SwissFinanceCouncil
Fostering International Dialogue

European Commission consultation on The Renewed Sustainable Finance Strategy

The Swiss Finance Council (SFC) engages in dialogue around policy developments in finance at a European and international level. It represents the interests of internationally active Swiss financial institutions and provides a platform to share their experience, expertise and knowledge through a permanent representative office in Brussels.

1. Introduction

The SFC would like to thank the European Commission for the opportunity to provide input to its envisaged Renewed Sustainable Finance Strategy. In this letter, we complement the technical feedback provided in our responses to the consultation questionnaire by highlighting key principles that in our view should underpin the future strategy. Our recommendations are aimed at enhancing the Commission's measures for the development of a robust and well-functioning sustainable finance market, allowing to meet the EU's climate neutrality objective.

The financial sector is key to support the transition to a sustainable and low carbon economy by mobilizing private and institutional capital towards changes in the real economy. Institutional and private investors want to contribute to tackling global challenges, participate in the investment opportunities arising from anticipation of key transition trends as well as to protect themselves against transition risks. Having recognized these dynamics, the SFC members have pro-actively driven innovation in sustainability product development and risk management solutions since the early 1990s.

We firmly support and advocate for a strong and ambitious response to climate change as demonstrated by our commitment to transparency through TCFD aligned disclosures and working with peers to embed sustainability into our business through the Principles for Responsible Banking and Principles for Responsible Investment. We are committed to supporting governments as they set the pathways for transitions in their respective economies and societies. Going forward, we are committed to working collaboratively with peers and our investee companies through initiatives such as Climate Action 100+ to support transitions across the economy.

2. Setting the scene: demand increases, barriers remain

On the demand side, globally, we observe increasing investor appetite for directing capital towards a low carbon and sustainable future. In a 2019 global survey of institutional asset owners, most European investors indicated that within five years, environmental factors could be playing a more important role in their investment processes than financial factors.[1] In 2018, a majority of ultra-high-net worth investors expected sustainable investing to become the norm within 10 years[2].

[1] UBS WEF Paper 2020, "*Becoming climate aware*", January 2020 (link)

[2] UBS, "*Return on values*", 2018 (link): "*58% of investors expect sustainable investing to become the standard approach to investing in 10 years. Investors in the UAE, China and Italy are the most convinced sustainable investing will be mainstream. Only one-third of investors in the US and the UK agree.*"

However, in the absence of data indicating which companies will face difficulties in the changing environment, financial markets cannot effectively price climate-related risks and opportunities. In, 2018, the lack of standardized terms and reporting prevented 40.5% of institutional investors from integrating ESG factors into their investment processes[3]. The progress to improve corporate disclosures and the quality of data varies greatly across jurisdictions. If sustainable finance is to scale up, the data challenge must be addressed.

Lack of international alignment in sustainable finance terminology is likely preventing widespread adoption in sustainable investing (SI). The terminology problem is clearly demonstrated by the significant divergences in the estimation of the global ESG investment universe size[4]. The 2018 UBS investor watch survey[5] revealed that 7 in 10 investors found SI language confusing. Terminology also poses challenges for financial advisors, who struggle to communicate sustainability in ways that match clients' personal preferences. As a result, "fewer than 10% of financial advisors are highly interested in ESG investing and 60% have little or no interest, compared to 75% of investors who favor investing sustainably."[6] We appreciate the EU Taxonomy as a first step in tackling this issue but global coordination is necessary, and further adjustments may need to be made to the taxonomy to make it as practical to use as possible.

Financial markets are global and so are the challenges in addressing climate change and delivering on the objectives of the Paris Agreement and the UN Sustainable Development Goals (SDGs). As highlighted by Credit Suisse's recent study on, inter alia, the emergence of political and regulatory framework conditions to foster sustainable finance, a patchwork of sustainable finance measures is emerging across jurisdictions at various speeds, varying degrees of ambition and targeting different areas of the financial market[7]. These uncoordinated measures are preventing the development of scalable solutions by institutional investors and halt market liquidity. Possibly conflicting regulatory expectations across borders also complicate effective fulfillment of investors' fiduciary duty. In addition, given the numerous simultaneous, often overlapping efforts in various international initiatives, it is often not clear where the industry should focus its attention. One center of coordination would be preferable.

