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Swiss Sustainable Finance Policy Brief on the "EU Action Plan: Financing Sustainable Growth"

1. Introduction

On March 8, the European Commission presented an action plan on how to finance sustainable growth, containing wide-ranging suggestions on how to make the European financial market more sustainable. According to Valdis Dombrovskis, Vice-President responsible for Financial Stability, Financial Services and Capital Markets Union, this plan is meant to redirect capital flows towards a more sustainable economy, to integrate sustainability into risk management and to foster transparency and long-term investment. Against the EU target to reduce greenhouse gas emissions by 40 % until 2030, the EU has to mobilise €180 billion a year for the energy and transport sector alone.

The Action Plan is based on the recommendations of the High-Level Expert Group (HLEG) on Sustainable Finance, published in January 2018. Industry and civil actors alike lauded it the "most ambitious sustainable finance package released by a major economic area so far".

Swiss players both from the private and public sector are following these developments closely, as several parts of the regulations in the making can be expected to have direct effects on the Swiss financial market. In this policy brief, Swiss Sustainable Finance provides a first assessment of the action points and their relevance for Switzerland.

2. Suggested action points and SSF comments

Action 1: Establishing an EU classification system for sustainable activities

Establishing a common language for sustainable finance – a classification system or taxonomy – to define what is sustainable and identify areas in which sustainable investment can have impact, is a starting point. For this, the Commission will draft a legislative proposal in Q2 2018 to ensure the development of this taxonomy and immediately set up a technical expert group on sustainable finance (TEGSF) to develop the taxonomy with a focus on climate change mitigation by Q1 2019. The topics climate change adaption and environmental activities are scheduled for Q2 2019. Other environmental and social topics will be covered later.

General SSF comment: Institutional and private investors as well as other players (e.g. NGO's) have frequently raised concerns about the lack of clear and generally accepted definitions in the realm of sustainable finance (SF). For SF professionals however, terminology is not seen as opaque, since several international initiatives (e.g. Eurosif, GSIA) have set de-facto universal definitions of sustainable investments. Based on the Commission's action plan, it will be the role of the TEGSF to build on existing and frequently applied terminology frameworks which can create a unified understanding of SF. SSF considers such a definition as helpful for further adoption of sustainable investments by institutional and private investors alike. Uniform definitions will foster comparability and help provide comparable data and statistics. Yet, it is important that such a taxonomy be kept

dynamic allowing it to be adapted to a constantly changing environment. Furthermore, it will be difficult to draw clear lines between what is "green" or "good" and what is "brown" or "bad", as many fields of investments will have shades of "grey". It therefore might be useful to develop a more gradual rating scale instead of a fully binary approach for the taxonomy.

Generally, we think it is important that the Swiss government becomes involved in the discussion around a taxonomy, and promotes the alignment with international players (i.e. with the G20 Sustainable Finance Study Group or Financial Centres for Sustainability). It would be preferable if such a taxonomy was supported more broadly in global financial markets rather than just in the EU.

Potential impact for SSF members: Once the EU classification system for climate change mitigation and climate change adaptation is ready, asset managers and asset owners will have to assess to which extent their investments and products can be attributed to respective categories. Further transparency on the attribution of funds to the different categories might be expected by clients in Europe and elsewhere.

Potential impact for Swiss financial centre: As mentioned above, it would make sense for Switzerland to get involved in the definition of the EU classification system for definitions of different types of sustainable investments. We expect discussions on the classification will generally raise awareness of different types of sustainable investments and therewith contribute to market growth in this segment. As Switzerland is home to a considerable amount of sustainability specialists, this market segment could profit from that growth.

Action 2: Creating standards and labels for green financial products

On the basis of this EU classification system, the EU aims to create EU labels for green financial products: this will allow investors to easily identify investments that comply with green or low-carbon criteria. The TEGSF will prepare a report on an EU green bond standard in Q1 2019, based on a public consultation and best practices. Moreover, the content of the prospectus for bond issuances will be specified by the commission in Q2 2019. It will also assess the use of the current EU Ecolabel framework for financial products, once the EU taxonomy on sustainable finance is adopted after Q2 2019.

