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Paradigm shift in financial markets

The economic and legal impacts of the EU Action Plan Sustainable Finance on the Swiss financial sector

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“Europe’s financial sector must lead the green transition and make our Union the global destination for sustainable investment. There is no greater return on investment than a healthy planet and economy.”

Jean-Claude Juncker (22.03.2018)
at High-Level Conference on sustainable finance

Foreword

"Finance will be green, or it won't exist in the future". The French Minister of Finance, Bruno Le Maire, made it clear. The transition to a more sustainable economy is a done deal internationally, and is gaining speed. The Sustainable Development Goals (SDGs) are being implemented by the signatory countries, and the Paris Agreement on Climate Change (Paris Agreement) was ratified in record time. Finance needs to adapt, and has an economic self-interest in doing so.

There are still those who continue to ignore reality and defend the self-interests of the old fossil world. However, upon closer inspection even Donald Trump's rejection of the Paris climate agreement had a limited impact in the face of the rapid energy transition that is under way. In the US, more coal power plants have been closed in Donald Trump's term as President so far than during the two terms of Barack Obama. Meanwhile, shortly after Mr Trump's announcement, the Chinese government cancelled plans to build 103 coal-fired power plants and resolved to invest an additional USD 360 billion in renewable energy by 2020.

The shift to a more sustainable, post-fossil economy is progressing much faster than many realise. If we look for historical precedents, in 1900, for example, few noticed the increasing importance of the combustion engine and most believed that horse-drawn carriages would be used forever. Less than 20 years later, the streets of major cities were filled with cars. More recently: who would have thought in 2009 that prices for photovoltaic panels would fall by over 80 % within the next seven years?

Transitions happen fast and, in their early stages, often go unnoticed. Change creates winners and losers – and the latter will not accept change without putting up a fight, whether it is the Luddites of the early 19th century or the fossil fuel industry and the "gilets jaunes" of today. But the choice is ours: either we bury our heads in the sand and adamantly oppose each and every move towards sustainability, or we actively embrace it to benefit society and strengthen competitiveness in the long term.

How does all this affect the financial sector? Finance has a key role to play in the transition to a more sustainable economy. It is the bridge between capital and the real economy. The European Union (EU) in its Action Plan on Sustainable Finance (Action Plan Sustainable Finance) highlights how financial service providers facilitate economic development and function as multipliers. They make an essential contribution to the transition and shape its direction – steering it either towards or away from a more sustainable economy.

Ultimately, the financial sector must develop practices to incentivise institutions and their employees to account for and integrate sustainability factors by default. By putting in place the Action Plan Sustainable Finance, the EU has created the necessary framework conditions for this to happen. The anticipated impact will be significantly stronger than was experienced under MiFID II, GDPR or AEoI.

Just as visionary Alfred Escher founded the *Schweizerische Kreditanstalt* to finance the forward-looking Gotthard railway project – a cornerstone of Switzerland's economic success – today, too, we need long-term investment in the sustainable transition and the infrastructure required to achieve it. This investment volume cannot be provided by the governments alone. A financial system that promotes sustainable development (sustainable finance) has enormous market potential for Switzerland.

Sustainable finance is gaining momentum internationally, be it in the shape of voluntary commitments from market participants or in the realm of regulation. Sustainable assets under management have shown impressive growth over the past few years. However, with about 8 percent market share, sustainable finance is still a niche phenomenon in Switzerland.

Meanwhile, pressure on the Swiss financial sector is increasing. On the one hand, civil society points to the sector's lack of engagement. On the other, recent legislative developments in the EU are increasing external pressure. The Swiss financial sector needs to adapt its practices if it wants to attract and retain European clients, and with laws and policies on sustainable finance that could be considered non-equivalent, it could soon face serious issues over market access.

For many years Switzerland was famous for its innovative financial market players, and proud to be a pioneer. More recently, a culture of preserving and managing existing structures has become more widespread. It is time to rediscover Alfred Escher's pioneering spirit — and with it the power to shape the transition that is under way, instead of clinging to the outdated practices of a dying fossil-fuel based system.

In short: if Switzerland does not move decisively now, it will face major economic and reputational risks. If it does take prompt action, it will enable the Swiss financial sector to tap into a growth market rich in opportunity.

Switzerland has the potential to be one of the innovative front runners in the financial sector's transition to sustainability. However, this requires bold action from all relevant players in the financial industry, be they private or public. The opportunity is ours to seize.

Dr. Guenther Dobrauz,
Leader PwC Legal Switzerland

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The core team of editors wants to thank all the contributors to this paper. As already mentioned in the foreword, it is a common path we all need to take.

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1. Sustainable finance in Switzerland

> “I am convinced that by focusing on sustainability, the Swiss financial community can raise its profile above international rivals, and, at the same time, make a vital contribution towards achieving international ecological and sustainability goals.”

Ueli Maurer, Member of the Swiss Federal Council, Head of the Federal Department of Finance. Cited in Swiss Sustainable Investment Market Study 2018 of Swiss Sustainable Finance

Known for its secrecy but also its power, the financial industry, along with pharmaceuticals, is the most important Swiss economic sector. Over the years, the Swiss financial centre has become particularly well known for its wealth and asset management. Switzerland was once a pioneer and world leader in sustainable finance and the country still has the necessary skills and expertise to regain this status.

Swiss asset managers and service providers such as Ethos, Globalance and SAM, were the pioneers who put sustainability centre stage. Mainstream players, such as UBS and Pictet, were among the first to adopt sustainability within their business lines. The recent Global Green Finance Index,[1] however, paints a different picture, with Switzerland losing its pole position to other centres, such as Paris, London, Luxembourg and Shanghai.

Despite impressive growth rates over the last ten years, the Swiss sustainable finance market has not yet breached the 10 % mark of all sustainable managed assets.[2] Many decision makers still regard sustainable finance as a niche. Nevertheless, Switzerland has reached an inflection point, meaning that the curve is slowly moving. First of all, sustainability movers are solidifying their business and mainstream players are starting to integrate sustainability into parts of their businesses. This slow movement is epitomised by a study by the Federal Office for the Environment (FOEN) indicating that on average, Swiss pension funds and insurance companies are financing a 4- to 6-degree world – far from the goal set by the Paris Agreement. However, this is likely to change in the future, as a strong push from the European Union (EU) will come and will impact the Swiss framework conditions very heavily.

The following paragraphs outline the various activities and engagements of different players involved in sustainable finance in Switzerland.

1.1. Sustainable finance market and self-regulation in Switzerland

As early as the 1990s, players in the Swiss financial industry had started to integrate sustainability factors into their investment and/or lending decisions. Since then, the market has grown significantly. The latest show that

[1] The Global Green Finance Index (GGFI) assesses ratings for financial centres calculated by a “factor assessment model” that uses two sets of data, namely, green financial centre assessments and instrumental factors (e.g. evidence of financial centres' commitments and achievements on ESG disclosure).
GGFI, 2019: https://www.longfinance.net/programmes/financial-centre-futures/global-green-finance-index/

[2] Sustainable managed assets covers all reported sustainable investment funds, sustainable mandates and sustainable assets of asset owners (Swiss Sustainable Finance, 2018:
http://www.sustainablefinance.ch/upload/cms/user/SSF_Swiss_Sustainable_Investment_Market_Study_2018_E_final1.pdf)

[3] WWF, 2019: https://www.wwf.ch/de/unsere-ziele/sustainable-finance-nachhaltige-finanzfluesse-foerdern

[4] WWF, 2018: https://www.wwf.ch/sites/default/files/doc-2017-09/2017-08-Gesamtstudie_WWF_Retailbanking_Rating_DE.pdf

CHF 390.6 billion is invested in sustainable financial products (Swiss Sustainable Finance, 2018) – approximatively 8 % of the Swiss fund market. Besides niche institutions whose raison d'être is sustainability (e.g. Nest, Stiftung Abendrot, Globalance and Alternative Bank Schweiz), there are also conventional financial institutions driving the sustainability agenda.

A good example is Swiss Re. This major insurer is taking a leading role in its sector, particularly regarding climate risk modelling. It also decided to switch from a 'conventional' to an 'ESG' benchmark in 2017. Furthermore, an increasing number of service providers are seizing market opportunities (e.g. ECOFACT, RepRisk, Carbon Delta, southpole, etc.) providing insights on sustainability issues regarding the financial sector.

Simultaneously, several financial institutions had already started to coordinate their approach to sustainable finance. The most prominent examples are the creation of:

- Sustainable Finance Geneva (SFG), founded in 2008
- Swiss Sustainable Finance (SSF), founded in 2014, and
- Swiss Association for Responsible Investments (SVVK-ASIR), founded in 2015

SFG and SSF have members and contributing actors that reflect the entire range of stakeholders, whereas SVVK-ASIR has a limited membership base. They play a vital role in maintaining an ongoing dialogue on the evolution of sustainable finance and its translation into business.

Recently, industry associations not specifically devoted to sustainability issues, such as Swiss Banking, the Swiss Insurance Association, the Swiss Funds & Asset Management Association and Swiss Pension Fund Association, have begun to acknowledge the importance and relevance of sustainability issues.

However, the WWF Switzerland ratings of the Swiss pension fund[3] and retail-banking[4] sector indicated that on average the financial institutions are not yet considering sustainability as part of their core business, but rather as a niche.

