ESG WITHIN FOREIGN EXCHANGE

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The bank for a changing world
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What is it?
The FX Global Code is a set of principles of good practice for the wholesale FX market, developed by the industry and maintained by the Global FX Committee (GFXC).

Who adheres to it?
Alignment demonstrated by signing a standardised “Statement of Commitment” to the code. There are currently 1,154 public participants. Most banks have signed up, but only 81 asset managers, 9 insurers, 14 pension funds and 30 corporates¹.

What’s needed?
We need to encourage greater take up of the code amongst end users, whom it is ultimately designed to protect.

¹ Source: Global Index of Public Registers (globalfxc.org)
LINK BETWEEN ESG AND AML

• Currently, money laundering and terrorist financing are addressed with strict regulation and legislation, expanding internationally after the terrorist attacks of September 11th 2001, which remains recent in the history of foreign exchange transactions.

• Environmental crimes and human trafficking are two of the most significant crimes behind money laundering, and have clear ESG implications.

• However, financing environmental destruction and companies with socially irresponsible supply chains is by in large still governed by voluntary codes of conduct, and the onus is on the creditor/investor to hold firms accountable.

• As the spotlight intensifies on unsustainable business practices, and if the list of criminal offences covered by AML regulations grows, banks and FX professionals will need to become even more vigilant.
MANAGEMENT OF FX RESERVES

• Traditionally, FX reserves have been used to demonstrate solvency, and thus liquidity and safety have been the key priorities.

• In recent years, however, quantitative easing has increased overall reserves, which has led reserve managers to seek additional returns.

This BIS working paper from March 2020 [Reserve management and sustainability: the case for green bonds? (bis.org)] suggests that an additional sustainability objective could be applied, on top of liquidity, safety and return, to determine where FX reserves are invested.

Source: Reserve management and sustainability: the case for green bonds? (bis.org)
The sustainability experts I’ve spoken to at BNP view FX as a neutral product, which makes it difficult to develop FX products that are inherently “green”, or “social”.

Therefore the existing ESG-linked FX transactions are KPI-based. Most notable are:

• Energy firm Siemens Gamesa signed an FX transaction agreement with BNP in 2019 linking the rate on its FX hedging to a third party sustainability rating;
• In 2020, JP Morgan and Enel SpA entered a EURGBP XCCY swap agreement in which both parties need to meet specific ESG targets or face additional costs;
• Deutsche Bank and Olam International executed a 1y USDTHB FX forward, which gives Olam a discount if it meets pre-agreed targets that support the UN’s SDGs, while it must pay a predefined sum to an NGO if it fails.

Drawbacks?

• Difficult to standardise the transactions, as each firm will have different sustainability goals and targets, so each transaction is very manual;
• High greenwashing risk. The sums of money being saved / spent are extremely small compared to the revenues of the companies in question. If the financial impact is minimal, does it de-legitimise the products, or do they still contribute to the overall transition?
RISE OF CRYPTO CURRENCIES

- The market for cryptocurrencies is still very small compared to traditional Forex ($100bn USD a day turnover, vs $5.3 trillion for FX), but it’s grown to be significant, and included in the portfolios of more and more money managers.

- The extreme energy demands of Bitcoin are well known (see chart left).

- Alternative coins have been designed to use significantly less energy, using different protocols to Bitcoin’s proof of work. Ethereum, the second biggest cryptocurrency by market cap, may be roughly 10x more efficient than Bitcoin, but it’s still 61,500 times less efficient than Visa payments per transaction.

- Energy considerations, alongside regulatory concerns, are why BNP Paribas has thus far chosen not to engage in cryptocurrency markets.
Thank You!

Hope this was helpful

Any questions please reach out to me: Clara.williams@bnpparibas.com
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