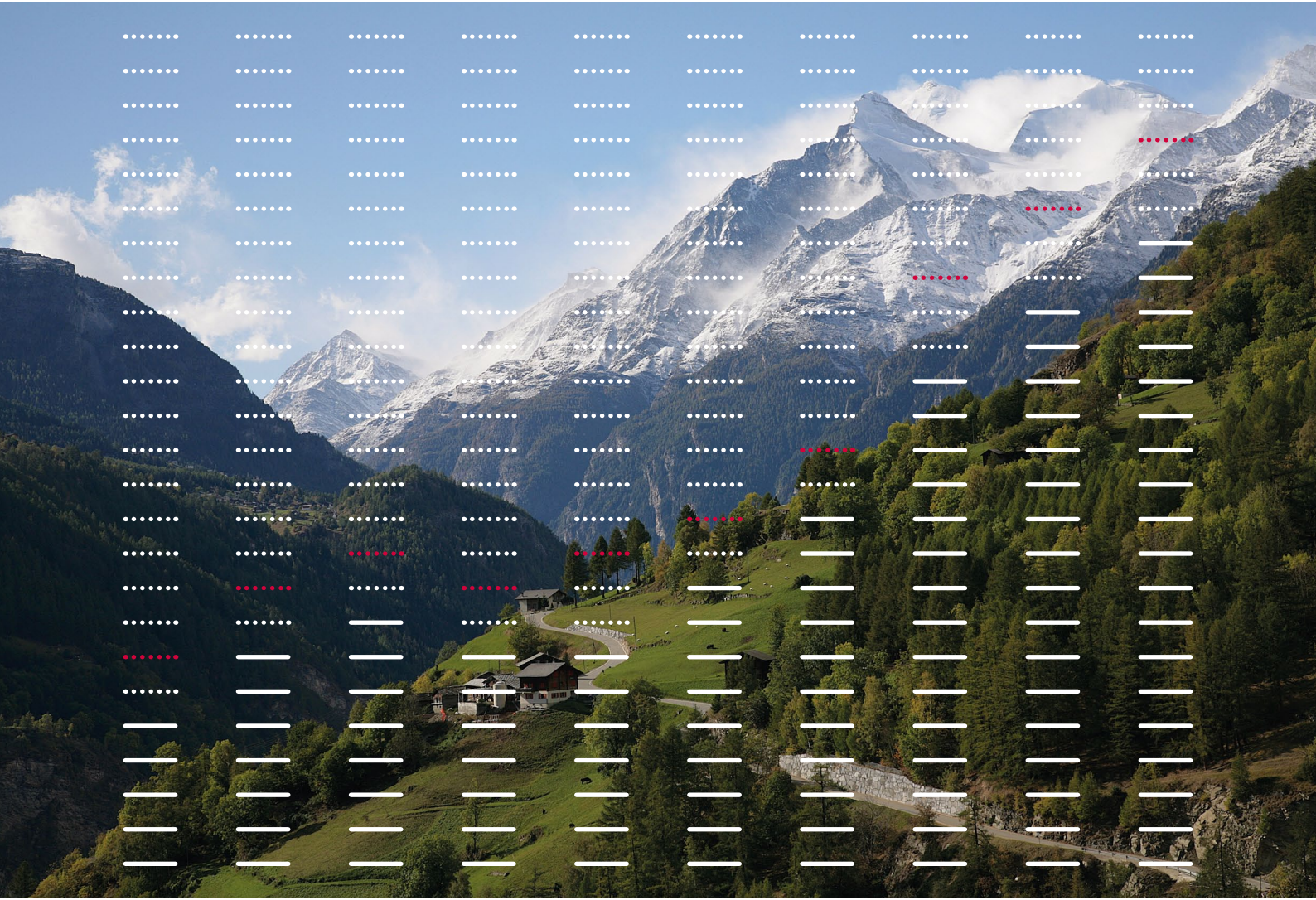


**The Sustainability Forum Zürich (TSF) and  
Sustainable Finance Geneva (SFG)**



**Path to the Sustainable  
Financial Centre Switzerland**

**A call to action**

**May 2013**



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# Foreword

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The Sustainability Forum Zürich and Sustainable Finance Geneva strongly believe in the important role of the financial sector in contributing to the current and future prosperity of Switzerland. The two organisations also share a vision of a financial sector that systematically considers social and environmental challenges of our time in their operations as well as products and services.

This vision of sustainable finance offers the opportunity of a proactive response to the current and foreseeable challenges the sector and its stakeholders are facing. Making sustainability an inherent part of the Swiss Financial Centre brings tangible and lasting benefits for its actors in terms of positioning, attractiveness and competitiveness on an international level. Furthermore, Switzerland can build upon

a strong tradition of democratic values and high environmental standards. The country is therefore placed at the forefront in a journey towards a sustainable financial system. Many experts, interviewed in the course of the preparation of this paper, share this opinion with us.


Of course, Switzerland is not the only place where such opportunities are addressed. A number of other financial centres have taken first steps to turn them into profitable business. Yet, we are convinced that Switzerland with its well-anchored commitment to sustainable development has the assets to create a competitive advantage. The window of opportunity is open and now is the time to act.

The Sustainability Forum Zürich and Sustainable Finance Geneva publish this White

Paper in order to analyse these opportunities and propose actions to best take advantage of them. The paper is intended to stir a discussion amongst important actors in the financial centre. An on-going dialogue will be required to further sharpen our suggestions and come up with concrete next steps. We look forward to leading it with you.



Zeno Staub  
Chairman  
The Sustainability Forum Zürich



Angela de Wolff  
Founding Chairperson  
Sustainable Finance Geneva

The Sustainability Forum Zürich and Sustainable Finance Geneva would like to thank the members of the Steering Committee, the Editorial Team, the experts being interviewed, as well as the lead authors PwC Switzerland and everyone who contributed to the paper, sharing extensive time and insight with us in its elaboration.

# The project

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## Our vision

For The Sustainability Forum Zürich (TSF) and Sustainable Finance Geneva (SFG), the aim of a “Sustainable Financial Centre Switzerland” is a financial centre that contributes to sustainable development and value creation in economic, environmental and social terms. In other words, one that ensures and improves economic efficiency, prosperity, and economic competitiveness both today and in the long-term, while contributing to, protecting and restoring ecological systems, and enhancing cultural diversity and social well-being.

## Objectives

Much has been published on the ever substantiating evidence of the negative effects of unsustainable business models. Aspects range from climate change or resource depletion over to social unrest, large-scale migration and the increasing occurrence of governance scandals in a globalised economy. At last, those megatrends and their impact on human development and business models have entered political and business agendas.