1.2. Sustainable finance framework conditions in Switzerland

Framework conditions comprise many components (laws, policies, and statements) and operate at different levels (federal, cantonal, and local). They are relevant as they define the playing field within which Swiss financial players operate, and they determine the behaviour expected of financial institutions by setting minimum standards. In the following, only the most relevant are briefly mentioned.

The Principles for Responsible Investment (PRI) database indicates that Switzerland has two hard sustainable finance laws that apply directly to financial players.

- Firstly, the War Materials Act prohibits financial institutions from investing directly in war materials;
- Secondly, the Executive Pay provisions (also called the Minder Initiative) that require shareholders to vote on the executive pay of invested companies.

Despite being hard laws, both have significant loopholes, allowing financial players to circumvent them.[5] At cantonal level, Vaud, Fribourg, and Geneva require their local public pension funds to invest sustainably, and there are several cantons (e.g. Zurich) that have integrated a sustainability mandate for their cantonal banks (where the canton is the major shareholder).

The clearest signals are currently coming from local city level. The Pension Fund of the City of Zurich has developed a forward-looking climate strategy, and Geneva has integrated sustainable finance in its economic outlook plan.

When it comes to policies and announcements, Switzerland has been more reactive compared with its neighbours. However, since 2015, the Federal Council has been acknowledging the relevance of sustainable finance.

1. Firstly, the Federal Council is participating in the G20 Green Finance Study Group set up under the Chinese Presidency.
2. Secondly, the Federal Council's current financial market policy (launched in 2016) mentions sustainable finance as a market opportunity for the Swiss financial sector – along with FinTech.
3. Thirdly, since 2016, the State Secretariat for International Finance (SIF) has been organising an annual sustainability meeting with the financial industry.
4. Lastly, the FOEN published several studies on particular issues, such as the performance of climate-friendly investment vehicles,[6] and encouraged all Swiss institutional investors to run a climate-compatibility test[7]. In 2016, the office published the Roadmap for a Sustainable Financial Centre, which focussed mainly on capacity building and education.

Overall, there is currently no clear willingness nor attempt to define framework conditions at national level. Certain cantons and cities are leading the way and have made explicit requests to their local financial sector. However, their authority only extends to specific financial players, such as public cantonal pension funds and cantonal banks.

More clarity and a coherent, cohesive approach at national level would boost the uptake of sustainable finance in Switzerland. An example: The Federal Council's public announcement that sustainability is part of fiduciary duty was an important signal to industry (16.3.2018)[8]. More signals and incentives are required.

[5] Both the War Material Act and the Executive Pay dispositions only apply to direct equity/investment.

[6] FOEN, 2016: https://www.bafu.admin.ch/bafu/de/home/themen/wirtschaft-konsum/dossiers/magazin2017-2-dossier/die-rendite-stimmt.html#3_1487082199171__content_bafu_de_home_themen_thema-wirtschaft-und-konsum_wirtschaft-und-konsum--dossiers_magazin-umwelt-2-2017-geld-bewegt_die-rendite-stimmt_jcr_content_par_tabs

[7] FOEN, 2017: https://www.bafu.admin.ch/dam/bafu/de/dokumente/klima/fachinfo-daten/klimavertraeglichkeitsanalyse.pdf.download.pdf/DE_Zusammenfassung_Bericht_Klimavertr%C3%A4glichkeitstests_2ii.pdf

[8] https://www.sif.admin.ch/sif/de/home/dokumentation/medienmitteilungen/medienmitteilung.msg-id-70127.html

Sabine Döbeli, CEO Swiss Sustainable Finance

> “There is growing awareness in the Swiss financial centre about the importance of integrating ESG factors into financial decision-making. The strong recognition of SSF and our activities, for instance through the broad uptake of our handbook on sustainable investments or our involvement on the national level in the advisory group of the State Secretariat of International Financial matters, is proof of this positive trend. With the EU action plan on sustainable finance, discussions are brought to a new level and the requirements will influence many Swiss financial players. While we can build on broad Swiss know-how in sustainable finance, we have to make sure that Swiss frameworks reflect international trends and help Swiss market players stay competitive in the long run.”

1.3. Political and public pressure regarding sustainable finance in Switzerland

Alongside the market and the state, politicians, civil society organisations, and the media are shaping public discourse on sustainable finance and pushing for more proactive sustainable finance engagement in Switzerland.

Politicians at local and national levels have actively acknowledged the importance of sustainable finance since 2000.[9] Between 2000 and 2007, the issue lost traction and between 2007 and 2017, it was mainly the Green Party showing interest in sustainable finance.

This has changed significantly since early 2017. Between then and the parliamentary session in December 2018, 18 parliamentary interventions have been submitted (see the full list in the Appendix) by all parties other than the CVP (Christian Democratic People’s Party of Switzerland) and SVP (Swiss People’s Party). This indicates that a majority of parliamentarians recognise the topic as being relevant and as an important opportunity for the Swiss financial sector. These parties mostly used “interpellations” (questions to the federal council) to bring forward their interventions.

At the cantonal level, the main target of political interventions has been public pension funds, influenced by the global divestment movement.

As for pressure from civil society, several NGOs have been active in Switzerland regarding sustainable finance. Greenpeace, for example, has been looking at the investment behaviour of Credit Suisse and UBS.[10]

Also, since 2012, WWF Switzerland has been actively encouraging the financial sector to integrate environmental issues into their investment and lending decisions, mainly focusing on retail banks and pension funds. Through the Climate Alliance, more than 70 organisations related to environmental protection have joined forces to increase awareness of the climate impact of the financial sector and educate the Swiss public. Lastly, media coverage of sustainable finance issues has grown significantly.

The SSF website mentions more than 70 media reports for 2018 alone. Since 2015, the number of reports has grown significantly, which confirms that sustainable finance is becoming a relevant topic for all sorts of players.

[9] The first parliamentary intervention was submitted in October 2000: Empfehlung Plattner 00.3517: Anlagepolitik nach dem Prinzip der Nachhaltigkeit; https://www.parlament.ch/de/ratsbetrieb/suche-curia-vista/geschaeft?AffairId=20003517

[10] Greenpeace, 2019: https://www.greenpeace.ch/wp-content/uploads/2019/01/Greenpeace_FactSheet_EN.pdf

2. Action Plan Sustainable Finance

Based on the Paris Agreement and the Agenda 2030, the EU acknowledged in 2015, the importance and core function of the financial system for sustainability through re-orienting investments towards more sustainable technologies and businesses, financing growth in a sustainable manner over the long term, and contributing to the creation of a low-carbon, circular economy.[11]

Consequently, the European Commission decided, in 2016, to establish the High-level Expert Group on Sustainable Finance (HLEG) as part of its Capital Markets Reform.

The HLEG was led by Christian Thimann (Axa) and comprised 19 other experts from industry, civil society, and academia, and welcomed a number of observers. This group was mandated to provide advice on steering private capital towards sustainable investments and identifying the next steps for financial institutions and supervisors to protect the financial stability from environmental risks, as well as providing measures that could be deployed on a pan-European level.

The final HLEG-report was published in January 2018. Based on these high-level recommendations, the European Commission adopted an **Action Plan on Sustainable Finance in March 2018,** setting out a comprehensive strategy to connect sustainability and finance, by amending financial regulations and policies and explicitly introducing sustainability aspects. Advancing at an enormous pace, the European Commission adopted, in May 2018, five packages of legislative amendments.

It is expected that following the elections for the new European Parliament in May 2019, the first legislative proposals will have undergone the trialogue and will be accepted. There have been proposals to incorporate sustainability standards (taxonomy and discloser requirements) to a varying extent in the following major regulatory frameworks:

- Markets in Financial Instruments Directive (MiFID) II;
- Capital Requirements Regulation-Capital Requirements Directives (CRR-CRD);
- Benchmark Regulation;
- Directive on the activities and supervision of institutions for occupational retirement provision (IORP) II;
- Alternative Investment Fund Managers Directive (AIFMD);
- Directive on undertakings for collective investment in transferable securities (UCITS)
- Insurance Distribution Directive (IDD)
- Credit Rating Regulation

The CRR-CRD or the IORP II were not kickstarted within the Action Plan Sustainable Finance, but the aim was that sustainability be integrated within these financial regulations beforehand. Both are now into force. Since 1 January 2019, IORP II has required all pension funds in the EU to integrate ESG factors and to report on them regularly. The CRR-CRD calls, amongst other things, for a mandatory disclosure of ESG risks for banks within the next three years

Overall, the process has been extremely fast-paced and concrete, and, interestingly, the legislative proposals grew stronger during the trialogue. This means that the EU is very serious about sustainable finance.

[11] See: https://ec.europa.eu/info/business-economy-euro/banking-and-finance/sustainable-finance_en

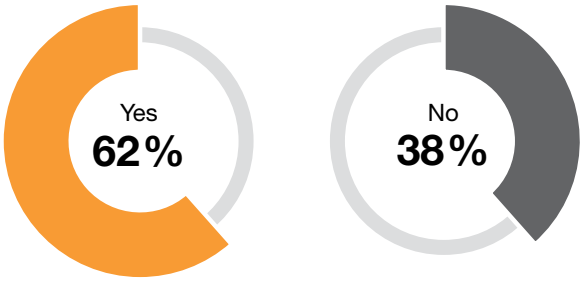
3. Sustainable finance in European countries: status quo

The regulations differ profoundly among countries which is why it is necessary to take a closer look at the individual regulations and their design.