General SSF comment: The creation of a green bond label can help bring clarity and confidence in the additionality, meaning the positive environmental benefit, of green bonds. SSF hopes the TEGSF will prudently include existing standards such as the principles of the Climate Bonds Initiative or the Green Bonds Principles from the International Capital Market Association.

Generally, providing transparency on the sustainability level and processes of different products (in the form of a sustainability indicator) seems more useful than introducing product labels, as there is no "one size fits all"-approach. Product labels should only be considered in a second step, based on the above-mentioned sustainability indicators. Such labels should not be limited to environmental topics only, but also take a broader sustainability perspective into account (i.e. social and governance issues)

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considering full value chains. Furthermore, it will be important to consider processes, fund content and actual impact when labelling sustainable products.

Potential impact for SSF members: An EU green bond label will turn into a relevant point of reference for Swiss green bond emitters and Swiss investors alike. With regards to further sustainable product labels, it remains to be seen if they will be limited to environmental criteria or if they manage to reflect a broader sustainability perspective already implemented in many Swiss sustainable finance products.

Potential impact for Swiss financial centre: An EU green bond label can help to further foster green bond markets not just in the EU but in Switzerland, too. Concerning further product labels it will be important to assess the outcome on the demand and on this basis decide about further steps. Demonstrating the high quality of Swiss sustainable investment products by introducing a sustainability indicator could help promote Swiss financial services.
SSF would support the Swiss government entering into a discussion with important stakeholders on what Switzerland could do to position its financial center as a hub for sustainable finance, e.g. by strengthening trust in the quality of our sustainable finance products, advice, and/or education.

Action 3: Fostering investment in sustainable projects

The EU aims to reinforce advisory capacity for developing sustainable infrastructure projects and generally foster support for such investments. The roll-out of the EU External Investment Plan (EIP) will encourage sustainable investments in partner countries, and mobilise private investments alongside public funds.

General SSF comment: The action point regarding advisory capacity is of a very general nature, which is why it is difficult to assess its effect. With regards to the EIP, this scheme will likely offer opportunities for Swiss investments for development specialists.

For institutional investors, a further standardisation of debt documentation for (sustainable) infrastructure investments is important in order to encourage further investments in this segment (the European Financial Services Roundtable initiated the creation of a template for debt documentation and reporting requirements).

Potential impact for Swiss financial centre: SSF considers it an opportunity for Switzerland to start a similar initiative and therewith promote investments in sustainable projects. It could be useful to bring together the key economic actors in Switzerland, in particular with regards to achieving the goals of the Swiss Energy Strategy 2050.

Action 4: Incorporating sustainability when providing financial advice

The EU will require investment firms and insurance distributors to advise clients on the basis of their preferences on sustainability. This will entail the inclusion of sustainability in the suitability assessment, which is why the Commission will amend the MiFID II and IDD delegated acts in Q2 2018. Based on this, the Commission will collaborate with the European Securities Markets Authority (ESMA)

to comprise provisions on sustainability preferences in its updated guidelines on the suitability assessment by Q4 2018.

General SSF comment: SSF welcomes the initiative to stress the importance of advisors, since they can be a driving force in helping asset owners to allocate their investment sustainably. Yet, SSF prefers a voluntary market approach Considerable capacity building is needed to further educate client advisors on sustainable finance, since sustainability is often not part of the standard finance curriculum.

Potential impact for SSF members: Members with advisory activities in the European Union will face new requirements regarding their client profiling and advisory processes, if MiFID II and IDD are amended. Integrating sustainability into the advisory process in Switzerland on a voluntary basis could strengthen the quality of the client relations and prevent the legislator from defining mandatory requirements.

Potential impact for Swiss financial centre: Switzerland has a keen interest of not being discriminated by an EU-legislation on the integration of sustainability into legislation on financial advice (MiFID II and IDD). It will make sense to monitor regulatory changes in the European Union and assess the effect of the amendments. If the EU moves forward, similar amendments for Swiss regulation would have to be considered. Not following suit could have negative repercussions on the perception of Swiss advisors, as EU actors would be perceived as more progressive. Supporting the private sector in establishing high quality financial advice – including the consideration of sustainability preferences – entails the opportunity to strengthen Switzerland's position as a center for asset and private wealth management.