Progress to meet the sustainable development challenges has so far been limited, especially on the political agenda (e.g. Kyoto-Protocol, UN Climate Change Conference in Copenhagen 2009 and Rio 2012). However, numerous concrete initiatives are in place, an

increasing number of studies addressing the impacts of inaction have been published, and there is strong evidence of the business opportunities linked to sustainable development to be grasped in the next few decades.<sup>1 2 3</sup>

**The ambitious, yet achievable objectives of this White Paper, mirror the missions of both TSF and SFG, and are centred on:**

- (i) **Making people aware that positioning Switzerland as a sustainable financial market will require a joint effort from stakeholders in industry, government and civil society;**
- (ii) **Focusing the dialogue between regulators, financiers and the general public on sustainability and stability of the financial system and finance industry;**
- (iii) **Increasing Switzerland’s financial innovation and its attractiveness to finance companies;**
- (iv) **Strengthening the Swiss Financial Centre’s reputation for integrity, thereby fostering future growth, and**
- (v) **Creating a dedicated network for all stakeholders to contribute to a sustainable financial market and ultimately to a sustainable real economy.**

## Methodology

This White Paper represents TSF’s and SFG’s opinions and proposals which have been shaped by structured interviews with more

than 30 people who have important roles in and around the financial sector. These include stakeholders in ‘mainstream’ finance, sustainability-related finance as well as the political, corporate and academic arenas. We’d like to thank them and everyone who contributed to this process, sharing extensive time and insight with us (see chapter 6).

## A White Paper

A White Paper in our view is one that builds awareness with readers through the factual documenting of information around a specific topic which is supplemented by views of the participating organisations behind the content, with the intention of being persuasive. In this regard, it is not our intention to present a detailed blueprint or action plan that simply must be implemented, but rather to give direction, make proposals and highlight opportunities of a path towards positioning Switzerland as the Sustainable Financial Centre over the course of the next decade, recognised amongst peers.

The White Paper is a document for all stakeholders of the financial services sector in Switzerland. We acknowledge that some of the topics as well as our proposals will be more relevant for specific players in the market, however, we believe that the financial sector as a whole has an intrinsic interest to learn of the value of the **“Path to the Sustainable Financial Centre Switzerland”**.

## Structure

The White Paper is presented in four main chapters. The first of these summarises the strengths Switzerland may build upon in this market, chapter two analyses the current state of affairs internationally, chapter three focuses on identifying issues in sustainable finance to be addressed in Switzerland, and chapter four details the consequent five pillars of the Sustainable Financial Centre Switzerland, which describe our proposals to go forward.

## Next steps

An important question remains: Who will make this happen? In the long run, everybody: the industry, its customers and its regulators. In the nearer term, the relevant actors have to join forces in order to be the brain, the voice and the motor of the Sustainable Financial Centre Switzerland and clear leadership is required from important actors of the Swiss financial sector.

Dialogue and further research, catalysed by this White Paper, will be the best way to identify more-concrete actions and timeframes. Initial dialogue sessions, planned by TSF and SFG in the coming months, are aimed at formulating concrete recommendations and creating detailed action plans.

# Executive summary

This White Paper on the “Path to the Sustainable Financial Centre Switzerland” is a joint initiative of The Sustainability Forum Zürich (TSF) and Sustainable Finance Geneva (SFG). Both institutions have committed to editing a high-quality, thought-provoking publication to spark the discussion and push the Swiss finance community to look beyond the current market turmoil, to anticipate change, and to address the chance to leverage the potential market opportunities rooted in sustainability-related mega trends that will lead to shared value creation for different stakeholders.<sup>4</sup>

For TSF and SFG, the aim of a “Sustainable Financial Centre Switzerland” is a financial centre that contributes to sustainable development and value creation in economic, environmental and social terms. In other words, one that ensures and improves economic efficiency, prosperity, and economic competitiveness both today and in the long-term, while contributing to, protecting and restoring ecological systems, and enhancing cultural diversity and social well-being.

Our discussions and research revealed a genuine consensus behind why we are advocating the “**Path to the Sustainable Financial Centre Switzerland**” which can be best summarised as follows:

## Leadership in sustainable finance

Leadership in sustainable finance offers a highly promising business case today and going forward:

- The systematic consideration of aspects related to the concept of sustainability is a fast-growing and irreversible trend in finance.
- Financiers of successful sustainability technologies, products and services will prosper, generating jobs, tax revenues and prosperity.
- Investors taking such aspects into account will profit from better risk-adjusted returns in the long-term – empirical evidence indicates that companies with stronger sustainability performance are more likely to outperform their peers in terms of stock price.
- And last but not least, sustainable finance and the innovation around the topic can catalyse change in the real economy, bringing social and environmental benefits, both to Switzerland and to the world at large.



## Swiss sustainability's seeds are growing

The positioning of the Sustainable Financial Centre Switzerland optimally leverages the existing and externally perceived "Swiss" values of stability, security, reliability, transparency, diversity and performance while being aligned with the Swiss Federal Council's Sustainability Strategy 2012–2015<sup>5</sup>:

- Finance is available, the country's balance sheets, both public and private, are strong enough to finance global leadership and Switzerland enjoys a disciplined financial budget.
- Added to that, many Swiss banks and insurers as well as academics, NGOs and supranational institutions have taken great strides in sustainability and Switzerland is home to a growing number of thought leaders and pioneers in sustainable finance.

This combination of an inherently 'sustainable' image with leadership in process and product development provides the Swiss financial centre with a strong opportunity to create a competitive advantage over other financial centres.

## The time to act is today

Maybe most importantly – act now or follow later:

- The global financial system is going through a significant change in various dimensions right now – and so is the Swiss financial industry, notably with regard to its strategic positioning.
- Establishing Switzerland as the centre of choice for sustainable finance offers opportunities others will not wait to seize.

While most financial organisations – and clusters – are finding it difficult to look beyond the current market turmoil, their survival and success will also depend on being able to deal with the longer term trends that are transforming the market and competitive landscape.<sup>6</sup>

## Five pillars of sustainability success

**Our proposals are built on five pillars. The first two pillars of principle are most critical and fundamental. These, when lived out by professionals and institutions, are the bedrock of sustainable finance and enable the three pillars of operation to be achieved.**

## The pillars of principle:

### 1. Clients and trust

**Build trust through client centricity** – ‘your interest is our interest’ – this is a sustainable finance institution’s omnipresent message. To bring this pillar solidly into effect requires successfully addressing the alignment of the financial sector with its clients, we propose that this includes:

- appropriate incentives and broader capacity building of finance professionals
- transparency in the value and impact of products and services both to clients and society as a whole
- strong leadership to embed values of integrity and sustainability throughout the financial sector.

### 2. Innovation and legislation

**Foster competition, innovation and growth within an appropriate legal framework** – competition should be fierce, but fair, allowing support for new market entrants while also fuelling innovation and growth. We feel that through the design of an effective risk and regulatory environment, many of the specified goals of the other 4 pillars in the Paper may be strongly catalysed. Our proposals include:

- enhancing transparency and disclosure
- critically building bridges across actors in the sector to shape together an effective regulatory framework geared to supporting the development of the Sustainable Financial Centre Switzerland.

## The pillars of operation:

### 3. Investment and long-term

**Adopt a long-term investment perspective** – Taking the long view – this needs to be standard procedure for institutional asset owners such as pension funds, insurance companies or foundations. This pillar is about them leading in sustainability by taking a more holistic view of investing, thereby guaranteeing profitable investment and shared value creation. We propose:

- a broader application of leading international responsible investment principles to raise the level playing field
- to Swiss pension funds to signing-up the stewardship guidelines on exercising voting rights in public companies presented by the Swiss Pension Fund Association ASIP, Swiss Federal Social Security Funds OAI/II/IC, economiesuisse, Ethos, Swiss Bankers Association, and SwissHoldings (Federation of Industrial and Service Groups)
- reporting on sustainability policies
- acknowledging again the need to bolster research and capacity building.