In January 2019, PwC and WWF conducted a survey to gain a better understanding of the situation in different countries across Europe. The participants were PwC and WWF experts with in-depth knowledge of the situation in their respective countries. The results show the differences and commonalities across the participating regions and provide insight into the need for regulatory support.

3.1. Regulatory framework conditions

Are framework conditions in your country (policies, regulations, etc.) conducive to sustainable finance and encouraging financial players to integrate sustainability factors into every step of the investment and lending decision-making process?



3.2. Availability of sustainability-promoting standards

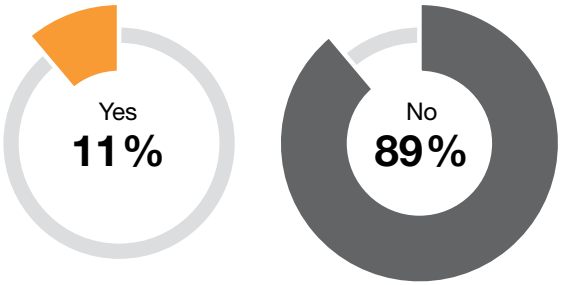
This question asked more specifically for the regulations, standards, and how they encourage financial players to integrate sustainability factors.

In **Sweden,** the financial supervisory authority is responsible for monitoring and promoting sustainable development through the financial system. While there is, as yet, no specific regulation in place, the authority is analysing how the financial sector is adopting and adapting to sustainability factors. In addition, since 2017 there has been a regulation in place requiring mutual investment funds to provide information and an annual report on how they are integrating sustainability factors into fund management.

In the **Netherlands,** several institutions are involved in regulating the financial industry. ABN AMRO, ING and Rabobank launched joint circular-economy finance guidelines. The Dutch Bankers Association Advisory Panel on Responsible Banking and the Dutch Banking Sector Agreement on International Responsible Business Conduct imposed checks as regards human rights.

3.3. Hindering standards

We asked if any framework conditions in your country (industry standards, regulations, etc.) are currently hindering financial players from integrating sustainability factors effectively at every step of the investment and lending decision-making process.



The result also has to be seen in light of the fact that the level of regulation is very low, thus nothing is hindering anyone currently as there is no regulation of any kind in place.

E.g. in **Sweden,** so far, no coherent standards exist. Apparently, the Swedish Central Bank, the Debt Office, and the Financial Service Authority (FSA) stated in 2018 that the cost for green government bonds is too high. The central bank is seeking a clear definition of green bonds. The green bonds that already exist are being affected by the absence of any clear regulation in Sweden.

3.4. Reaction of policy makers to the Action Plan Sustainable Finance

The reception given to the Action Plan Sustainable Finance by decision makers is somewhat diverse. In Greece, the reception was positive, but pointed to the fact that the guidelines are still unknown.

Most banks issue sustainability reports and follow certain standards relating to sustainable finance (e.g. Climate-related Financial Disclosures (TCFDs), PRI, etc.) and are familiar with ESG-standards. The Hellenic Capital Market Commission also published its members' contribution to the consultation paper. In **Sweden,** the reaction was positive, and the **Dutch** Government is currently working on a National Climate Agreement in the wake of the Paris Agreement. This also takes into account the Action Plan Sustainable Finance. Decision makers in **Belgium, Austria,** and **Italy** showed neither positive nor negative reactions to the Action Plan Sustainable Finance.

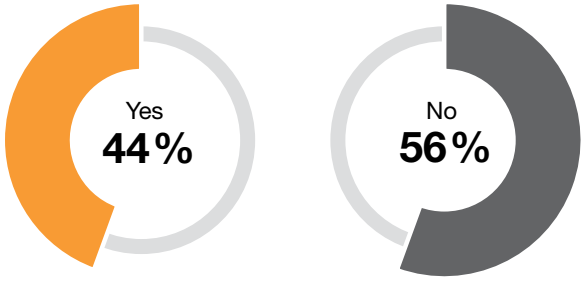
3.5. Attitude of decision makers

The perceptions of several decision-makers differ depending on the country.

- In **Greece,** the Hellenic Capital Market Commission, the Bank of Greece, the Hellenic Bank Association, and the Hellenic Ministry of Finance are the most relevant players.
- In **Sweden,** it is politicians and regulators, the financial inspectorate, large banks, and insurance companies.
- In the **Netherlands,** the Government and the Climate Agreement Working Group play central roles in the decision-making processes.
- In **Belgium,** the answer was the Federal Government, the Belgian National Bank, and the Financial Services and Markets Authority (FSMA).
- In **Austria,** the most important players are the largest banking groups, industry representatives, and the Government.
- In **Italy,** the Government, the Bank of Italy, the Italian Companies and Exchange Commission (Consob), the Italian Banking Association (ABI), the Investment Management Association (Assogestioni), and the Insurers Association (ANIA) play key roles.

3.6. Intention of local considerations

We asked if political parties and/or the government in your country was currently thinking of or debating integrating the different items of the action plan on financing sustainable growth into the national framework conditions in order to have equivalent legislation or have concrete changes already been decided.

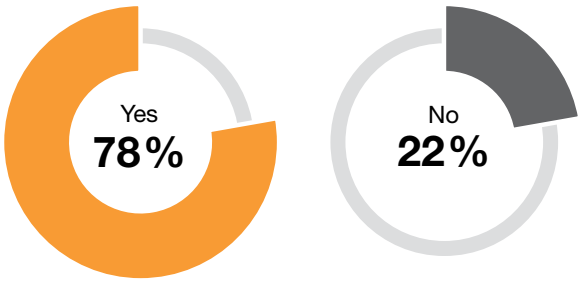


3.7. Planned measures

The planned measures also differ by country.

In **Sweden,** the Government plans to increase the requirements on national pension funds to invest explicitly only in sustainable investments. Mandatory non-financial reporting is required for all large companies that goes beyond the requirements imposed under EU directives since 2017. In the **Netherlands,** the effect and legislative actions for the Paris Agreement are still being discussed at national level. In **Italy,** actions are planned on incentives for renewable energies, implementation of EU proposals on ESG taxonomy, ESG disclosure, and the integration of sustainable finance criteria into investment decision processes.

Moreover, it was asked whether there were any local industry working groups being formed to foster a unique and sound industry standard on the different aspects of sustainable finance.

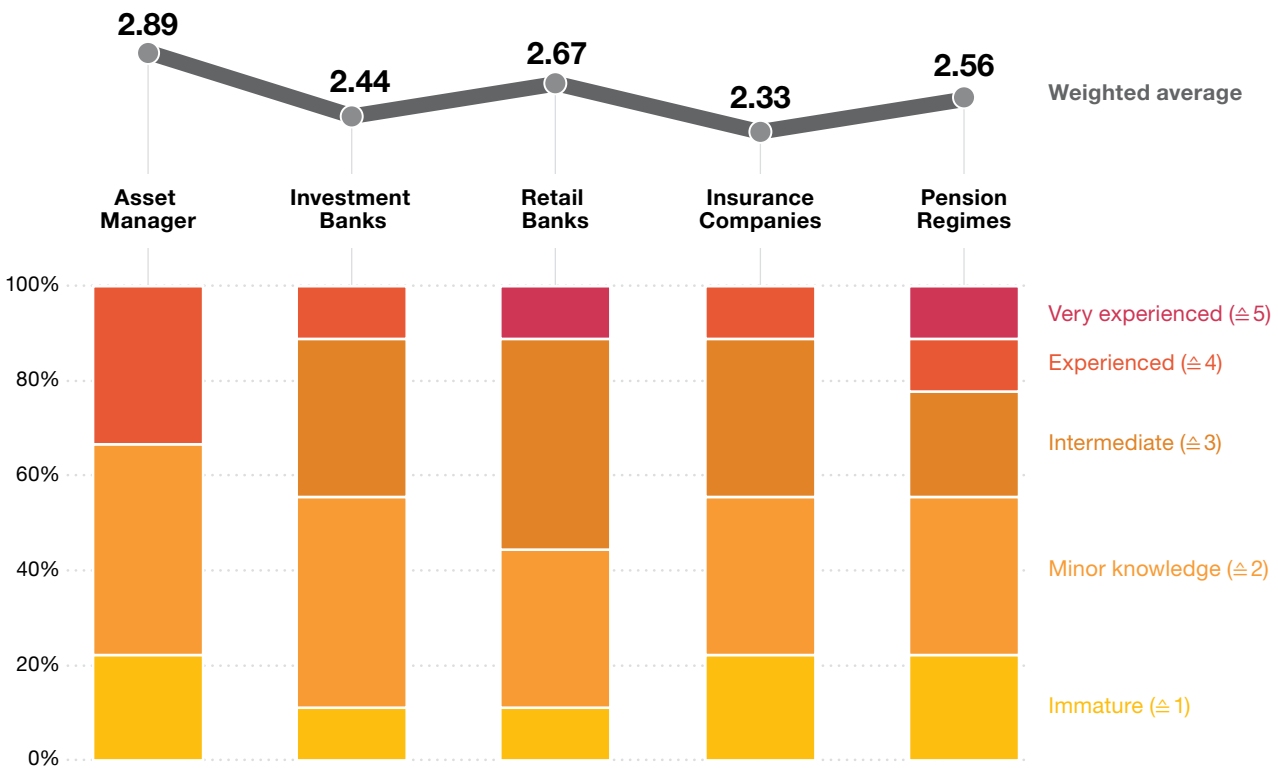


Several countries have formed or have already put in place industry working groups. As mentioned above, ABN AMRO, ING, and Rabobank launched joint circular-economy finance guidelines in the **Netherlands,** in association with the Dutch Bankers Association Advisory Panel on Responsible Banking.