Action 5: Developing sustainability benchmarks

The EU plans to define sustainability benchmarks to facilitate asset allocation through improved tracking and measuring of performance. The Commission plans (i) to adopt delegated acts, within the framework of the Benchmark Regulation, on the transparency of the methodologies and features of benchmarks by Q2 2018; and (ii) to harmonise benchmarks comprising EU low-carbon issuers, once the climate taxonomy is in place. The TEGSF will present a report on the design and methodology of the sustainability benchmark by Q2 2019.

General SSF comment: Sustainable Benchmarks play a crucial role for the broad implementation of sustainable investments. It will be important to develop further benchmarks that build on agreed taxonomies and on the TCFD recommendations. Also, further transparency on index methodologies helps investors to choose the right product for their needs. Yet, we see a considerable risk in aiming for one standardised approach to calculating sustainability and climate indices, as there are different client needs. Competition is an important driver of innovation and we think it's important to stick to an open market for sustainability indices. Close cooperation of index providers with their clients when establishing such indices is key.

Potential impact for SSF members: Members offering sustainability indices or products based on such indices will potentially be affected strongly, if the EU aims for one harmonised form of calculating sustainability indices.

Potential impact for Swiss financial center: It is too early to assess the impact on the financial centre as a whole, because financial players may adopt new benchmarks according to their preference.

Action 6: Better integrating sustainability ratings and market research

The creditworthiness of companies and public institutions also depends on ESG factors. Therefore, the Commission plans to engage with stakeholders to see whether the Credit Rating Agency Regulation needs to be amended to integrate sustainability factors proportionally. It will report on the outcomes in Q3 2019.

General SSF comment: SSF welcomes the intention to incentivise credit rating agencies to include material ESG factors. A study on sustainability ratings and research will provide useful information to Swiss players too. We consider it important that Swiss players can provide input to this study, as Switzerland is home to several well-renowned sustainability research houses and specialized asset management teams with extensive knowledge and experience.
We consider it important that the integration of ESG-factors into credit ratings is aligned with international regulators, governments and private financial market participants to strengthen global and consistent integration.

Action 7: Clarifying institutional investor's and asset managers' duties

The EU aims to clarify the fiduciary duty of asset managers and institutional investors to take sustainability into account in the investment process and enhance disclosure requirements. The Commission will draft a legislative proposal to clarify institutional investors' and asset managers' duties in relation to sustainability considerations by Q2 2018. It will include explicit requirements (i) to integrate ESG considerations in the investment decision-making process and (ii) to increase transparency on the integration of ESG factors and related risk exposure towards end-investors.

General SSF comment: SSF generally considers it useful, if the definition of fiduciary duty and the role of ESG factors in this context is clarified. A clear definition of the role of sustainability in the fiduciary duty of asset owners and asset managers at the European level could create clarity for asset managers and asset owners.

In Switzerland, the Federal Council has answered several parliamentary interpellations concerning this topic during the last months and shows a propensity to include the consideration of ESG criteria in its interpretation. This is in line with the PRI report "Fiduciary duty in the 21st Century" based on the assessment of the situation in different jurisdictions. Also, the more inclusive understanding corresponds with the voluntary portfolio screening freely offered by the Swiss federation to pension funds and insurance companies to create awareness on their investments' impact.

The Swiss perspective on the role of ESG in fiduciary duty could be supported by an effort to clarify and ascertain that nothing in the current legal framework prevents asset managers and owners from

considering long term trends and ESG factors that may have a material impact on financial returns when making investment decisions. We think it could help position Switzerland at the forefront of sustainable investment markets, if a clear statement on the role of fiduciary duty with regards to the integration of ESG factors would be prepared, be it by the industry or by the government.