### 4. Extra-financial factors and performance

**Integrate environmental, social and governance (ESG) factors into mainstream business** – ESG criteria need to move from their current ‘nice-to-have’ niche into the mainstream where they are applied regularly and consistently to the broadest range of decisions. There is a strong business case for doing so, empirical

evidence demonstrates positive contribution to portfolio performance, and clients, investors and society at large are demanding it. We propose that:

- the Swiss financial sector actively supports and concretely builds on authoritative international initiatives that address and request the integration of ESG criteria
- the evaluation, accounting and reporting of ESG risks is broadly promoted and integrated.

Financial Centre Switzerland and clear leadership is required from principal actors of the Swiss financial sector.

## 5. Investors and green and social issues

**Lead in green and social finance** – these areas of finance, already growing significantly, are potentially huge. Total investment for decarbonisation alone could amount to US\$ 700–850 billion, around 10% of global infrastructure investment per year<sup>7</sup>. Environmentally and socially beneficial projects and companies will continue to grow, and by definition these are funded and insured by sustainable financiers. This pillar is about building and deepening that relationship, and identifying long-term growth potential. We propose that:

- the relevant players in Switzerland come together, create awareness, analyse the current data to discern market needs and assess impacts
- opportunities are identified and a formal strategy for green and social finance is developed and implemented.

**Who will make this happen?** In the long run, everybody: the industry, its customers and its regulators. In the nearer term, the relevant actors have to join forces in order to be the brain, the voice and the motor of the Sustainable

# 1 Sustainability's seeds are growing

**Establishing Switzerland as the recognised Sustainable Financial Centre is no greenfield project. The country already has powerful bases in finance and in sustainability.**

These can be built upon further, and inter-linked, to create a global leader in the field. Research and interviews for this paper have identified five key areas where this building should focus. These five 'pillars of sustainable finance' will guide discussions and activities, and they will also underpin the finance sector's mainstreaming of sustainability.

industries, exports twelve times as much business as it imports.<sup>10</sup>

Switzerland has long set high standards in private banking. Banks are service-minded, and their advisors offer in-depth knowledge of financial markets and innovative products.

## 1.1 A strong financial centre

Switzerland is clearly among the world's leading financial centres (see box 1). With some 10% of global securitized assets under its management<sup>8</sup>, the country trails the United States and is slightly behind the UK in market size. Switzerland is world number one in cross-border private banking (USD 2.1 trillion).<sup>9</sup>

Banks are the most visible players in finance, followed by primary and secondary insurers. Commodity and trade financiers also have a strong presence and history. As would be expected for a country with only 8 million people, a majority of the business is export based. The primary customer base is in Europe, with substantial representation in the Americas and Asia. OECD figures illustrate that Switzerland, in the combined banking and insurance

### Swiss story, in numbers

1

- 1 Switzerland's rank in The World Economic Forum's Global Competitiveness Report 2011 and 2012, and in the INSEAD Global Innovation Index 2012
- 3 Swiss banks among the 10 largest wealth managers
- 27% Swiss market share in cross-border private banking – making it the global leader
- 70%+ Share of Swiss insurance premiums earned abroad



Not surprisingly, finance accounts for a serious slice of Switzerland's economy though this has decreased over the last few years. The Swiss financial centre accounted in 2011 for 10.3 % of gross domestic product, 10 % of income tax and 5.7 % of employment in Switzerland.<sup>11</sup>

A recent Credit Suisse study analysing the overall challenges facing the Swiss financial centre highlights the high quality of advice in financial services, political, economic and social stability, a flexible labour market, a high-quality educational system and a strong industrial tradition supporting innovation and research and development as traditional strengths of Switzerland on which a successful and competitive financial centre can be built.<sup>12</sup>

The strong attributes of political and economic stability, legal security along with the Swiss franc as a stable currency are widely recognised as key supporting elements of the current strength of the Swiss financial centre as well as the fundament for future growth and success in the industry.<sup>13</sup>

## 1.2 A strong record in sustainability

Switzerland is well known in sustainability, and not only through its financial sector.

### Sustainability is part of the nation's fabric

It is one of the few countries to include sustainability in its constitution (see box 2). Its commitment to environmental quality is renowned: according to Yale University's Environmental Performance Index, it is the world leader in protecting environmental health and in ecosystem vitality.<sup>14</sup> It is also known for good governance, ranking among the top ten nations, as rated by Transparency International.<sup>15</sup> Zurich, Geneva and Bern consistently come out favourably in rankings of the world's cities with regard to the quality of living; all three cities appear in the top ten list in the yearly Mercer survey which takes into consideration aspects including the natural and social environment.<sup>16</sup> Finally, the Swiss population recognises the strength of the home market as illustrated in the World Bank Government Effectiveness Index which assesses a population's perception of the quality of public and civil services and their degree of independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government's commitment to

Swiss Constitution, Article 73

2

The Confederation and the Cantons shall endeavour to achieve a balanced and sustainable relationship between nature and its capacity to renew itself and the demands placed on it by the population.

such policies, all aspects that underpin a stable, secure and sustainable market.<sup>17</sup>

### Long term durability of social welfare

Switzerland's policy to curb public debt has resulted in the reduction of debt of around CHF 20 billion in the last 5 years.<sup>18</sup> It is a strong fundament of a sustainable financial policy; it is coherent with ensuring the long-term durability of social welfare and has an international acceptance such that the European Union is adopting a similar mechanism to manage countries with structural deficits and growing public sector debts. Public debt in Switzerland has been reduced from 53 % to 40 % of GDP in the last 5 years whereas the euro area has seen the same average public debt figure rise from 70 % to 85 % of GDP over the same period.

### Home of international organisations

Switzerland is the home of many organisations devoted to sustainability, such as the

Intergovernmental Panel on Climate Change (IPCC), the World Business Council for Sustainable Development (WBCSD), the World Wildlife Fund for Nature (WWF) and the International Union for Conservation of Nature (IUCN). It also hosts several supranational organisations that are devoted in part to sustainability: the World Health Organisation (WHO), World Meteorological Organisation (WMO), United Nations Children's Fund (UNICEF), the International Labour Organisation (ILO), the UN Conference on Trade and Development (UNCTAD) and the World Trade Organisation (WTO).

### Pioneers in sustainable finance

Sustainable products and finance are researched and practiced in Switzerland to a certain extent (see box 3). It is home to the Dow Jones Sustainability Indexes (DJSI) as well as the UN Environment Programme's Finance Initiative (UNEP-FI). With approximately 25 % of the world market, microfinance is dominated by Swiss asset managers.<sup>19</sup> Roughly 4 % of Swiss funds are sustainability funds – applying strict sustainability principles in investment selection – and a growing number of other funds integrate sustainability criteria into the investment process. Some insurers also apply them in their portfolios, and they are pioneering management of environmental risks as well. Renowned universities contribute to the development. Institutes such as Chair of Sustainability and Technology at the Swiss Federal Institute of Technology or the Center for Microfinance at the University of Zurich (to name only two) contribute innovative research on sustainable finance. The Ethos Foundation has pioneered thought leadership on responsible corporate governance and has been rewarded for its work with the International Corporate Governance Network Award in 2009.