The **Italian** Banking Association (ABI) Working Group on the Implementation of the EU Proposal on ESG Investments is working on local implementation of the proposed amendments to MFID II, IDD, the Solvency Directive, the UCITS Directive, and AIFMD.

3.8. Maturity of the local financial industry

The last question asked how mature the local financial industry is in integrating sustainability factors into decision-making – probably the most sensitive but also most important question.



4. Switzerland vs. Europe: Commonalities and differences regarding sustainable finance

Overall, Switzerland and European countries are increasingly focussing on sustainable finance. Most European as well as Swiss market and state representatives acknowledge the business opportunity that sustainability represents, there is agreement that there is a necessity to act and various established and newly formed organisations aim to shape the discussion.

Despite these commonalities, the authors distinguish three main differences, potentially why the Swiss financial sector is currently not considered a sustainable finance frontrunner anymore[12]:

- Role of the state. Sustainable finance has been adopted as a national strategy to promote the competitiveness of the Swiss financial industry, and has been named as one of two innovation areas for future growth in the Federal Council's financial market policy. Switzerland's sustainable finance aspirations aim to secure future growth while at the same time helping resolve the sustainability challenges that Switzerland has committed to addressing (e.g. the 2030 Agenda for Sustainable Development and the Paris Agreement). Currently, there are no plans to set up incentive structures nor sanctions regarding sustainable finance. The preferred approach is to facilitate the process and provide some guidance. Arguably the financial sector can "shift the trillions" only if there are conducive framework conditions in place. This means that the Government (public administration) and political decision-makers must acknowledge sustainable finance as being a priority, set incentives for sustainable finance and impose minimum requirements on all financial actors regarding sustainability.
  This approach is currently adopted by the EU, trying to standardise, clarify, increase the transparency, and finally to incentivise the uptake of sustainable finance. The Action Plan Sustainable Finance therefore tries to integrate the sustainability criterion in most of the framework conditions relevant for the financial sector:

- Leadership of central banks and financial regulators. After the G20 and the EU the central banks are part of the driving forces regarding the sustainable finance agenda. Many central banks and financial regulators of European countries[13] are member of the recently established Network for Greening Financial Systems (NGFS). They acknowledge the importance of climate risks on the micro-prudential level and aim to assess the relevance on the macro-prudential level, mandate common research, and set up discussion platforms for capacity-building and knowledge exchange. Thereby, they drive the uptake of environmental risks by their regulated entities, set a positive example and increase momentum on sustainable finance. Neither the Swiss Financial Market Authority (FINMA) nor the Swiss National Bank are part of the NGFS and are currently not encouraging sustainable finance.

- Strong support and commitment of top management and champions. Many countries have a variety of individuals from the political, business or financial sphere who are actively championing sustainable finance. Mark Carney (Governor Bank of England), Bruno Le Maire (Finance Minister France), François Villeroy de Galhau (Governor Banque de France), Frank Elderson (Governing Board DNB), Ralph Hamers (CEO ING), are just few of the most prominent ones. This non-exhaustive list indicates that alongside top management business support there is also political support. In Switzerland there are currently no leaders within the federal administration who are driving the agenda, in contrast to the few finance top-shots such as Axel Weber (Chair of UBS) or Patrick Odier (managing partner of Lombard Odier) who are driving the sustainable finance agenda.

  Nevertheless, a report from Swiss Finance Institute[14] indicates that among Swiss financial actors there is still a lack of top management support

The job of building on and developing the leading position of sustainable finance in the Swiss financial industry is to be accomplished with the strong commitment of political, federal administration and business leaders, as well as the effective support of well-established platforms working jointly in the common interest.

[12] Mentioned by Swiss Finance Institute, 2016 (http://www.sfi.ch/system/tdf/WP_SustainableFinance_WEB_1.pdf?file=1) and the Global Green Finance Index, 2018 (https://www.longfinance.net/media/documents/GGFI_2_Full_Report_2019.02.07_v6.0.pdf)

[13] Banca d'Italia, Banco de España, Banco de Portugal, Bank of England, Bank of Finland, Bank of Greece, Bank of Thailand, Banque centrale du Luxembourg, Banque de France / Autorité de Contrôle Prudentiel et de Résolution (ACPR), Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin), Central Bank of Hungary, De Nederlandsche Bank, Deutsche Bundesbank, European Banking Authority, European Central Bank, European Insurance and Occupational Pensions Authority (EIOPA), Finansinspektionen (Swedish FSA), Finanstilsynet (Norwegian FSA), National Bank of Belgium, Norges Bank, Oesterreichische Nationalbank, and Sveriges Riksbank

[14] Swiss Finance Institute, 2016: http://www.sfi.ch/system/tdf/WP_SustainableFinance_WEB_1.pdf?file=1

5. Third-country applicability of first Legislative Proposals of the Action Plan Sustainable Finance

As described in the previous chapters, legislative proposals have been suggested by the European Commission and the European Parliament as part of the Action Plan Sustainable Finance. These were launched in May 2018. This chapter mostly, analyses these five legislative proposals (analysing the period from May until 31 December 2018) and reflects as to what these changes mean for Swiss financial players from a legal standpoint. This is because Switzerland is not part of the EU and therefore not legally bound to directly follow the new provisions.[15]

The five legislative proposals focus on asset management, insurance and pension providers, and will impact the following major financial market participants:

- Investment firms providing portfolio management or investment advice
- Alternative investment fund managers (AIFMs)
- UCITS management companies
- Insurance undertakings
- Intermediaries providing investment advice
- Pension product providers and institutions for occupational retirement, and
- Benchmark providers and administrators.

The legislative measures put forward by the European Commission will also impact financial products offered as sustainable, such as UCITS funds, alternative investment funds (AIFs), portfolio management, and insurance-based investment and pension products.

5.1. Legislative Proposals May 2018

Introduction of a harmonised taxonomy with respect to "sustainability"

The rules on sustainability taxonomy seek to increase transparency for end investors and enhance comparability with respect to asset managers and institutional investors who claim to pursue sustainability objectives with their respective financial products.

Going forward, financial market participants offering such financial products would have to demonstrate how, and to what extent, their financial products align with specific sustainability taxonomy standards, such as the active contribution (and the absence of significant harm thereof) to the following major areas of the forthcoming sustainability taxonomy:

1. Climate change mitigation
2. Climate change adaptation
3. Sustainable use and protection of water and marine resources
4. Transition to a circular economy, waste prevention and recycling
5. Pollution prevention and control, and
6. Protection of a healthy ecosystem.

Furthermore, financial products may only be viewed as "environmentally sustainable" if the undertaking complies with procedures it has implemented to ensure that the principles and rights set out in the eight fundamental conventions identified in the International Labour Organisation's Declaration on Fundamental Rights and Principles at Work are observed.

The information to be disclosed with respect to these financial products must enable investors to identify:

1) The percentage of holdings pertaining to companies carrying out environmentally sustainable economic activities, and
2) The share of the investment that is funding environmentally sustainable economic activities as a percentage of all the economic activities.

New disclosure requirements for financial services and products

Written policies are to be published on websites regarding the integration of sustainability risks in the investment decision-making process, investment or insurance advice. Descriptions related to specific sustainability risks are to be included in pre-contractual disclosures. The disclosures to be made cover: 1) procedures and conditions applied for integrating sustainability risks in investment decisions and advice; 2) expected impacts of sustainability risks on returns; and 3) the consistency of remuneration policies with the sustainable investment target of the financial product and the integration of sustainability risks.

[15] This chapter is based on the legal opinion published in December 2018 by LCR Services AG and the PwC Sustainability Whitepaper published in October 2018

Financial market participants will also have to publish and maintain on their websites the following information.

1) Financial-product-related information on how sustainability targets are reached
2) Regular reports covering the overall sustainability-related impact of the financial product based on relevant sustainability indicators, and
3) Information in relation to the financial product sustainable investment target and the methodologies used to assess, measure, and monitor the impact of sustainable investments, including data sources, screening criteria for the underlying assets, and the relevant sustainability indicators used to measure the overall sustainable impact of the financial product.

Financial market participants, insurance intermediaries, and investment firms will need to ensure that their marketing communications do not contradict the information disclosed pursuant to the new sustainability rules.

Furthermore, investment firms are to disclose to investors the types of financial instrument that may be included in the client portfolio, based on any ESG preferences of the client. A general description of the nature and risks of financial instruments, taking into account in particular any ESG considerations, must be provided to clients.

