (European Bank for Reconstruction and Development, EBRD) taking part in it. During the panel discussion, the participants discussed the development of the transition into a green economy with respect to the financial sector, and what credit institutions and supervisory authorities could do in order to direct the world's sustainable financial activities onto the right path. One of Campanale's key messages was that all regulators should declare a moratorium on the issue of bonds related to fossil fuels to prevent the expansion of the fossil fuel system. However, governments and individuals are not able to realise all these plans without each other since the problem is within the system, which needs to be handled at a systematic level. In his opinion, the issue could be tackled by involving the central banks into the solution through the International Organisation of Securities Commissions (IOSCO), the World Federation of Exchanges (WFE) and the Basel process. He added that reducing the funding of fossil fuels does not mean that funding for these programmes should be completely stopped, but that new research projects should not be allowed to start. According to Campanale, we cannot emphasise enough that renewable energy sources should be prioritised in the power supply systems, for example, instead of natural gas, as leaving fossil fuels behind may involve not only financial but also political benefits, such as reducing dependence on energy imports.

At *Gábor Gyura*'s request, *Robert Spruijt* explained that ING has recently joined the Net-Zero Banking Alliance, and detailed the future targets of ING related to sustainability. The Net-Zero Banking Alliance is a banking association founded by the United Nations (UN), whose members have committed themselves, among other things, to making their lending and investment portfolios carbon neutral by 2050 at the latest, in line with the goals set in the Paris Agreement. In 2018, ING launched a new initiative called Terra with the objective of influencing climate change measures more positively by means of its outstanding loans at each credit institution, via the funds lent to the companies and clients. Thus, hundreds of billions of euros are used in their loan portfolio to achieve net zero climate goals, while ING does not finance projects aimed at oil and gas exploration or expansion.

Since its establishment, the European Bank for Reconstruction and Development, as an international financial institution, has significantly supported the transition of the Central and Eastern European (CEE) countries, previously to a market economy, and nowadays increasingly to a green economy, explained *Gábor Gyura* and asked *Beata Paróczai* to present the EBRD's green strategy and its projects in the CEE region. Paróczai explained the EBRD's efforts regarding the Green Economy Transition, which has the aim of promoting the funding of projects that support the transition to an environmentally sustainable economy with low CO_2 emission, while using the environment without the complete depletion of natural resources. The EBRD has implemented several successful energy efficiency programmes in the Central and Eastern European region (mainly building energy efficiency investments, using small-scale solar and wind energy), as it seeks to create systemic changes in the economies of the countries of this region through technical assistance projects by developing their capital market especially green bonds market.

The role of green finance in the transition

The last panel discussion of the conference was led by *Eric Usher* (UNEP Finance Initiative). In his presentation, he pointed out that we can see rapid growth in the green economy, but in his opinion, the underlying cause of the problem is that financial companies are still funding the "old economy", whereas climate risks have not yet been incorporated in pricing. These are mainly due to the changing objectives of climate policies, the lack of adequate data and the immaturity of methodologies. He urged banks to elaborate on their climate stress tests, sector and scenario analyses, and take them into consideration in their pricing. The Principle of Responsible Banking was originally signed by 132 banks in 2019, and currently, it has 300 members, including the OTP group from Hungary, and other Hungarian institutions are also expected to join.[2]

Following the introductory presentation, the second panel discussion was moderated by *Pál Péter Kolozsi* (MNB), with *Luca Bertalot* (European Mortgage Federation), *Thibaud Clisson* (BNP Paribas) and *Andreas Rauter* (UNIQA Group) taking part in the conversation. The participants discussed the impact of green finance on the economic transition. *Pál Kolozsi* presented the estimates of the transition costs of the institutions, among others, OECD estimated an annual cost of USD 6.9 trillion, while McKinsey estimated an annual cost of USD 9.2 trillion to be spent in the next 15 years. This raises the following question: how much is the financial sector able to take over, and how can certain operators contribute to it? In his answer, *Andreas Rauter* highlighted that in addition to proper regulation, the most important focus of market institutions should be placed on joining associations internationally recognised in the field and initiatives launched by international organisations. As a good example, he mentioned the initiatives of Principles for Sustainable Insurance and Principle for Responsible Investment established by the UN. In his opinion, the return on the green transition is a long process, but a clear, positive correlation can be observed. The UNIQA Group intends to increase its green portfolio from the value of EUR 400 million to EUR 1.7 billion in the next three years, but the institutions are further hindered by the fact that unloading securities in polluting industries in a high yield environment involves higher losses.

According to *Luca Bertalot*, one of the main tasks in the field of finance is to turn challenges into opportunities. To take the example of a historical analogy, the Medici family also established the first banks during the time of the plague, the most destructive epidemic in Europe, which made the rise of city-states possible and laid the foundation of the Renaissance. The European Mortgage Federation, which has 2,000 European banks as members, developed a trademark similar to

[2] MKB Bank Nyrt. also joined the framework of Principles for Responsible Banking on 14 October 2022.

the Medici's fiorino to promote green mortgage bonds, supporting institutions to achieve a unified green rating. According to *Thibaud Clisson*, the actors of the financial system are able to influence the economy to a significant extent by means of capital allocation, for example, they do not finance certain activities, or they apply lower cost of capital for green investments. At the same time, due to increasing competition, it is more and more difficult to find green projects with good financial conditions. Another serious opportunity for asset managers is that they can participate in general meetings and, based on their ownership stake in certain companies they invested in, they can make proposals to the management.

In the second half of the panel discussion, *Pál Kolozsi* invited the participants to share their opinion on the challenges and opportunities related to green bonds and sustainability-linked bonds in the current market situation. *Luca Bertalot* emphasised that transparency is very important, which they paid special attention to on their website *Cover Bond Label* as well. All actors are looking for guidance; therefore, the guidelines of central banks are essential, which is why MNB's exemplary engagement is outstanding, as the central bank was one of the first to show the way forward in this field. In addition to regulatory issues, the green revolution is also an IT challenge, so all actors must allocate significant resources to IT developments, and at the same time, state actors need to provide a public central database, for example, for the availability of energy certificates.

Besides IT investments, *Thibaud Clisson* deemed it necessary to harmonise regulation as well, as the greenium (negative yield premium of green bonds) cannot be identified due to different state ratings and rules. With respect to sustainability-linked bonds, it is also problematic how companies define their sustainability targets. In contrast to traditional green bonds, many times there are no impact assessment reports, so if targets are not met, late realised penalty interest rates have little deterrent effect, which makes sustainability-linked bonds unattractive to investors. *Andreas Rauter* also found it important to learn who are financing 'brown' (environmentally harmful) investments at the moment. According to the investigative report of the Economies, these types of investments have been repackaged at 3–4 levels lower, and as funds of funds, they are held at less experienced asset managers, typically at smaller universities or pension funds. This is one of the reasons why a consistent and strict regulation is needed so that brown industries cannot just disappear from view.

Luca Bertalot drew attention to two additional problems as well. On the one hand, social opportunities and climate should also be taken into consideration, and no unrealistic expectations should be set when the majority of the society are looking at worsening living conditions. On the other hand, although Europe is moving in the right direction, the EU taxonomy is excessively complicated. Therefore, it is possible that we will have the most energy efficient buildings, but the knowledge will be hard to share with emerging countries as they will not be able to implement it, whereas emerging countries provide the best opportunities for sustainability since the properties of their population will be built in the near future.

At the end, *Dávid Papp* (MNB) summarised the main remarks of the conference in his closing statement, and concluded the conference hoping that in the future, we can continue investigating the questions raised and finding solutions together, to which all the participants are warmly invited by MNB.