#### Seeds of Swiss sustainable finance 3

Switzerland already is the leading contender for world leadership in sustainable finance.

The country is home to the UN Environmental Programme's Finance Initiative, the World Business Council for Sustainable Development, the World Economic Forum, and the World Wildlife Fund.

Switzerland also hosts innovators such as the Dow Jones Sustainability Indexes, the first retail microfinance fund and an index for reputational risks.



# 2 Lessons from other financial centres

Switzerland has a strong base in sustainable finance – one of the strongest of any financial centre. It also is attractive to finance in general, because it offers a stable economic climate, an environment of low corruption and ease of doing business<sup>20</sup>. But for long-term, global leadership in sustainable finance, this is not enough. Others – London, Luxembourg, New York, and Singapore, and to a lesser extent Hong Kong – have claims to the title themselves.

A recent study<sup>21</sup>, commissioned as part of this project, surveyed the strategy and actions of these competitors. In all of these financial centres, sustainability is gaining momentum. Still, none has emerged as an undisputed leader. Five actions appear to be those where any pretender – including Switzerland – should be focusing its efforts:

- Define sustainability strategy
- Mobilise the movement
- Use public funds
- Rewrite the rules
- Make the markets

## 2.1 Define sustainability strategy

**Switzerland has currently no coherent strategy for sustainability of the financial sector. The Swiss Constitution encourages all Swiss actors to contribute, given their individual means, to sustainable development. Any future strategy of the Sustainable Financial Centre Switzerland should be based on this reference.**

### London: Sustainability driven by politicians

The city continues to reign at or near the top of the world's financial centres in conventional measures such as turnover, jobs, tax receipts and global reach. In recent years, London has also set its sights upon sustainability. Leading politicians and financiers have clearly expressed their ambition to become the global





leader in sustainable finance, noting the many benefits this will bring to the economy, the environment and society at large.

Richard Sermon, Sheriff of the City of London, together with Lady Susan Rice, a strong advocate of integrity in banking, are spearheading an initiative begun in 2011 entitled “Restoring Trust in the City”. The project provides a template of best practice that financial services companies in the City of London can adopt and which should guarantee integrity and ethical corporate behaviour.

### **Luxembourg: Building a hub for sustainable funds**

Luxembourg is Europe’s largest investment fund domicile, and has made recent noise about its intention to make responsible investment the ‘third pillar’ of its € 2 trillion funds industry. It is arguably Europe’s domicile of choice for sustainable funds and is targeting 10% of assets, over time, going into responsible investment.

Luxembourg, led by HRH Grand Duchess Maria Teresa of Luxembourg and senior members of government, has committed to quickly and efficiently ensuring the right regulatory environment; structures and processes are put in place from the outset to support their ambitions. Furthermore, Luxembourg aligns its internal ambitions with external promotion and has set-up an interesting public-private partnership

called “Luxembourg for Finance”, which represents an agency primarily tasked with improving the image of Luxembourg as a financial centre abroad.

### **New York: Promoting governance and cleantech**

The United States enjoys a culture of public policy engagement that is truly world class. Although the US generally suffers from political and regulatory deadlock on environmental and social issues, the financial centre of New York City has nonetheless spearheaded important developments in sustainable finance. These include attention to corporate governance issues, shareholder proxy voting and engagement, the cleantech investing industry where it came out in first place in the G20 clean energy investment table with \$ 48.1 billion worth of clean energy investments<sup>22</sup>, and emerging ‘social or impact investing’.

### **Singapore: Attracting clients through green and social finance**

The Asian city-state is among the leading global financial centres – in conventional terms. Located between India and China, Singapore sits at the nerve centre of the region, and is often referred to as ‘Switzerland of the Far East’. Recently, it has begun to see sustainable finance as an opportunity for competitive differentiation.

Thanks to its concentrated governance, Singapore is able to fast track its growth in sustainable finance. It has upped its stake in cleantech investment to enhance its industrial strategy, and it has grown in social finance to increase its attractiveness in private banking.

### **Hong Kong: Taking care of reputation**

This Asian finance hub, ranked second in the World Bank's latest ease of doing business index<sup>23</sup> and where more than 70 of the world's top 100 banks have branches<sup>24</sup>, is progressing more slowly on sustainability. There is a strong focus on ensuring that companies listed on the stock exchange do not pose reputational risks. The local regulator also pays close attention to the centre's reputation, by enforcing high accounting and disclosure standards.

## **2.2 Mobilise the movement**

**Leadership in sustainable finance will have to be earned. First, Switzerland needs to declare its ambition to lead, and then openly pursue this. The UK and to some extent the US have been particularly effective at this:**

### **Express the ambition**

The UK national government and the City of London Corporation (the local government) have been vocal about this and are strong at marketing themselves, claiming leadership in sustainable finance – especially with regards to carbon finance, Islamic finance and social finance. Statements of support have been made all the way to the top, including the Prime Minister's office.

### **Get organisations going**

London financiers started the UK Sustainable Investment and Finance Association that “aims to ensure that the UK finance sector is the world leader in advancing sustainable development through financial services.” The London Corporation founded and supports TheCityUK, a think-tank and lobbyist that (among other things) promotes UK sustainable finance. Most recently it launched an initiative called “The Next Generation Vision – A positive future for financial services.”<sup>25</sup> The national government has funded a variety of multi-stakeholder sustainable finance programmes, including a social investment task force.

The US is home to a number of organisations with a strong record in mobilising and lobbying for legislation. The Forum for Sustainable and Responsible Investment (US SIF) actively works and engages with the Securities and Exchange Commission (SEC) to promote the development of rules favourable to sustainable finance. More for Mission is a growing association of foundations dedicated to broadly promoting responsible investing, its membership now includes 75 foundations that represent approximately USD 30 billion in total assets.

### **Build the international network**

London has become home to important institutions in sustainable finance. These groups employ fewer than 100 people collectively, but they leverage London's knowledge and visibility in sustainable finance. The UN-backed Principles for Responsible Investment (PRI)<sup>26</sup> convenes over 1,000 asset owners, asset managers and sustainable finance service providers with assets under management exceeding \$ 30 trillion<sup>27</sup>. The International Corporate Governance Network has over 500 institutional

investor members with \$ 18 trillion in assets, and the Carbon Disclosure Project<sup>28</sup> works on behalf of 655 investor members representing \$ 78 trillion in assets<sup>29</sup> to advocate for greenhouse gas emission reporting and management by companies and cities.

## 2.3 Use public funds

**Governments are, by far, the largest single movers in modern economies. So it makes sense to harness their financial power in the service of sustainability. In Switzerland, a few public pension funds have already declared a commitment to responsible investment.**

### Invest public money sustainably

CalPERS, the US's largest public pension fund, has a historically strong position in sustainable finance. This year CalPERS released its first report on sustainable investing<sup>30</sup>. This outlines the journey to create a fiduciary framework for integrating sustainability across its portfolio, and explains how this will improve long-term, risk adjusted returns.