Action 8: Incorporating sustainability in prudential requirements

Banks and insurance companies are an important source of external finance for the EU economy. The Commission will explore the feasibility of recalibrating capital requirements for banks (the so-called green supporting factor) for sustainable investments, when it is justified from a risk perspective, while ensuring that financial stability is safeguarded.

General SSF comment: The solvency assessment of sustainable development investments should be carried out in the same manner as for any other investment. Capital requirements need to be purely defined on a risk basis and unless there is clear indication for lower risks of green investments, a lower capital requirement is not justified.

Prudential regulation of environmental risk would therefore be premature before a common classification for assets serving green policy goals is established and current challenges with modelling and stress testing climate change risk are addressed.

Action 9: Strengthening sustainability disclosure and accounting rule-making

The Commission aims to enhance transparency in corporate reporting by revising the guidelines on non-financial information. The guidelines will be aligned with the recommendations of the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD) and the climate-related metrics developed under the new taxonomy by Q2 2019. For this, the Commission foresees a fitness check, which should also evaluate relevant aspects of the International Accounting Standards Regulation and elicit how the IFRSs allows for specific adjustments, when not conducive to the European public good, e.g. where the standards could pose an obstacle to long-term investment objectives. Furthermore, the EU plans to establish a Corporate Reporting Lab to foster best practice in corporate reporting. The EU further aims to make it mandatory for asset managers and institutional investors to report on how they integrate sustainability risks.

General SSF comment: SSF welcomes the harmonisation of corporate reporting for the sake of clarity for asset owners. It may simplify the inclusion of ESG factors into decision-making, ESG integration into financial evaluation and provide a higher degree of comparability. This effort should include revisiting work on the EU Non-Financial Reporting Directive to make it more workable and put more focus on substance rather than form. In order to be meaningful and effective for investors, we believe disclosure standards should take a forward-looking perspective with respect to risks and opportunities, rather than a backward-looking view, e.g. on past emissions, such as by using footprinting as a metric.

With regards to further transparency on the sustainability of portfolios – both by asset managers and institutional investors – we think Switzerland should move ahead and start the discussion on best ways to provide such transparency. Swiss market players have already developed different systems to demonstrate the sustainability performance of portfolio. We can build on this know-how and

strengthen the Swiss financial centre by further developing useful tools. Generally, there are different ways to demonstrate the sustainability of a portfolio and SSF thinks there is no one solution serving all needs.

Potential impact for SSF members: Sustainable financial service providers will get access to more reliable and comparable sustainability data which will help to better integrate sustainability opportunities and risks into investment decisions.
Proactively demonstrating the sustainability performance of financial products helps to strengthen competitiveness of individual players and the Swiss financial centre as a whole.

Potential impact for Swiss financial centre: It remains to be seen if Swiss companies will voluntarily adopt European reporting standards and therewith improve comparability of their sustainability data. If such an adaptation is slow, a discussion on mandatory sustainability reporting standards might have to be raised.
Proactively demonstrating the sustainability performance of financial products helps to strengthen competitiveness of individual players and the Swiss financial centre as a whole.

Action 10: Fostering sustainable corporate governance and attenuating short-termism in capital markets

In Q2 2019, the Commission will assess the need for corporate boards to develop and disclose a sustainability strategy with clear targets and the need to clarify the rules according to which directors are expected to act in the company's long-term interest. Furthermore, the Commission will ask the European Supervisory Authorities (ESAs) to monitor undue short-term pressure from the market on corporations, such as portfolio turnover and equity holding periods, by Q1 2019.

General SSF comment:
SSF welcomes the research on undue short-termism influencing different market players. Such research may provide useful insights into possible and useful actions to foster a longer-term perspective in financial markets and provide a basis for discussion between supervisors and industry with regards to their respective roles in ensuring appropriate consideration of ESG risks.
SSF has prepared courses on the negative effects of short-termism in financial markets in the past and considers it useful to further evaluate ways to foster long-termism in financial decision-making.