Last but not least, investment firms are to provide a description of the factors, including any ESG factors, taken into consideration in the selection process used to recommend financial instruments.

Client profiling and investment advisory process to integrate ESG client preferences and ESG factors

Under MiFID II, investment firms have to determine the extent of the information to be collected from clients in light of all the features of the investment advice or portfolio management services to be provided to them. Going forward, the information to be collected from clients will also have to include information on any ESG preferences the client has.

In view of such client risk profiles enhanced by ESG client preferences, the amended MiFID II rules now require a transaction to meet the investment objectives of the client in question taking account of the corresponding ESG considerations in addition to the client's risk tolerance and any preferences. Investment firms will need to be able to demonstrate that they have in place adequate policies and procedures, now also including ESG considerations.

Furthermore, when providing investment advice, investment firms must provide a report to the retail client, including an outline of the advice given and explaining how the recommendation provided is suitable for the retail client and meets their ESG preferences.

In the context of insurance-related advice, a personal recommendation will now have to satisfy the client or potential client's ESG preferences in addition to their investment objectives and risk tolerance. This means the information regarding the customer's or potential customer's investment objectives will now also have to include their ESG preferences.

New categories of benchmarks

The current EU framework as of February 2019 on sustainable finance establishes two new categories of low-carbon benchmarks:[16]

1) Climate-transition benchmark, and
2) Specialised benchmark that brings investment portfolios in line with the Paris Agreement goal.

An administrator has to publish or make available an explanation of how the key elements of the methodology laid down above reflect ESG factors for each benchmark or family of benchmarks that pursue or take into account ESG objectives.

The European Commission is also seeking to enhance the ESG transparency of benchmark methodologies, and is putting forward standards for the methodology of low-carbon and positive impact benchmarks in the EU.

Daniel Wild, PhD Co-CEO of RobecoSAM and Board Member of Swiss Sustainable Finance (SSF)

"Any step, big or small, towards systemically integrating ESG aspects into investment decisions and moving financial markets in a more sustainable direction is a gain for society. At RobecoSAM, we've been advancing this thinking since our founding in 1995. Regulations can help in reducing confusion around terminology, rendering clearer and more meaningful discussions with clients and stakeholders. Embracing sustainability for a future-proof economy should be a natural thing anyway. It is a positive way of being selfish – as an individual, a corporation or, in our case, as a nation, if Switzerland wants continue its prosperous path."

[16] European Commission, 2019, http://europa.eu/rapid/press-release_IP-191418_en.pdf

5.2. Financial services and products offered across borders to clients in the EU impacted by the new rules

The new rules in the EU in essence introduce additional sustainability/ESG-related requirements into existing elements of EU financial market legislation – these are in particular the following:

- UCITS – Directive 2009/65/EC
- PRIIP – Regulation (EU) No 1286/2014)
- Solvency II – Directive 2009/138/EC;
- AIFMD – Directive 2011/61/EU
- MiFID II – Directive 2014/65/EU
- IDD – Directive (EU) 2016/97
- IORP – Directive (EU) 2016/2341
- European venture capital funds – Regulation (EU) No 345/2013
- Regulation (EU) No 346/2013 (European social entrepreneurship funds), and
- Regulation (EU) 2015/760 (European long-term investment funds).

In other words, if a financial institution based in Switzerland is already subject to any one of these EU policy frameworks as a financial actor providing relevant in-scope services across the borders of the EU, it will also have to adhere to the requisite EU proposal-based rules adding sustainability and ESG aspects to the pertinent EU policy.

This may be the case, for example, where investment firms based in Switzerland export to the EU: 1) investment management services for UCITS or AIFs; 2) investment services within the scope of a branch or other EU Member State-specific third-country cross-border regimes in the context of MiFID II; or 3) export AIFs to the EU under national private placement regimes (NPPRs) or AIFMD.

5.3. The gap in standards between EU and Switzerland is widening

Following the introduction of AIFMD and MiFID II/MiFIR (Markets in Financial Instruments Regulation) in the EU, Switzerland amended its Collective Investment Scheme Act (CISA) and established the Financial Services Act (FinSA) to maintain equivalence with EU standards – which is a prerequisite for potential EU market access.

The equivalence of standards between the EU and Switzerland may also be a key factor underlying the discussions on an institutional framework between Switzerland and the EU.

All non-EU alternative investment fund managers (AIFMs) based in Switzerland wishing to market and/or manage their AIFs in the EU using the AIFMD passport, or non-EU AIFs to be marketed by EU AIFMs, would need to comply with the new ESG and sustainability disclosure requirements established by the EU.

The new EU rules change the standards to be taken into account for a European Securities and Markets Authority (ESMA) assessment or passporting decision of the European Commission. Compliance with AIFMD provisions, which have now been supplemented with ESG transparency obligations, is seen as a pre-condition for an AIFMD passport.

Furthermore, market access for Swiss investment firms wishing to service eligible counterparties and professional investors would also be subject to an equivalence decision by the EU.

Should FinSA not be enhanced with ESG and sustainability-related conduct rules, the gap in terms of deviations between FinSA and MiFID II will further increase in light of the requirements introduced by the EU in areas such as taxonomy, disclosures, investment process and policies, risk management, client profiling, the ESG-related suitability of advice, advisory protocols and reporting.

In granting a decision on equivalence with respect to Switzerland, the European Commission would have to consider whether the regulatory framework in Switzerland would enable authorities in the EU to rely on supervised entities' compliance with the equivalent foreign (Swiss) framework and thereby achieve the same results as the corresponding EU legal provisions and supervision. This is currently not the case in relation to the ESG and sustainability objectives pursued by the EU.

The European Commission would also need take into account whether Swiss firms would be put at an advantage over investment firms from EU Member States if these Swiss firms were given access to the EU market while themselves being governed by less stringent standards than those applicable to investment firms from EU Member States.

Although we have only looked at a limited time horizon and the first legislative texts are subject to constant change, it is already very likely that, as of now, sustainability preferences and disclosures in particular will prevail and that they will be tightened up.

6. Impact of the Sustainable Finance Action Plan on the different actors in the Swiss financial industry

Michaël Lok, Head of Investment Management, UBP and
Nicolas Faller, Head of Institutional Clients, UBP

> "Given ongoing secular shifts taking place in business and society, both sustainable and impact investing are gaining increasing traction and will soon be an integral part of financial analysis standards, leading to investment decisions that carry greater conviction. Incorporating environmental, social and governance-related information into wealth management is one of the core duties that a bank owes to its clients."

The ESG standards are a game changer for the whole financial industry and, of course, for the non-financial industry as well. This is underpinned by the fact that proposals for amending existing key regulations, as mentioned above, are already in the final consultation phase and the European Commission has indicated that the whole European Economic Area has to invest EUR 180 billion annually until 2030 to reach the goals.

Furthermore, all the measures proposed by the EC for financing sustainable growth will have an impact on the financial industry as every sector will be affected by the new obligations to consider ESG and abide by stricter disclosure requirements. In this context, the entire investment decision-making and advisory process will have to be reviewed and amended.

6.1. Retail banking

Given their unique position as facilitators of capital flows through their lending, investment, and advisory processes, banks play a pivotal role in financing environmental projects. Retail banking activities affect the environment in which they operate not only by financing portfolios, but also by helping retail clients transition to more sustainable investments. This means that banks will have to review their suitability and appropriateness questionnaires and all related internal processes and guidelines. For example, they will need to have a conflict of interest policy that ensures that the inclusion of ESG considerations in the advisory process does not lead to misselling practices or damage the interests of retail clients.

6.2. Private banking

Clients have to be provided with general information about the types of financial instrument that may be included in their portfolio, based on their investment objectives and taking account of any ESG preferences, as well as the nature and risks of the financial instruments. In other words, prior to the advisory process, banks are required to assess clients' investment objects and risk tolerance so as to be able to recommend suitable financial products. This means that as part of the private banking process, bankers have to ask their clients about their preferences and take them into account when assessing the range of financial products to offer. In this regard, ESG factors have to be considered in the product classification process and banks have to develop different methodologies for assessing suitability:

- Simplified approach, where clients are asked about their investment preferences for ESG products;
- Advanced portfolio approach, where client's preferences are based on ESG factors for calculating the ESG profile.

According to the ESMA, assessment of clients' ESG preferences should not be limited to wealthier clients because over two-thirds of retail investors consider environmental and social objectives to be important factors in their investment decisions.

Dr. Jan Amrit Poser, Chief Strategist & Head Sustainability, Bank J. Safra Sarasin

"Bank J. Safra Sarasin welcomes this comprehensive study by PwC and WWF which provides insights into how to face up to the sweeping regulatory changes that will affect the entire value chain. As a pioneer and thought-leader in the field of sustainable investments, we are glad to see that the market will have to embrace the integration of sustainability considerations into every step of the investment process. We endorse the trend to transparency, embedding ESG in client advice, product design and portfolio reporting."

"Consistent with our fiduciary duty to act in the best interests of our clients, we are committed to integrating material ESG criteria in our investment processes and ownership practices, with the conviction it will enhance returns and mitigate risks over the long term."

Laurent Ramsey, Managing Partner and CEO of Pictet Asset Management

6.3. Asset management

With regard to the asset management business, the EC plans to amend the current regulatory framework of MiFID II, the UCITS Directive and the AIFMD by integrating sustainability risks (i.e. ESG risks) along the value chain from product development to distribution.