Singapore has been even bolder, designating a substantial amount of its sovereign-wealth fund, Temasek, for sustainable investment. In France, the state reserve fund (which complements the state pension) "Fonds de Réserve pour les Retraites" (FRR) and the governmental additional insurance for civil servants "Etablissement de Retraite Additionnelle de la Fonction Publique" (ERAFP) are pioneering SRI with the objective of considering sustainability criteria for all their investments.

### Push the policy

In the UK, a number of consultations and reviews have been done to discover and to define areas where government can encourage or promote sustainable finance. These include broad inquiries and public policy reviews such as the Myners Principles, the UK Stewardship Code and the Kay Review. These initiatives explore notably the role of finance as an intermediary and its relation to the real economy. The government has also sponsored research and convened seminars to spread knowledge.

## 2.4 Rewrite the rules

**Through rules and regulations, governments also define many features of finance. Nonetheless, there is no country, including Switzerland, that has substantial, comprehensive support from regulators for sustainable finance. The following examples show positive regulatory initiatives from competing countries:**

### Use legal incentives

The UK government has taken numerous measures to see that these are aimed more at supporting sustainability. Two notable results have emerged from this. One, the government has offered tax incentives (Community Investment Tax Relief) to social investment.<sup>31</sup> The other, future pensioners are being allowed greater choice in how their funds are being invested. There is some scope for them to apply sustainability criteria in choosing a portfolio.

## Encourage standards

Following the 1989 Exxon Valdez oil spill in Alaska, investors founded Ceres, a US-based non-governmental organisation (NGO) dedicated to “building a sustainable global economy.” The organisation focuses on policy advocacy and investor-company-stakeholder dialogues on sustainability issues, most notably climate change, water and energy. While many NGOs work on sustainability, Ceres is unique as a neutral platform for bringing investors into policy advocacy, an area where few investors have made their voices heard (as they frequently do in the corporate sector). In 1997, along with the United Nations Environmental Program and the Tellus Institute, Ceres launched the Global Reporting Initiative (GRI)<sup>32</sup>, the de-facto standard for corporate reporting on environment, social and governance issues. More recently, Ceres was instrumental in encouraging the US Securities and Exchange Commission to issue guidance on how existing rules could obligate companies to report on climate change risks and opportunities.

## Develop labels

Founded in 2006, The Luxembourg Fund Labelling Agency (LuxFLAG)<sup>33</sup> awards a label to microfinance investment vehicles. By driving competition it raises the standards and contributes to the effectiveness and impact of microfinance. Another lesson to be learnt from LuxFLAG is its governance. Under the honorary president, HRH Grand Duchess Maria Teresa of Luxembourg, important players joined forces – from the Stock Exchange to the European Investment Bank (EIB), from Luxembourg Bankers’ Association (ABBL) to selected ministries.

Novethic, financed by the state controlled Caisse des Dépôts, is an information agency

on SRI. It recently created a label for SRI funds that systematically take ESG criteria into consideration. Novethic is widely recognized as a key driver of the development of SRI in France.

## 2.5 Make the market

**It is important to develop adequate guidelines for the registration of investment funds dedicated to sustainability. Present leaders in investment funds are taking the challenge. But Swiss sustainable asset managers continue to register their funds in Luxembourg, mainly due to the simple, efficient registration process introduced by the Association of the Luxembourg Fund Industry.**

### US, UK, Europe are on track...

Both London and New York are home to responsible investment funds, as well as to foundations and charities that practice or promote sustainable finance and advocate sustainability.

In Europe, France and Luxembourg dominate the market of ESG (cross-sector) funds. Nearly half of all such funds are domiciled in one or the other, reports a recent European Responsible Investing Fund Survey<sup>34</sup>, and the countries are home to 56 % of such assets under management. The figure jumps to 66 % of the total assets under management in microfinance.

### Australia develops a mandatory approach

The fund industry body in Australia, the Financial Services Council (FSC), has begun a

process to set new guidelines for ESG integration at Australian super fund firms. Fund providers will be required to implement and disclose ESG risk management policies under new standards that will come into force in July 2013 and be mandatory one year later. The new guidance follows an ESG Reporting Guide for Australian companies published with the Australian Council of Superannuation Investors in 2011. The FSC has 130 members with combined assets of more than Euro 1.5 trillion<sup>35</sup>.

### **Don't forget stock exchanges**

Another vehicle here is the Sustainable Stock Exchanges project. This UN-organised programme aims to require listed companies to make disclosures about their sustainability performance. So far it has been promoted mainly by bourses in South Africa, Brazil and Malaysia.

# 3 Five key challenges of sustainable finance

**What does sustainable finance look like in practice? Research and interviews for this report suggest that it can be defined by five main issues. This chapter analyses the challenges for the path to develop the Sustainable Financial Centre Switzerland, outlines the issues in broad terms and looks at today's picture. Suggested approaches for dealing with the identified challenges will be aggregated into five pillars for sustainability success which will be detailed in chapter 4.**

## 3.1 Clients and trust

**A customer-oriented approach is a fundamental requirement of a successful Swiss financial centre in the future.**

Trust is central to sustainable finance, notably in the area of wealth management. If clients lack confidence in their financial advisor or broker, (or if they trust another one more), they will take their business elsewhere – thus undermining the essence of sustainability. This challenge is about financiers earning that trust, namely addressing the principles that foster client satisfaction. It's about appropriately rewarding advisors for providing valuable and pertinent products and services that satisfy clients. It's also about competence – as with all professional services, practitioners must have a solid understanding and skill set to optimally manage and communicate both the financial and non-financial impact of the products and services they offer.

### Clients are key drivers

The UN Global Compact CEO survey from 2010 for example highlighted that end consumers, including business and government customers, are the key driver of both how companies will manage societal expectations as well as a company's strategy for developing sustainable products and services.<sup>36</sup>

Another study among leading business CEOs clearly indicates that customers are the perceived most influential stakeholders in shaping the future business agenda.<sup>37</sup>

Furthermore, Switzerland has long been active in promoting and adopting sustainable consumption. Scenarios for housing, transport, food, consumer goods and public utilities have been developed based on key factors, actors and decisions to help develop effective policy approaches.

Within the OECD countries, Switzerland's leadership is acknowledged notably in the area



of sustainable procurement. Switzerland leads the Marrakech Task Force on Sustainable Public Procurement, an initiative to shift public purchasing towards goods and services that meet high environmental, social and economic standards throughout their life-cycle.

### Finance needs trust

Trust is clearly one of the most important requirements of long-term viability of the financial sector and it is coherent with the principles of financial privacy.

*“Client centricity must be based on Swiss core values – we need to emphasise the value of the ability to listen and the delivery of a reliable and quality service respected by privacy, discretion, modesty and independence”*

Interviewee of the Paper

Looking closer at the relationship of trust between the client and the financial advisor in Switzerland, a study by the University of Zurich corroborates the outcome of the interviews we held and concludes that the regaining and strengthening of trust with clients represents the most important challenge facing the future of the financial sector with respect to the advisory role they play.<sup>38</sup> The results of the study indicate the level of dissatisfaction with the services of

the financial centre institution serving them. On closer analysis this dissatisfaction can be broken down into expectations not being met in all of the individual elements of reliability, assurance, responsiveness, empathy and tangibles.