3. Switzerland's market-led experience

Sustainable finance has been one of the core elements of the Swiss national strategy to promote competitiveness of its financial centre[8]. In 2019, the penetration of financial instruments managed in accordance with ESG considerations in Switzerland was approximately 21%, which is about twice as high as the global average of 11%[9]. Having observed a 62% year-on-year growth rate in the sustainable

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[3] UBS WEF Paper 2019, "*Awareness, simplification, and contribution*", January 2019 (link)
[4] IIF,"*The case for Simplifying Sustainable Investment Terminology*", October 2019 (link)
[5] UBS, "*Return on values*", 2018 (link)
[6] UBS WEF Paper 2019, *"Awareness, simplification, and contribution*", January 2019 (link)
[7] CS, "*Swiss Financial Center post-COVID-19: Focus remains on sustainable growth"*, June 2020 (link)
[8] FDF, *Switzerland's financial market policy*, January 2020 (link)
[9] SBA position paper, "*Sustainable Finance",* June 2020 (link)

investment market, the 2020 Swiss market study[10] illustrates that sustainability is far from a niche topic. The trend of mainstreaming sustainability into investment approaches saw a significant shift from a broader ESG integration towards more outcome-orientation i.e. combining impact investments (growth rate +209% in 2020 vs. +35% in 2019) and ESG voting (+134% in 2020 vs. +35% in 2019) with ESG engagement (+121% in 2020 vs. 82% in 2019).

From our perspective, the market-driven self-regulatory approach based on voluntary industry standards has been a key enabler for the significant growth of sustainable finance in Switzerland. Following this self-regulation trend with the aim of supporting the continuous adaptation of the industry, the Swiss Bankers Association, Swiss Funds & Asset Management Association, and Swiss Sustainable Finance recently issued guidelines[11] and recommendations[12] on ESG integration into client advice and all investment processes. In June 2020, the Swiss Federal Council adopted a report[13] and guidelines[14] on sustainability in the financial sector reaffirming its commitment to the market-based approach. Regulatory intervention was recommended only where clear signs of market failure can be found or where voluntary measures are not deemed sufficient.

4. Recommendations

Taking inspiration from the Swiss approach, the driving principle in shaping the Renewed Sustainable Finance Strategy should be turning sustainable finance into a competitive advantage for Europe. In our view, such an approach mandates a certain degree of flexibility rather than prescriptive rules that might have stifling effects on the market. The importance of the EU competitiveness angle is further reinforced in the context of the efforts to advance the Capital Markets Union.

In its future efforts to deliver on the Green Deal, the European Commission should consider leveraging those areas where the EU sustainability objectives can be most effectively met. The financial sector plays an important facilitating role in the transition endeavour by mobilizing and redirecting financial flows towards sustainable activities and sectors. However, as pointed out by the European Central Bank[15], sustainable finance can only catalyse, and not substitute a credible climate policy. A speedy transition to sustainability is more likely to occur through direct regulation of primary sectors rather than indirectly through regulation of financing activities. We would encourage the Commission to further develop science-based transition pathways to guide sustainable investments by measuring the journey towards green. More broadly, to provide incentives for change, we believe that externalities must be priced into economic transactions. In this respect, transparent, cross-border and sufficiently high pricing of carbon is a key element needed to support the climate transition.

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[10] SSF, "*Swiss Sustainable Investment Market Study 2020*", June 2020 (link)
[11] SBA, "*Guideline for the integration of ESG considerations into the advisory process for private clients*", June 2020(link)
[12] SFMA & SSF, *"Sustainable Asset Management: Key Messages and Recommendations of SFAMA and SSF"*, June 2020(link)
[13] Federal Council, "*Sustainability in Switzerland's financial sector*", June 2020 (link)
[14] Federal Council, *"Sustainable finance guidelines*", June 2020 (link)
[15] ECB, "*Eurosystem reply to the European Commission's public consultations on the Renewed Sustainable Finance Strategy and the revision of the Non-Financial Reporting Directive*", June 2020 (link)

The participation and involvement of all stakeholders is of paramount importance. The financial system relies on information flows from the real economy and can play such a catalysing role only if businesses also play their part through disclosure. It is therefore important that the regulatory mandates placed on the financial sector and on non-financial corporates are adequately aligned. In the same vein, we note that the public sector plays a key role in the acceleration of transition progress. The removal of fossil fuel subsidies and the incentives they create does not depend on the actions of the financial sector or the establishment of a brown taxonomy.

