Climate-related Risk Disclosure in Switzerland – First Conclusions

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Key takeaways

- **The financial year 2021 was the first year for which the largest financial institutions in Switzerland had to disclose climate-related financial risks and the impact thereof pursuant to FINMA's disclosure rules.**
- **FINMA reviewed how these institutions complied with the new disclosure rules and published its key findings in Guidance 03/2022.**
- **While the institutions generally adhered to the disclosure rules, FINMA still identified certain areas for improvement.**
- **According to FINMA, the information disclosed presented a mixed picture regarding both scope and degree of detail. Thus, readers may find it difficult to get a clear idea of the relevance of climate-related financial risks for the specific institution.**

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Introduction

In 2021, FINMA revised its existing Circulars 2016/1 "Disclosure – Banks" and 2016/2 "Disclosure – Insurers" and stipulated specific disclosure rules for climate-related financial risks. These revised circulars entered into force on 1 July 2021, applying only to major financial institutions (i.e. institutions in supervisory categories 1 and 2).

Pursuant to these rules, banks and insurers in supervisory categories 1 and 2 must disclose significant climate-related financial risks, the impact thereof on the institutions' business and risk strategy, as well as any effects on existing risk categories. Furthermore, they must disclose the risk managing structures and processes in place for identifying, measuring, and addressing such risks as well as relevant quantitative data and a description of the methodology used. Lastly, the institutions must also describe the main features of their governance structure relating to climate-related risks.

As part of the annual reporting on the financial year 2021, the financial institutions concerned provided disclosure on climate-related financial risks for the first time. FINMA subsequently reviewed this reporting and published its key findings in its recent Guidance 03/2022.

Indeed, the aforementioned requirements apply only to Switzerland's largest financial institutions. Nevertheless, other financial institutions may also need to report and to disclose climate-related financial risks – either on a voluntary basis, due to soft law or self-regulatory prerequisites, or due to disclosure requirements at the point of sale. Therefore, FINMA’s disclosure rules and the corresponding Guidance may still be of interest as a supplementary guideline and benchmark, even if the regulation does not directly apply to a specific financial institution.

FINMA's Key Findings

Form of Disclosure

FINMA concluded that most affected banks and insurers provided the required disclosure either in their annual report or in their financial condition report. FINMA further observed that the financial institutions regularly referred to other reports (e.g. sustainability or TCDF reports) for providing the required disclosure, all of which is permissible under FINMA's disclosure rules.

However, FINMA identified such references as a potential source of ambiguity. A lack of concise referencing or the absence of a clear distinction between climate-related financial risks and other sustainability information may cause confusion or even prevent readers from finding the relevant information – all of which undermine the objective of the disclosure rules.

Main Features of the Governance Structure

The disclosure rules require that affected financial institutions describe their main governance feature pertaining to the identification, measurement, management, and monitoring of climate-related financial risks. FINMA observed, however, that a number of institutions

merely described their governance structure on a general level without a specific connection to climate-related financial risks.

A general description of an institution's governance structure provides readers with little information on how climate-related financial risks are being managed. Thus, FINMA underlines the importance of providing concise information pertaining specifically and in concrete terms to climate-related financial risks.

Description of Climate-related Financial Risks and Their Impact on the Institution

In Guidance 03/2022, FINMA reiterates the importance of a comprehensive disclosure of climate-related financial risks. This includes not only a description of the risks identified by the institutions but also the impact thereof on their business strategy and on their risk profile. In this regard, FINMA identified one of the main shortcomings of the first reports prepared pursuant to its disclosure rules. While the affected institutions indeed provided descriptions of the climate-related financial risks identified, the discussion of their impact was often of a rather generic nature and was explained in insufficient detail. Thereby, the institutions failed to provide the readers with a clear picture of the impact of climate-related financial risks on the institution. Specifically, FINMA criticised the lack of differentiation according to time horizons, underlining the importance of distinguishing between short-, medium-, and long-term time horizons when discussing the impact of climate-related financial risks on the reporting institution.

Risk Management Structures and Processes

Under the disclosure rules, the institutions must explain how the climate-related financial risks identified are managed and taken into account within the institution-wide risk management framework.

In this regard, FINMA concluded that the institutions' disclosure largely met the stipulated requirements. Yet still, FINMA calls upon the institutions to ensure that the structures and processes used to identify, assess, and manage climate-related financial risks are presented clearly and transparently.

Quantitative Information

The disclosure rules require affected institutions to disclose quantitative information with a clear connection to climate-related financial risks. Considering the plurality of methods of measuring climate-related financial risk, the institutions enjoy a significant degree of flexibility regarding disclosure.

In view of this flexibility, Guidance 03/2022 underlines the importance of clarifying the connection between the quantitative information and climate-related financial risks as well as providing further explanation regarding the relevance and significance of the metrics the institutions applies. In particular, the institutions shall clearly disclose which (sub-)portfolios

are covered by the metrics and the size thereof.

Criteria and Methods Used to Evaluate Materiality

The disclosure rules require affected institutions to lay out both the criteria and the assessment methods used to evaluate the materiality of climate-related financial risk. Providing the reader with an understanding of how the institution determines climate-related risks as material is a necessary prerequisite of a meaningful disclosure of how the institution monitors and controls such risks.

Herein lies another major shortcoming of the reports prepared pursuant to the new disclosure rules: the institutions concerned neither disclosed the criteria nor the assessment methods used to evaluate the materiality of climate-related financial risks.

Conclusions

Based upon FINMA’s evaluation, the disclosure of climate-related financial risks, pursuant to the revised Circulars 2016/1 and 2016/2, was generally well implemented. Nevertheless, there still remain a number of shortcomings and deficiencies in the institutions' reporting.

As outlined above, the findings of FINMA's review may also be of interest to financial institutions that fall outside the disclosure rules' scope. They may wish or need to report on climate-related financial risks in order to further refine their disclosure and enhance transparency pertaining to such risks.

Next steps

In addition to the findings published in Guidance 03/2022, FINMA also discussed the evaluation results with the institutions concerned as part of its regulatory dialogue and communicated the individual improvements expected from the institutions. Hence, the financial institutions concerned are expected to implement these findings and improvements as part of their reporting for the financial year 2022.

Subsequently, FINMA will again review the disclosures and conduct an ex-post evaluation to identify any possible future adjustments to the disclosure rules, taking into account national and international developments in the field of climate-related financial risks.

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