### For finance to be sustainable, it must be trusted.

A Weatherill/IBM study explored the notion of trust in a survey capturing the views of high net worth clients and wealth managers, albeit on an international basis. The study concludes that trusted financial advisors are almost 5 times more profitable than their untrusted counterparts over the course of their client relationships thanks to a 26% higher share of wallet than untrusted advisors, double the amount of referrals and virtually no client attrition/turnover. The study also clearly illustrates similarly to the University of Zurich study that key performance indicators of wealth managers and clients are currently not aligned, pointing to a fundamental flaw in the performance management systems.<sup>39</sup>

### Swiss privacy

Privacy is an inherent part of Swiss culture, and financial privacy has long been a central element of Swiss finance where the understanding is rooted in a trusting relationship between government and citizen. Switzerland

and the financial sector is at the forefront of preventing privacy abuse, by setting and practicing stringent anti-money laundering standards.<sup>40</sup> The Swiss government is now formulating a clear strategy on the issue of financial privacy and the protection of personal data in light of current discussions on an international level within the G20 and the OECD which must then be consistently adopted by the financial sector. Furthermore, the Swiss Federal Council has acknowledged the importance of client security and has given the task to the Federal Department of Finance to detail the required legal basis in order to improve client protection with regard to the distribution of financial products.<sup>41</sup>

### Expanding know-how

Many of those interviewed agreed that Swiss financial sector professionals hold many of the ingredients required to be recognised and perceived as a trusted partner, this is notably the case with regard to strong financial sector know-how. However, our interviewees often emphasised that know-how will in the future not be assessed on traditional financial skills alone, a broader understanding of social and environmental issues, the risks and opportunities that these create, will help financial advisors to successfully create value for their clients in the future. Also, as we have mentioned earlier, competence alone is insufficient to address the satisfaction gap. Soft skills clearly differentiate financial sector advisors in the eyes of the client.<sup>42</sup>

### Align interest

The topic of aligned interests, whereby the incentives to finance professionals are aligned with the best interests of their customers is

partly covered by the proposed changes in the MiFID II<sup>43</sup> regulation that are aimed at protecting customers. We believe that ideally financial advisors should act without being forced; they should know that protecting clients is in their own interest.

### Improved transparency

Many interviewees pointed to the complexity of the financial sector's products and services as an issue to address. Improved transparency – in terms of an open culture and reporting allowing customers and regulators to verify interest-alignment and competence is perceived by many as a must-have going forward.<sup>44</sup> FINMA has addressed this topic to some extent in its report on the distribution of financial products in 2010, with the aim of fostering the sector to disclose diligent, neutral and transparent information on financial products.<sup>45</sup>

Finally, the notion of digital technology needs to be considered in the transparency argument. Current technology allows clients to both compare value and expand choices in a simple and quick manner, thus emphasising the requirement for greater transparency. Continuing digital transformation is changing the way people interact, share ideas and access products and services.

### Our vision...

Future action in Switzerland to fit the 'build trust through client centricity' pillar must recognise this social and behavioural change that is only set to further continue – change, which if managed well, will create significant competitive advantage.



## 3.2 Innovation and legislation

### Competition, innovation and regulation are essential to sustainable finance

There usually exists a tension between industry and regulators. On one hand, competition drives innovation and growth. On the other hand, regulation is needed to prevent excesses and to enable the desired conduct to those who it applies. This tension will never disappear, nor should it; the key is to keep it balanced and healthy. Both competition and regulation are essential to sustainable finance. This challenge addresses the appropriate regulatory or legal framework to support the development of the Sustainable Financial Centre Switzerland.

#### Ruling a new global financial system

There was a broad consensus among the interviewees we dialogued with that regulatory change in the industry sector will become commonplace in the future. This change is perceived both in terms of the development of hard rules but also notably the development of guiding principles and industry driven self-regulation based on the strong belief in better risk management in the global financial system in response to the public outrage following the financial crisis and the political agenda this has engendered.

The difficulties experienced in the last five years in the financial services sector have exposed significant public policy flaws that the Swiss Financial Market Supervisory Authority is currently addressing, for example through the Too Big to Fail (TBTF) legislation. Further

regulation on an international level also impacts the financial services industry in Switzerland, for example the EU Markets in Financial Instruments Directive (MiFID), a directive centred on increasing financial market transparency and improving investor protection. Another example is the Dodd Frank Act enacted by the United States Congress which created new financial regulatory processes that enforce transparency and accountability while implementing rules for consumer protection.

*“There is an extremely formal culture in Switzerland currently with regard to dialogue between the different industry players and the regulators. There is also insufficient constructive communication between the different financial services companies. This is not supportive of efforts to create a competitive advantage in Switzerland as a sustainable financial centre”*

Interviewee of the Paper

#### Addressing sustainability challenges needs new rules

Our interviewees recognised also that the sustainability megatrends – for instance the war for natural resources, the impact of climate change and inequality of income and wealth are phenomena that will have a fundamental impact on the way people live and companies do business. It was often mentioned that this is likely to become one of the main, if not the key driver of, government policies in the area of sustainable finance. At the same time, and equally as important, customers and investors are also expected to push for more long-term orientation and behaviour by financial sector players and their management.

The sustainability megatrends will open up new markets and business models for organisations that both understand the changing dynamics of supply and demand, and know how to mitigate the risks and grasp the opportunities. The insurance industry with its familiarity with risk management, modelling and limitations can provide valuable guidance to other financial services segments. A prospective regulatory framework, that is fair and balanced, that is driven and supported by the industry sector, that increases transparency and does not stifle competition (and subsequently innovation) will facilitate these opportunities and the subsequent creation of prosperity that will address the sustainability megatrends.

### **Past weaknesses partly still valid**

The TSF has looked at the regulation question in the past. The TSF Symposium in 2009 concluded that the domestic character and focus of regulation was inadequate given the global integration of companies and economies. Further, the risk posed by individual organisations to the financial system as a whole was not sufficiently accounted for. The Symposium further highlighted insufficient disclosure requirements, too little public intervention in corporate governance and the perceived insufficiency of funding for the national regulatory bodies to attract high calibre professionals with the requisite training and experience to appreciate and analyse the complexity and implications of the issues facing the sector as a whole, as crucial factors impacting the sector difficulties during 2008–9.<sup>46</sup> Many of these conclusions remain largely valid today, though it should be recognised that FINMA has since made progress to enhance the quality of its most senior professionals.

### **Ending the compensation debate by adopting adequate standards**

Executive compensation was another material topic that was highlighted in our interviews and research. In terms of compensation, the Financial Stability Forum's Principles for Sound Compensation Practices<sup>47</sup> and their Implementation Standards<sup>48</sup> which were developed on the back of the financial crisis to align compensation with prudent risk-taking, particularly at significant financial institutions, have been endorsed by G20 leaders and represent a concrete and credible solution providing practical recommendations to both national authorities and firms to address the sensitive issue of executive compensation in a sustainable manner.