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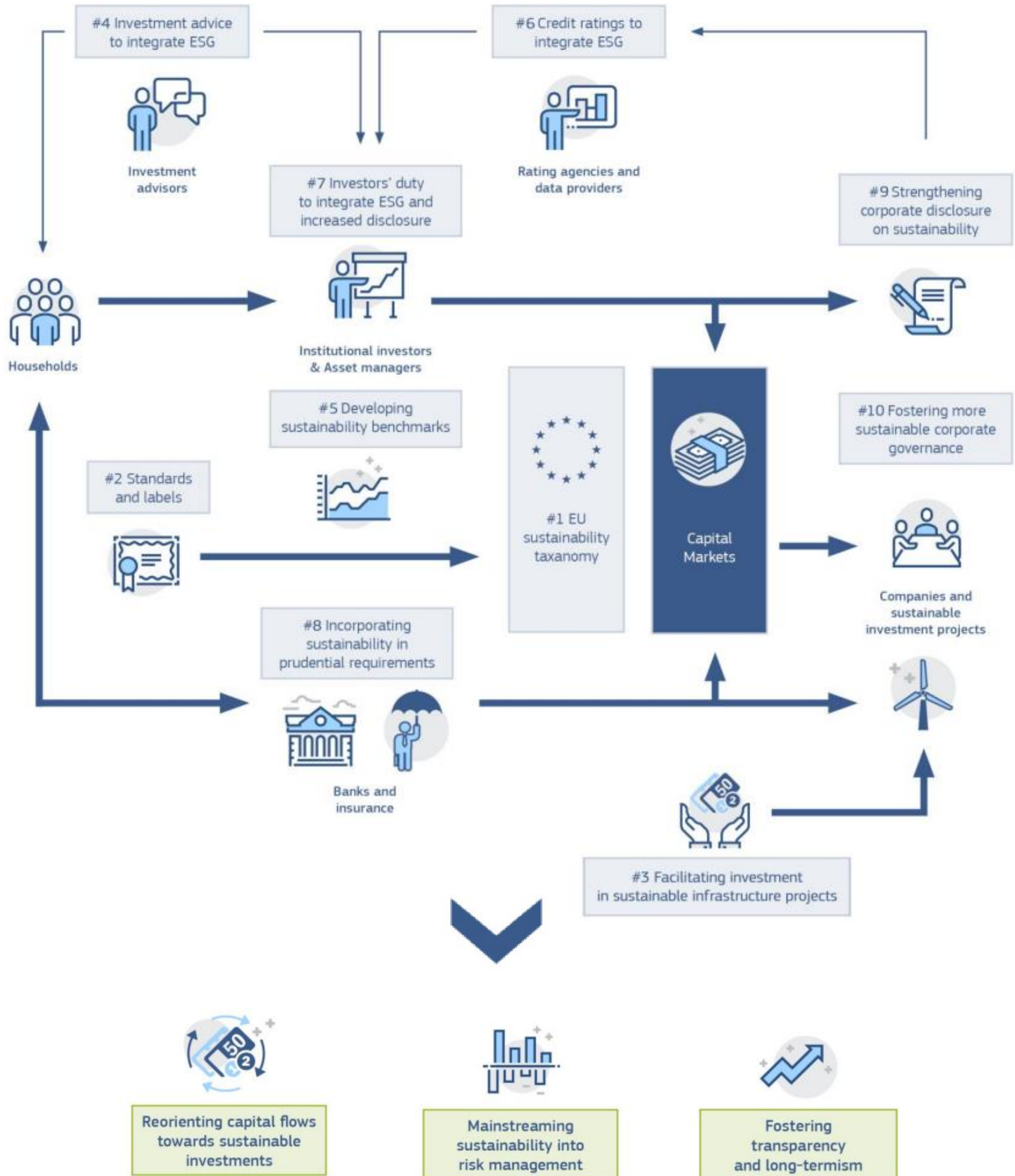
3. Further information

Summary chart of different action points



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Links to important documents

Commission's regulatory proposals

Commission's action plan

Condensed factsheet on action plan

Commission's press release on action plan

Federal Council Press on fiduciary duty

Technical Expert Group on Sustainable Finance: list of members

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