The EC has asked ESMA to provide technical advice by 30 April 2019 recommending how and where asset managers should integrate relevant sustainability risks and factors within their business models and procedures, and in particular within:

- Organisational requirements
- Operating conditions, including investment strategy and asset allocation, and
- Risk management.

Asset managers will be required to disclose how sustainability risks are incorporated into their investment decision-making processes, including the impact of sustainability risks on returns on any financial product and the consistency of their remuneration policies with the integration of sustainability risks.

Under MiFID II, UCITS Directive and AIFMD, these requirements would apply to all asset managers, regardless of whether they actively pursue sustainable investment strategies or not. For funds with no sustainability focus, managers will need to consider whether the new disclosure requirements will only result in limited additional disclosure or whether they will generally need to consider sustainability in their investment process and strategy. Furthermore, they will also need to consider whether the required disclosure might have an impact on their respective marketing regimes, in particular as regards the publishing of any fund-specific information on their websites.

Where financial products are marketed as sustainable investments, asset managers will have to disclose the sustainable investment target and the methodologies used to measure the impact of the investment, together with the provision of regular reports detailing the sustainability-related impact of the financial product.

Asset managers may also need to capture and reflect clients' ESG preferences where suitability assessments are required under MiFID II.

6.4. Investment banking

Growing demand for tailor-made, green, structured products means that investment banks will have to build ESG standards into their entire product governance process. In identifying the target markets, they will have to make sure that both the manufacturer and distributor take account of ESG factors. This will result in two categories of target markets for investment banks: ESG-positive structured products and non-ESG structured products. A native target market does not need to be specified. It will also need to be determined whether the product will be comparable with those for clients who do not have ESG products. Moreover, research for both the buy- and sell-side in Mergers and Acquisitionstransactions will have to reflect ESG standard taxonomy parameters to fit into the new taxonomy standards for sustainable investments.

6.5. Insurance companies

Insurance companies are affected if they act as a producer or distributor of green insurance-based investment products (IBIPs). The delegated IDD Regulation sets out new requirements, particularly, in terms of the suitability assessment and statement. ESG criteria must be taken into account in both areas. This means insurers must revisit their product oversight and governance arrangements to ensure they are in line with their clients' interests in terms of suitability and appropriateness. They also need to review their product oversight and governance arrangements because ESG factors influence all stages of the IBIP life cycle, especially the definition of the environmental target market. In addition, it will not be sufficient for insurance companies to specify green IBIPs as a target market; clients who are interested in environmentally sustainable, social, and good governance investments will need to specify precisely which ESG factors are to be fulfilled.

6.6. Pension funds

So far, the level of sustainable investment by Swiss pension funds has been relatively low, but ESG obligations in Europe will result in growing demand. The fact that pension funds focus on long-term objectives and factors (such as environmental and social conditions) in their investment decision-making process means that there will be increasing interest in integrating ESG factors into the composition of institutional investors' portfolios. In other words, ESG factors will reflect a shift by institutional investors, including pension funds, towards three areas incorporating ESG criteria into their investment decision process. In this context, investment decisions are made across multi-layered asset owner organisations supported by rating agencies. For example, a pension fund typically has a long investment chain:

- Beneficiaries (pensioners and future pensioners)
- Supporting functions, such as finance, accounting, legal, and compliance, and
- External and internal asset managers.

For this reason, all fund managers will have to formulate an ESG investment strategy, formalise their ESG policies and apply them to the stock market or corporate bonds.

6.7. Independent asset managers

The EC's legislative proposals will apply to the following asset management firms:

- UCITS management companies
- AIFMs under the AIFMD
- Managers of European venture capital funds and European social entrepreneurship funds, and
- Investment firms that provide portfolio management under MiFID II.

The proposed rules cover all financial products offered as well as individual portfolio management and advisory services provided by the above-mentioned firms, regardless of whether they follow sustainability investment objectives or not.

Other independent asset managers do not fall within the scope of application of the EC's legislative proposals and will consequently not be put under the legal duty to consider sustainability factors and risks in their respective investment processes and disclosure obligations.

6.8. Trading venues

Trading venues (e.g. multilateral trading facilities and organised trading facilities) will have to update their ratings based on ESG performance and update their databases. This means that they will have to provide a comprehensive ESG benchmark system to help investors navigate around ESG risks by providing ESG indices, methodologies, and proper ratings. In other words, trading venues have to introduce ESG tools into their platforms.

6.9. Data providers

Data providers play an important role in the process of disclosing and supplying ESG factors. Thomson Reuters, for example, has compiled and published a list of ESG-friendly asset managers based on publicly reported data (e.g. emissions and human rights). The table shows the top 10 ESG-friendly asset managers. They include UBS, State Street and BNY Mellon.[17]

Company Name	ESG score
UBS Group	92.6
State Street	88.9
BNY Mellon	79.4
EuroStoxx 50 average	78.8
Legal & General	77.4
Amerprise	71.1
Franklin Resources	71
BlackRock	70.4
FTSE 100 average	69.5
T.Rowe Price	69.1

Source: IGNITES Europe (2018)/PwC (2019)

Buying ESG data from data providers will become increasingly important. The main challenge is the availability of ESG data, although the problem of a lack of data should diminish over time with the establishment of a clear framework and taxonomy. Nevertheless, data providers will have to revise their processes to make them more systematic when it comes to delivering ESG data.

[17] See Schoenmarker and Schramade (2018:14)

6.10. Financial industry impact matrix

Based on several expert interviews and the experience that editorial groups bring, an impact rating, based on the Sustainable Finance Regulation for the different areas of industry, has been drawn up.

As this is a quantitative rather than a qualitative assessment, the impact is shown as being between medium (3) and high (5).

A medium impact in the past would be a regulation, such as the PRIIP regulation. Whereas MiFID II and GDPR would be rated as high (5) in specific areas where strategic changes were required.

Area	Topics	Degree of impact from low (1) to high (5)
Retail banking/private banking	Investment advice	**4**
	Portfolio management/discretionary mandates	**4**
	General disclosure requirements	**4**
	Transparency	**2**
	Product selection/investment policy	**3**
Asset management	UCITS products	**4**
	AIFs	**4**
	Document production	**4**
	Investment strategy	**5**
	UCITS management companies	**4**
	AIFM	**5**
Investment banking	M&A	**3**
	Benchmarks	**4**
	Research (buy and sell side)	**5**
	Corporate action	**3**
	Refinancing/corporate bonds	**4**
Insurance companies	Insurance-based products (IBIPs)	**4**
	Disclosure requirement	**3**
Pension funds	Portfolio composition	**4**
	Disclosure requirement	**3**
Independent asset managers	UCITS products	**4**
	Investment strategy	**3**
Trading venues	Ratings of ESG performance	**4**
	ESG benchmark system	**3**
Data providers	Disclosure requirement	**4**
	ESG data delivery	**4**

7. Impact of the Action Plan Sustainable Finance on financial products offered by Swiss players

With the establishment of ESG standards, most investment products will be impacted, either directly or indirectly. The idea of sustainable investment was initially limited to equities, but now the spectrum is much broader and covers all major asset classes. Here we describe the products affected, including structured investments, collective investments, corporate bonds, mortgages, IBIPs, pension plans, and corporate loans, in more detail.

7.1. Structured investments

Investment banks offer structured solutions that combine the financial characteristics needed by clients with the rapidly developing ESG criteria. However, the biggest challenge is to clearly define what qualifies as a sustainable structured product. Some market participants say a structured product where the underlying is ESG-compliant will qualify, whereas others see the use of proceeds as the key criterion. In this regard, financial institutions are calling for industry-wide standards to help the market for sustainable structured products mature. Clearer definitions and formal guidelines would create more consensus and could pave the way for a more tangible asset class. This is because, at present, financial institutions identify sustainable investable assets in-house and on a voluntary basis, based on different taxonomies. In this context, the European Commission's proposal for a regulation on the establishment of a framework to facilitate sustainable investment (EU) 2018/0178 and the taxonomy pack published by the European Technical Expert Group (TEG) provide the basis for establishing a framework that closes the aforementioned gaps.

The framework will enable the degree of environmental sustainability of a given institution to be determined. This means that if a company only engages in ESG activities, the structured investment will be deemed environmental. By the same token, shares in such a company will be deemed to be an environmental asset. Companies with a variety of activities will have different degrees of environmental sustainability that will incentivise investments in sustainable activities without creating disincentives for investments in other activities.