#### **Our vision ...**

**A balanced regulation is essential to sustainable finance, and so is supervision. The supervisors must be treated with the priority, diligence and respect they deserve, though the supervisors themselves must adopt a stakeholder-oriented approach. As stipulated in article 5 of the Financial Market Supervision Act<sup>49</sup>, the supervisory authority's objective is to contribute to sustaining the reputation and competitiveness of Switzerland's financial centre. For competitive advantage, we believe appropriate, stable and recognised supervision needs to be maintained.**

## **3.3 Investment and long-term**

The financial services industry has to address client's and society's needs in the long term.

Sustainability is, by definition, about the long term. Only over generations can a company, an industry or an investment be judged as long-lasting. This challenge is about advocating the business case for long-term investment – notably to asset managers, emphasising the benefits to the financial services sector, to customers and to society of doing so. It focuses mainly on the pension fund industry, a very tangible example of where the long-term philosophy is perceived as a fiduciary duty.

### Investing for tomorrow

The interviewees we spoke with were in agreement that a healthy financial centre needs to anticipate demographic and migration developments and bring products and services into line with the changing customer base in the different markets served. As people live longer and state support declines, the competitive frontline will likely shift from lending towards helping people to fund and manage their retirements. Furthermore, urbanisation increases the stress on physical and service infrastructure, creating demand for investment to support the migration of people into cities.<sup>50</sup>

The overriding purpose of long-term savings institutions, notably pension funds is to deliver financial security in retirement or income at other stages in life, to millions of ordinary people. To do this, these investors depend on markets that are stable, well regulated, transparent and fair, thus closely linking this challenge with the previously detailed one in this Paper. The Swiss pension fund system is well financed, money is available, there's a strong track record in asset management and Switzerland enjoys a well established pension scheme based on three pillars (1) old age and survivors' insurance, (2) mandatory occupational benefit

plan and (3) optional tax-privileged provision. This is a strong basis to build on.

### How much can the financial markets contribute?

Current figures on Swiss pension fund performance and returns show a below-expectations figure, depressed by short-termism and financial instability. One large institution measuring returns since 2000 communicated an average figure of 1.85 % yearly return against promised returns of 3.3 to 3.7 %.<sup>51</sup> When one looks and compares how selected pension funds managed in other countries are performing, there is often a gulf in performance compared to the Swiss-based funds. The above-cited article details that some of the Canadian funds for example still bring yearly returns of over 10 %. Swiss pension fund owners simply accept these figures as they do not have the power to influence the way their savings are invested in the current legislation. The pressure on pension fund reform in Switzerland is increasing though. The same article clearly identified required improvements in the regulatory environment, the incentive system of pension fund managers and the level of professionalism and expertise of the whole industry.

*“Research shows clearly that companies forego investment opportunities with positive long-term net present value in order to satisfy the market’s short-term performance expectations. Companies have little incentive to invest in serious emission reductions (beyond the lowest of the low-hanging fruit) if their shareholders would prefer short-term earnings or share buy-backs over capital expenditure or R&D with a longer-term payback*

*that may be uncertain if carbon prices remain low or nonexistent. Why invest in human capital development when expenditure on training is a cost in the accounts and the markets salivate when you announce lay-offs?”*

Rob Lake, Director of Strategic Development, UN PRI

### **Retirement system challenged by low interest rates**

Expansive monetary policies in most industrialised countries in the last decade have led to historically low interest rates aimed at easing financial conditions, reducing unemployment and assisting economic recovery. However, low interest rates discourage saving in the long-term and put pressure on financial services companies and the interest sensitive long-term financial products they issue, notably life insurance and pensions. The World Pensions Council (WPC) researchers have argued that durably low interest rates in most G20 countries will have an adverse impact on the funding positions of pension funds and that pension investors face the real value of their savings declining.

### **Tapping into new opportunities**

Echoing Rob Lake’s comment, it is widely felt that sustainable finance offers new investment opportunities for pension funds. Infrastructure for example is one important area for economic development and for the improvement of living conditions. Sustainable infrastructure investment opportunities both in Switzerland and in emerging countries can be found in areas like renewable energy, water, agriculture and education. The same is true for sustainability-related technology enhancement, an area offering strong long-term opportunities.<sup>52</sup>

### **Thinking long term adds value**

In terms of performance, there is a wealth of empirical evidence confirming the positive relationship between sustainability and financial performance, for example measuring the stock price performance of companies with a strong overall sustainability performance demonstrates better long-term returns than those with a low sustainability performance.<sup>53</sup>

On a theoretical level, both environmental and social health represent genuine assets with economic value, so their depletion must be part of a true, fair income statement. Our interviewees and our research led us to believe that these assets tend to be overlooked because of short-sightedness and minimal awareness of the impacts of this course of action, as well as wrong incentives at all levels of decision making. To satisfy short-term financial expectations, companies too often forgo investment opportunities that offer long-term net present value. This can be misguided, as the example of climate-change mitigation suggests. Increasingly, research such as the Stern Review<sup>54</sup> concludes that modest mitigation and adaptation measures, taken now, are significantly more economic than any measures postponed and taken in future.

### **Thinking sustainability is part of fiduciary duty**

Long-term investment requires assessment of non-financial risks and opportunities. Of all asset owners, pension funds should be, at least in theory, the most supportive of sustainable investment policies and shared value creation due to their fiduciary duty. It is now broadly recognised that pension funds have the duty to consider sustainability factors in investment policy-making and decision-making; this at least is the conclusion of the UNEP FI.<sup>55 56</sup> Pension funds

need to guarantee stable returns in the long run, and will face the consequences of global challenges such as population growth, wealth increase in emerging economies, climate change and the shortage of clean water, raw materials, etc. A Eurosif Study in 2011 of 169 corporate pension funds in 12 different European countries found that 66% feel that having a sustainable investment policy is part of their fiduciary duty. However, only 56% currently have such a policy; and the study concludes that this percentage is probably significantly lower for the total market.<sup>57</sup>

### Measuring and reporting the right performance

We have written about the need to build trust with clients, as well as the opportunities for the financial services industry to address clients' and society's needs in the long term. There is, therefore, a strong business case for institutions to measure performance in three dimensions – economic, environmental and social. One pension fund that has systematically integrated sustainability performance in its investment portfolio is CalPERS (see box 4).<sup>58</sup>

A minority of countries in Europe have in place a specific legislation on sustainable investing for pension funds (public or private). Where legislation does exist it mirrors the UK “Socially Responsible Investment Pensions Disclosure Regulation” requirement on reporting rather than setting concrete and quantitative objectives for sustainable finance. France, Germany, Austria, Belgium and Italy have followed this example, while Sweden and Norway have requirements on the largest public pension funds to account for environmental and ethical aspects in their investment policies.

### Our vision...

On a practical level, institutions, especially pension funds, manage enormous sums of money (compared to gross domestic product or value of infrastructure – and estimated currently at 794 billion Swiss francs<sup>59</sup>). This gives them significant influence over spending and investment. Long-term investors play a stabilising role in financial markets and an important role in funding long-term corporate growth and infrastructure development. We believe that in a sustainable system, mega-investors will use their influence to create long-term value for a broad range of stakeholders and, in so doing, make the world a better place.