The 2018 Action Plan on Financing Sustainable Growth must first be properly implemented. The Action Plan laid down the legislative foundations for greening the European financial system by addressing the key prerequisites for its success i.e. transparency and a common understanding of sustainable economic activities. We encourage the Commission to focus first on the finalization of the outstanding pieces of this framework (including the revision of the Non-Financial Reporting Directive, the establishment of an EU Green Bond Standard, retail EU Ecolabel, and the prudential mandates given to the EBA) and allow the industry to gain experience and properly implement this groundwork.

Building on the lessons of the 2018 Action Plan, the Renewed Sustainable Finance Strategy must be based on realistic timelines, ensuring mutually supportive sequencing and full consistency of the potential future measures with the existing rules. While recognizing the urgency to act, we believe that speed should not come at the expense of quality. Early legislative revisions could lead to double implementation costs and result in a dissuasive rather than incentivizing effect on the industry. Going forward, we underline the importance of an evidence-based approach. Further legislative action should be informed by ex-post impact assessments of the existing measures indicating their effectiveness in supporting growth of sustainable financial services.

In the absence of a global carbon price, we support the Commission's initiative to explore possible measures within and outside the prudential framework to incentivize green and transition investments. We see merit in exploring mechanisms that could provide a preferential prudential treatment to green investments that can be considered safe in the long term while ensuring that capital requirements remain risk sensitive. In the absence of evidence for a risk differential[16] between green, non-green and brown assets, the Commission could encourage banks and their regulators internationally to partner to develop risk assessment methodologies that include a forward-looking perspective to improve the risk-sensitivity of the current framework. The classification of an asset under the taxonomy should, however, not be a proxy for its risk profile, nor lead to an automatic risk weighting adjustment.

The EU taxonomy should be conceived and used as a dynamic guidance reflecting the EU sustainability priorities and supporting the transition from brown to green. We question the feasibility of an exhaustive classification system and would therefore advise against the establishment of brown and/or neutral taxonomies at this stage. This could lead to unnecessary uncertainty for

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[16] NGFS*, "A Status Report on Financial Institutions' Experiences from working with green, non-green and brown financial assets and a potential risk differentia*l", May 2020 (link)

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activities that would not be captured by such framework and further increase complexity of an already complex system.

Given the EU aspiration to lead the sustainable finance agenda globally, we call on the Commission to duly consider the need to prevent regulatory fragmentation and prioritize international coordination and alignment. In this context, we very much welcome the establishment of and the Swiss membership within the International Platform on Sustainable Finance (IPSF). While recognizing the usefulness of peer discussions and exchange of best practices, we note that neither the IPFS nor the Network for Greening the Financial System (NGFS) have a legal personality or standard setting mandates. More work activity should thus occur, and be encouraged by the Commission, in the international standard setters, making use of the new IOSCO Task Force on Sustainable Finance and the Basel Committee Task Force on Climate-related Financial Risk.

It is important that the overall sustainable finance agenda gets coordinated via the G20/FSB with a view to establishing common principles-based global standards. The Commission could leverage the technical knowledge and political commitment built up within IPFS at G20 level. In its effort to lead the global fight against climate change and given the widely recognized need for sustainability considerations in the post COVID-19 recovery, the Commission could initiate the establishment of a 'sustainable finance agenda' within the G20 similar to the post-2008 crisis financial regulatory reform agenda.

We would like to thank the Commission for considering our comments. We look forward to the Renewed Sustainable Finance Strategy and would be pleased to contribute to this debate in a constructive manner. We would be pleased to answer any questions you may have and to have the opportunity to discuss the issues we address in this letter in more detail with you.

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The Swiss Finance Council was established in 2013 to engage in dialogue around policy developments in finance at a European and international level. It represents the interests of internationally active Swiss financial institutions and provides a platform to share their experience, expertise and knowledge through a permanent representative office in Brussels. The current members of the Swiss Finance Council are Credit Suisse and UBS. The Swiss Finance Council supports an integrated Single Market that can contribute to the creation of a strong, open and globally competitive European financial sector, and it advocates for an EU that remains attractive to foreign investors and service providers.

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