The taxonomy determines the activities that can be considered as environmentally sustainable structured investments across the EU. Moreover, it provides market participants with a common understanding of and a common language for activities that can be considered as sustainable or green. In other words, it addresses and avoids further market fragmentation resulting from different standards in the EU. In this regard, the TEG has adopted the Statistical Classification of Economic Activities in the European Community and established a framework that can be used for structured investments.[18]

7.2. Collective investments

Collective investment schemes (i.e. investment funds) are assets raised from investors for the purpose of collective investment and that are managed for the account of such investors. The investment requirements of the investors are met on an equal basis.[19]

As regards investment funds, the ESMA issued a consultation paper on 19 December 2018 containing its proposals on how to amend the UCITS Directive and AIFMD to integrate sustainability risks and factors into the regimes. Since neither the UCITS Directive nor the AIFMD provide a legal definition of "sustainability risks", the ESMA proposes that "sustainability risk" be defined as "the risk of fluctuation in the value of positions in a fund's portfolio due to ESG factors".[20]

Under the proposals, UCITS management companies and AIFMs will, amongst others, need to consider sustainability risks resulting from their investments (in addition to all other relevant risks, such as market, interest and credit risk) in their risk management framework, in each case to the extent that is appropriate to the size, nature, scope, and complexity of their activities and the relevant investment strategies pursued. Consequently, they will have to take into consideration, in the investment process and structuring of collective investment schemes, the risks, costs and complexity of the financial instruments' level of sustainability. Furthermore, these aspects will have to be disclosed in the annual reports as well as the regular reports.

7.3. Corporate bonds

Corporate bonds are vehicles for transferring projects to the market. In this context, green bonds are a suitable financial instrument for investing in the environmental sustainability of economic activities that contribute to one or more environmental objectives (e.g. climate change mitigation, climate change adaptation, or transition to a circular economy). In other words, a bond that is issued to finance environmental projects is defined as a "green bond". Although there is a growing market for green bonds

[18] See TEG (2018: 8)

[19] See Art. 7 of the Swiss Collective Investment Schemes Act (CISA)

[20] See section 17 ESMA34-45-569 Consultation Paper

and players are adopting the Green Bond Principles and have entrusted their coordination to the International Capital Market Association, these principles lack a definition of the criteria that enable projects to qualify as "green",[21] and only a small portion of all EU investments explicitly qualify as "green".[22] In other words, due to a lack of clear and uniform definitions as to what constitutes green products, investors and banks are seeking ways of identifying green investments. It is difficult for fund managers to indicate in a fund's pre-contractual disclosure document the way and the extent to which criteria for environmentally sustainable economic activities are used to determine a fund's investment. The establishment of a unified classification system for sustainable activities would enable fund managers to better assess and manage the financial risk related to "green" or "sustainable" projects, thereby fostering transparency and long-termism in financial and economic activity.

Furthermore, a key driver for increasing ESG investment in corporate bonds are the credit rating agencies that use ESG principles in their research and ratings (Moody's Investor's Services, for example, is boosting efforts to integrate ESG considerations). Likewise, Standard & Poor's has proposed including ESG assessments of corporate bond issuers that emphasise their environmental risk profile. In this regard, the new ESG taxonomy can be expected to impact corporate bonds, and we can expect to see more corporate bond funds on the market that are tied to ESG principles.

7.4. Mortgage and Lombard loan business

A green mortgage is a mortgage-based financial product offered by banks that rewards the purchase of a green home. By definition, owners of green homes will see a significant reduction in their utility and repair bills, allowing them to save extra cash that can be used to pay back their mortgage. This additional monthly income for the homeowner significantly reduces the risk of mortgage default by owners of green homes compared with owners of standard houses. For this reason, a number of financial institutions have started to issue green credit facilities with margins linked to the sustainability performance of the borrower. In this context, in 2018, thirty-seven European banks successfully launched a new energy efficiency mortgage pilot scheme[23] to help boost the market for homes with lower energy bills. These institutions (including BNP Paribas, ING and Nordea Bank) believe the initiative will test whether their risks are lowered because homeowners with reduced bills are less likely to default on mortgage repayments.[24] Such loans would then represent a lower risk on their balance sheet and could qualify for better capital treatment.

[21] See Reichlin (2017: 113)

[22] See EBF (2017: 21)

[23] "The Energy Efficient Mortgages Initiative aims to create a pan-EU framework for energy efficient mortgages. These mortgages incentivise borrowers to improve the energy efficiency of their buildings or acquire highly energy-efficient properties" (See EC 2018: 3).

[24] See EC (2018: 16)

7.5. Insurance-based investment products

The ESG requirements are applicable to all insurance products, in particular insurance-based investment products offering a maturity or surrender value and featuring an "investment element" (i.e. where the maturity or surrender value is wholly or partially exposed, directly or indirectly, to market fluctuations). This part of the definition is the same as that used for IBIPs in the PRIIPs Regulation, which requires a pre-contractual disclosure document (a key investor information document or KIID) for certain products, such as occupational pension schemes and life-assurance products.

7.6. Pension plan products

ESG investing is growing in popularity in the public sector. In this context, pension funds and insurance companies are driving sustainable investment and investing directly in equity and indirectly through investment funds. The table below shows that pension funds and insurance companies hold 39.1 percent of listed equities.

Type of institutional investor	Share of equity markets (in %)
Investment funds	41.1
Investment funds (excluding pension funds/insurers)	19.1
Pension funds and insurance companies	39.1
Traditional institutional investors	58.2
Sovereign wealth funds	5.6
Hedge funds	1.6
Alternative institutional investors	7.2
Total institutional investors	65.4

Source: Schoenmaker (2019: 3) / PwC (2019)

In this regard, the key drivers of pension fund asset allocations include diversification, risk management, hedging against inflation, asset and liability management, and return on investment . With the integration of ESG factors, the whole asset allocation process will be impacted. This means pension funds have to revise their asset allocation process.

7.7. Corporate loans

Business loans in the corporate client context support environmental projects. For companies, ESG corporate loans provide access to preferential interest rates based on sustainability improvements and demonstrate to stakeholders a commitment to sustainability. Generally speaking, green loans cover a variety of areas, such as greenhouse gas emission reduction and renewable energy. In other words, corporate green loans are made available exclusively to finance or refinance environmental projects based on the following four components:

1. **Use of proceeds:** The major component of a green loan is the use of the loan proceeds for environmental projects that should be described in the finance documents and, if applicable, marketing materials. In this context, financial institutions must include descriptions of:

   a. The procedures and conditions applied for integrating sustainable risks into investment decisions

   b. The extent to which sustainability risks are expected to have a material impact on the returns, and

   c. How consistent the remuneration policies are with the integration of sustainability risks.

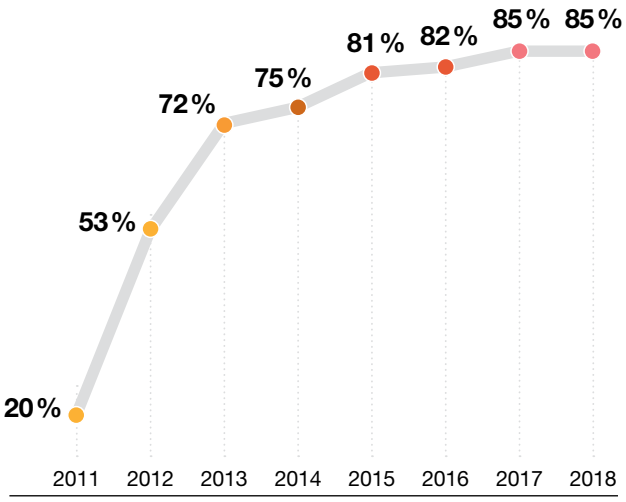
   Moreover, the ESG taxonomy will have a fundamental impact on the description in the finance document.

2. **Process for project evaluation and selection:** The borrower of a green loan should clearly communicate to its lenders its environmental sustainability objectives (e.g. climate change mitigation, climate change adaption, sustainable use and protection of water and marine resources).

3. **Management of proceeds:** The proceeds of a green loan should be credited to a dedicated account in an appropriate manner so as to maintain transparency and promote the integrity of the product.

4. **Reporting:** Investors expect companies to disclose ESG information they can trust and understand. Many financial institutions have started to report ESG factors in response to these increased expectations for more transparency. In fact, 85 % of S&P 500 companies issued sustainability reports in 2018 (see figure). But there is work to be done by the European Commission to bridge the gap between what investors want and what financial institutions are providing.

Growth in ESG reporting in the S&P 500



Source: Global Newswire (2018) / PwC (2019)

7.8. Financial products impact matrix

Based on several expert interviews and the experience the editorial groups bring in, an impact rating of the Sustainable Finance Regulation on different groups of financial products has been carried out.

The methodology follows the same as that applied for the impact assessment on the different industries as such (see 6.10)

A medium impact in the past would be a regulation such as the PRIIP regulation. Whereas UCITS can be rated as high (5) in specific areas where strategic changes were required.

Area	Topics	Degree of impact (1–5)
Structured investments	ESG derivatives	**3**
	Options	**3**
	Indices	**4**
	Debt issuance	**4**
	ESG structured investments	**4**
Collective investments	UCITS products	**5**
	AIFs	**5**
Corporate bonds	Green bonds	**5**
	Corporate bonds	**5**
Mortgage and Lombard business	Green mortgages	**4**
	Green Lombard loans	**4**
Pension funds	Portfolio composition	**4**
	Disclosure requirement	**3**
Insurance-based investment products	Occupational pension schemes	**4**
	Non-life insurance products	**4**
Pension plan products	Pension plans	**4**
	Individual pension products	**3**
Corporate loans	Business loans	**4**
	Retail loans	**3**

Conclusion and recommendations

On the state of sustainable finance in Switzerland – March 2019:

- The financial market is moving – also due to increased client-demand. Sustainable investment is becoming more important but is still a niche market. There is no perceivable "shift of the trillions" towards a low-carbon, sustainable economy, and sustainability remains confined mainly to sustainable investment (i.e. sustainable lending remains a niche theme).

