Disclosure of climate change-related risks in the Swiss financial sector

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Introduction

The Swiss Financial Market Supervisory Authority (FINMA) – a member of the Network for Greening the Financial System (NGFS) since 2019 – announced in November 2020 its intention to increase transparency with regard to climate change-related risks in the (Swiss) financial system. Climate change-related risks include transitional risks and physical risks.

Following FINMA's announcement, a public consultation took place on amendments to its regulatory circulars related to disclosure obligations of banks and insurers. The consultation ended recently on 19 January 2021. Entry into force of the amendments later this year would fit in seamlessly with the (international) market trend to standardise environmental, social and governance-related (ESG) disclosure and reporting requirements for the financial sector, e.g. banking and insurance.

Though not affected by the amendments, the asset management sector is also a part, and indeed a driving force, of the ESG trend. Therefore, this legal update outlines the implications of the amendments for the Swiss banking sector and the Swiss insurance sector. It also provides an example of the disclosure practice in the asset management sector based on 'international soft law'.

Disclosure of climate change-related risks in the banking and insurance sector

The Swiss banking sector and the Swiss insurance sector are increasingly involved in national and international initiatives related to the creation of transparency standards concerning the disclosure of ESG risks and the integration of sustainable investment objectives.

On a national level, the two circulars (once amended by FINMA) will set out climate change-related disclosure obligations of systemically important banks, securities firms and insurers. These financial institutions must then disclose the management of climate change-related risks on a consolidated and annual basis.

For example, such disclosures should contain information on how a financial institution identifies, evaluates, manages and monitors transitional and physical risks. In particular,

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financial institutions must have an adequate governance structure in place and possess sufficient risk management resources to deal with, describe and quantify climate change-related risks. Annual reports for the current reporting period (2021) will already have to include the respective information.

The amendments will not directly affect banks, securities firms or insurance companies that do not qualify as systemically important financial institutions (SIFs). For smaller (international) financial institutions, the 'climate change-related regulatory regime' remains unchanged for the time being. In principle, such financial institutions are not required under Swiss regulations to disclose climate change-related risks, but they can voluntarily observe disclosure rules or recommendations, such as the recommendations of the Task Force on Climate-related Financial Disclosures.

Nevertheless, Swiss banks or insurers that solicit customers outside of Switzerland should pay attention to certain foreign regulations on sustainability, such as the EU regulation on sustainability-related disclosures in the financial services sector dated 27 November 2019; it may already affect them.

Disclosure of climate change-related risks in the asset management sector

The Swiss asset management sector has been involved – like the Swiss banking sector and the Swiss insurance sector – in national and international initiatives to increase transparency in relation to sustainability risks.

On a national level, Swiss asset managers are not obliged under Swiss regulations to disclose or report climate change-related risks to the public. However, the clients of asset managers, such as banks, insurance companies and pension funds, are increasingly demanding that asset managers make responsible investments according to international standards, such as the UN Principles for Responsible Investment, and that they publish the relevant information in an annual report.

Hence, climate change-related transparency rules do exist for Swiss asset managers in form of 'soft law'. Asset managers can declare that they wish to be subject to such standards and to comply with the information disclosure and reporting rules. The relevant information that asset managers should disclose includes both information related to financial products (product level), such as 'green fund products' or 'green bonds', and information on the asset manager's performance, investments and organisation (entity level).

For example, Swiss asset managers may be obliged to disclose the ESG risks and effects of the products and investments on climate change or sustainability. Further, fund documents should include information about ESG performance indicators, ESG benchmarks and sustainable investment strategies or policies. Information on governance structures and risk management should include descriptions and metrics on evaluating and monitoring the 'green' performance.

On a Swiss corporate law level, recent ESG developments have led to amendments to financial reporting law pursuant to the Swiss Code of Obligations. Once the amendments, as suggested under the indirect counterproposal to the rejected Corporate Responsibility Initiative, come into effect, asset managers (like any other financial institution) that are incorporated in

Switzerland may become subject to ESG transparency and reporting rules. These rules will apply if, among other things, asset managers exceed certain thresholds such as the number of employees, turnover and balance sheet total (and provided no exemption applies).

Further, the Swiss Parliament strengthened FINMA's position by adopting the amendments to the Federal Act on the Reduction of CO2 Emissions in September 2020. Under this Act, FINMA will have the mandate to review, on a regular basis, the Swiss financial institutions' exposure to climate change-related risks on a micro-prudential level. An optional referendum (public vote) will be held on the amended act.

Practical implications

Going forward, the regulatory developments towards disclosure of non-financial risks may increasingly require Swiss financial market participants, particularly SIFs, to review their organisational structures and business operations in terms of ESG risks, and to duly report adverse effects to FINMA.

Therefore, Swiss market participants are advised to establish (or enhance) adequate organisational structures and processes to mitigate ESG risks (similar to credit risks, market risks or operational risks). For example, financial institutions should avoid concentration risks vis-à-vis corporations that (heavily) pollute the environment, or mitigate legal or reputational risks by proactively managing greenwashing issues, which (retail) investors may be exposed to.

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No legal or tax advice

This legal update provides a high-level overview and does not claim to be comprehensive. It does not represent legal or tax advice. If you have any questions relating to this legal update or would like to have advice concerning your particular circumstances, please get in touch with your contact at Pestalozzi Attorneys at Law Ltd. or one of the contact persons mentioned in this legal update.

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