- The federal and cantonal governments and administrations in Switzerland are taking up the issue, but mostly in a compartmentalised manner, without a clear sustainable finance strategy and focusing on strict voluntary measures. There are no or only marginal incentives in place for the market to adopt sustainable finance. The opportunity costs for market players to commit fully to sustainability therefore remain high.

- The media, civil society and politicians recognise the importance and relevance of sustainable finance, and there is a trend towards clearer and stronger requests coupled with more resonance in the public sphere – meaning that the public is showing more interest in the impact of investments.

- All Swiss financial market actors having cross-border activities in European countries will have to take into account the legislative changes resulting from the Action Plan Sustainable Finance.

- The Action Plan Sustainable Finance is widening the gap between the Swiss and European standards, and increases the risk that the current framework conditions in Switzerland, particularly FinSA and CISA, are not anymore equivalent to those established in the European provisions. As a result of this, market access is also under threat for all Swiss financial players that are actively involved in cross-border business.

- The Action Plan Sustainable Finance defines a new norm and standard and is thereby a game changer for the financial but also non-financial sector! Therefore, also all the other Swiss or institutions from any other country that aims to operate in Europe or with European clients, will be benchmarked against this new soft law. The costs for not taking into account sustainability factors are increasing significantly.

- Regardless of equivalence or otherwise, the impact on financial instruments and institutions issuing and buying such instruments will be massive – moreover, the impact on potentially reduced capital requirements reflecting a positive impact on own fund requirements might even trigger positive incentives for opting for sustainable portfolios.

- In short: if Switzerland does not move decisively now, it will face major economic and reputational risks. If it does take prompt action, it will enable the Swiss financial sector to tap into a growth market rich in opportunity.

According to the authors, the lack of legislative and economic incentives is the main reason why Switzerland has gone from being a frontrunner in sustainable finance to being a mere also-ran. However, Switzerland is no longer capable of maintaining its strict "voluntary-only" approach. Firstly, because the internal pressure from civil society, increased political attention and stronger requests from the market players is building up. Secondly, the external pressure in becoming stronger every day, stemming from the legislative adaptations in the EU, the strengthening positions from voluntary initiatives such as PRI or TCFD, market momentum and increasing demand from clients.

Overall, not engaging proactively regarding sustainable finance and tapping into the market segment is a missed opportunity. Patrick Odier (Partner Lombard Odier) called sustainability the biggest investment opportunity of the 21st century.[25] This means that conducive framework conditions and a proactive, forward-looking federal administration and government would enable Switzerland to become once again a frontrunner in sustainable finance, because it is a business opportunity. Otherwise, we run the risk of losing market access. Switzerland has the necessary expertise and knowledge to be one of the leading financial centres.

[25] Lombard Odier, 2019, "our sustainability manifesto": https://www.lombardodier.com/home/sustainability/our-sustainability-manifesto.html

The authors recommend the following:

State:

- The Swiss federal administration must develop a conducive framework to incentivise financial institutions to account and integrate sustainability factors by default. The anticipated impact of the Action Plan Sustainable Finance will be in some ways more intensive than what we experienced under MiFID II, GDPR or AEoI.
- The Federal Council should mandate an impact analysis of the Action Plan Sustainable Finance on Swiss legislation and evaluate the most pressing needs for legislative changes – in light of safeguarding market access to the EU.
- The Federal Council should develop a Swiss Action Plan Sustainable Finance, suggesting concrete legislative and incentivising measures, in order that Switzerland becomes a leader again in Sustainable Finance.
- The Federal Council should establish a steering committee on Sustainable Finance (involving the financial industry, think tanks, academia and civil society), reflecting and defining how Switzerland should adapt to the new legislative requirements, improving the knowledge base on Sustainable Finance issues and commenting on the Action Plan Sustainable Finance of the Federal Council.
- The Federal Council should actively support companies to disclose their sustainability impacts in a standardised manner and publish them on a centralised platform.

Financial market:

- Every Swiss bank, insurance or asset manager, that has cross-border activities should start proactively setting up internal processes to be able to comply with the toughened disclosure requirements (e.g. start reporting according to the TCFD guidelines) and develop guidelines on how to integrate the sustainability preferences of retail and private clients into the client onboarding process.
- As the Action Plan Sustainable Finance is also an opportunity and even provides the possibility to create huge capital relief if the investment strategy is set up properly, this topic shall be discussed at board level at the banks to make a strategic decision.
- The largest Swiss banks, insurance companies and asset managers have the opportunity to add weight to and shape the ongoing discussions on climate-friendly benchmarks. They could co-sign a request to index providers calling for the development of “net zero carbon benchmarks”.
- Market players and specifically the most relevant industry associations should commonly define to which extent the green taxonomy developed by the EU is useful for them and to what extent it needs to be adapted to the Swiss context.
- Every Swiss pension fund, cantonal, or regional bank should disclose their sustainability impacts, use a climate risk reporting tool such as the TCFD guidelines, and start gathering the sustainability preferences of their clients.

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Appendix

When	Who	Title (translated from German)	Link
Spring 2017	Isabelle Chevalley (NR)	Interpellation: What is Switzerland regarding sustainable finance?	https://www.parlament.ch/de/ratsbetrieb/suche-curia-vista/geschaeft?AffairId=20173120
Autumn 2017	Lisa Mazzone (NR)	Interpellation: Pension funds and climate urgency: public disclosure of the investment impacts on climate.	https://www.parlament.ch/fr/ratsbetrieb/suche-curia-vista/geschaeft?AffairId=20173904
	Adèle Thorens (NR)	Interpellation: A sustainability-test for all future financial market regulations?	https://www.parlament.ch/de/ratsbetrieb/suche-curia-vista/geschaeft?AffairId=20173946
	Beat Jans (NR)	Interpellation: When will the financial sector be held accountable?	https://www.parlament.ch/de/ratsbetrieb/suche-curia-vista/geschaeft?AffairId=20173914
	Beat Jans (NR)	Interpellation: When will the FINMA account and control for climate risks?	https://www.parlament.ch/de/ratsbetrieb/suche-curia-vista/geschaeft?AffairId=20173915
Winter 2017	Martin Landolt (NR)	Interpellation: Incentives for climate-friendly investing	https://www.parlament.ch/de/ratsbetrieb/suche-curia-vista/geschaeft?AffairId=20174104
	Martin Landolt (NR)	Interpellation: Support by the Federal Council for implementation of TCFD Guidelines	https://www.parlament.ch/de/ratsbetrieb/suche-curia-vista/geschaeft?AffairId=20174103
	Raphaël Comte (SR)	Interpellation: Institutional investors: fiduciary duty and climate change	https://www.parlament.ch/fr/ratsbetrieb/suche-curia-vista/geschaeft?AffairId=20174315
Summer 2018	Adèle Thorens (NR)	Interpellation: Does the compensation fund AVS/AI/APG invest in a climate-friendly manner, conforming to the Paris Agreement?	https://www.parlament.ch/de/ratsbetrieb/suche-curia-vista/geschaeft?AffairId=20183451
	Isabelle Chevalley (NR)	Interpellation: Instruments for tracking sustainable finance	https://www.parlament.ch/fr/ratsbetrieb/suche-curia-vista/geschaeft?AffairId=20183589
	Beat Jans (NR)	Interpellation: Fiduciary duty of the Swiss National Bank	https://www.parlament.ch/de/ratsbetrieb/suche-curia-vista/geschaeft?AffairId=20183652
Autumn 2018	Eric Nussbaumer (NR)	Motion: Increasing the capital requirements for credits and investments in climate-damaging resources.	https://www.parlament.ch/de/ratsbetrieb/suche-curia-vista/geschaeft?AffairId=20183964
	Nadine Masshardt (NR)	Motion: Climate strategy for the Swiss financial sector	https://www.parlament.ch/de/ratsbetrieb/suche-curia-vista/geschaeft?AffairId=20183918
	Jacqueline Badran (NR)	Motion: The Swiss National Bank shall be responsible for combatting climate change and safeguarding the related financial stability.	https://www.parlament.ch/de/ratsbetrieb/suche-curia-vista/geschaeft?AffairId=20183921
	Adèle Thorens (NR)	Interpellation: Regarding the current state of regulation, should financial market players already be taking account of climate risks?	https://www.parlament.ch/de/ratsbetrieb/suche-curia-vista/geschaeft?AffairId=20183561
	Beat Jans (NR)	Motion: Reduce the most serious polluters' ability to access credit.	https://www.parlament.ch/de/ratsbetrieb/suche-curia-vista/geschaeft?AffairId=20183974
Winter 2018	Adèle Thorens (NR)	Interpellation: Couldn't the Swiss National Bank already take into account climate risks, within the current regulatory requirements?	https://www.parlament.ch/de/ratsbetrieb/suche-curia-vista/geschaeft?AffairId=20184324
	Beat Flach (NR)	Interpellation: Climate risks = financial risks. Necessary adaptation of BSV practice.	https://www.parlament.ch/de/ratsbetrieb/suche-curia-vista/geschaeft?AffairId=20184343


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