### CalPERS

4

The California Public Employees' Retirement System (CalPERS) is the largest American public pension fund currently managing 231.9 billion USD. It has a long standing commitment to sustainable investment and a history of leadership and innovation in the field. Acting as fiduciaries first and foremost, the goal of the CalPERS investment program is to achieve the highest possible long-term, sustainable, risk-adjusted returns consistent with fiduciary duty. As a significant institutional investor with a long-term investment time horizon, sustainable investment means taking account of environmental, social and governance factors across all day-to-day investment business. CalPERS recognises that issues such as climate change, human rights, board quality, alignment of interests on shareholder rights and executive compensation practices create material risks and opportunities for the investment portfolio, and that they have a financial duty to manage these issues.

### 3.4 Extra-financial factors and performance

#### **Environmental, social and governance (ESG) criteria are material for investment performance.**

Most decisions involving investment, insurance and trade are driven by financial considerations, and sometimes by those alone. The integration of sustainability or what is now commonly termed ESG criteria into financial decision making is nothing new, however, its relevance has increased dramatically with the understanding of the financial relevance of ESG aspects and with the recognition of a positive effect on performance. This has been followed by respective client demand. This challenge, which is relevant for all financial services actors,

#### **UN Principles for Responsible Investment (PRI)**

**5**

The United Nations-backed Principles for Responsible Investment Initiative (PRI) is a network of international investors, who work to put into practice the six Principles of Responsible Investment.

The Principles, devised by the investment community, presume that environmental, social and corporate governance (ESG) issues can affect the performance of investment portfolios, therefore must be given appropriate consideration by investors or their fiduciaries. The Principles set a voluntary framework for investors to incorporate ESG issues into decisions and practices, so to align better their objectives with those of society at large.

most notably asset managers, addresses the need to turn a niche into a mainstream, everyday practice. Switzerland has the advantage of recognised players in the market with the capacity to integrate ESG factors in a broad area of financial services.

#### **And the winner is... performance**

There exists now a growing body of academic research demonstrating the positive value and impact of ESG factors on an investment portfolio performance. A recent Mercer study summarizes and comments on sixteen academic studies, ten of which show a positive relationship between ESG factors and companies' financial performance, four of which show a neutral relationship and two which show a neutral to negative relationship.<sup>60</sup> Deutsche Bank corroborates this trend in their research of more than 100 academic studies of sustainable investing around the world.<sup>61</sup> The publication emphasises four clear outcomes: (i) that 100 % of the academic studies agree that companies with high ratings for ESG factors have a lower cost of capital in terms of debt (loans and bonds) and equity; (ii) 89 % of the studies show that companies with high ratings for ESG factors exhibit market-based outperformance; (iii) in the hierarchy of factors that count with investors and the markets in general, Governance factors are perceived as more important than Environment or Social factors; and (iv) 88 % of studies of actual SRI fund returns show neutral or mixed results.

#### **Demand is growing massively...**

The interest in the application of ESG information in investment is impressively displayed by the exponential development of United Nations-backed Principles for Responsible

Investment Initiative (PRI) as well as the analogue initiative in the insurance industry (PSI) (see boxes 5 and 6). Rooted mostly in the asset management industry, PRI signatories explicitly state that “we believe that environmental, social, and corporate governance (ESG) issues can affect the performance of investment portfolios“, and commit to “incorporate ESG issues into investment analysis and decision-making processes”.<sup>62</sup> Founded in 2005 by 20 institutional investors, the initiative has been joined by more than 1,100 signatories with more than USD 30 trillion assets under management (excluding double counting). Swiss institutions are represented via 7 asset owners, 32 investment managers and 12 professional service partners.

Importantly, the application of the UN principles feeds through, from those asking for, to those offering investment solutions – research illustrates that “in 2008 just over one-quarter of equity Requests for Proposals (RFPs) asked specifically about ESG. In the first half of 2010, the proportion had risen to one-half.”<sup>63</sup>

Research also details the rise of the integration of ESG in practice. The recently published “European SRI Study 2012” from Eurosif illustrates that all seven responsible investment strategies that they survey in their study (including integration of ESG in financial analysis) have outgrown the market.<sup>64</sup> A separate Eurosif report focused on high net worth individuals illustrates the strength of belief in the value of integrating ESG in investment decisions. The proportion of respondents allocating more than half of their assets in responsible investment has doubled in the last two years from 12 % to 25 %.<sup>65</sup>

### **Asset management: still a niche approach**

Some of the most elaborate – and award-winning – processes to integrate ESG data are

developed by a significant number of Swiss asset managers such as the Ethos Foundation, LGT, Lombard Odier, Pictet, SAM, Sarasin, Swisscanto, Vontobel or Zuercher Kantonalbank as well as the large players UBS and Credit Suisse. Similarly, other actors in the financial industry increasingly develop hands-on and value-adding tools for the integration of ESG data into their processes.

### **Principles for Sustainable Insurance (PSI)**

**6**

At the Rio+20 conference, the UN Environmental Program Finance Initiative launched PSI.

1. We will embed in our decision-making environmental, social and governance issues relevant to our insurance business.
2. We will work together with our clients and business partners to raise awareness of environmental, social and governance issues, manage risk and develop solutions.
3. We will work together with governments, regulators and other key stakeholders to promote widespread action across society on environmental, social and governance issues.
4. We will demonstrate accountability and transparency in regularly disclosing publicly our progress in implementing the Principles.

However, while the Swiss financial industry can claim leadership credentials in some areas of ESG integration, it is clear that much remains to be done especially with regard to integration into the mainstream. It is important that Switzerland must acknowledge and work alongside actions either on a European or international level, while seeking an authentic positioning in line with the Sustainable Financial Centre Switzerland.

### **Lending and project finance: focusing too much on the risk side only**

On the lending and project finance side, important players such as Credit Suisse have established dedicated teams whose sole purpose is the expert support on ESG aspects of potentially exposed financing projects.

A recent WWF study analysing the banking sector<sup>66</sup> exposes challenges the sector is facing with regard to integrating ESG – notable conclusions of the study are that there is no systematic identification, assessment, mitigation and monitoring of environmental or social risks at inception and throughout the lifetime of loans; further that ESG factors are not yet considered by banks as relevant to the credit risk contained in their portfolios; and that the integration of environmental and social considerations in mainstream product offerings appears very limited, where it does exist it focuses principally on the downside risk in the area of transactions.

### **Insurance: climate change already at the heart of the business**

The insurance industry is another heavy-weight in the Swiss finance industry. Interviewees acknowledged that players such as Swiss

Re and Zurich Insurance Group can be said to lead the global pack in ESG- and climate change related research and its application to financial decision making and product developing processes. While Swiss Re employs specialised researchers and risk management models, Zurich, for example, employs an Emerging Risks Group developing strategies for aspects ranging from climate change to pandemics through to drowsiness during driving.

### **Commodity trading: under public scrutiny**

Commodity trading is also an important field when it comes to integration of ESG aspects, with Switzerland having an important market share in this business. Research points out that increasing commodity trade finance is recognised as an attractive growth option for Swiss banks, this both in terms of benefitting from the substantial growth seen in commodity trading in Switzerland, and in gaining market share from the foreign banks that currently dominate this business.<sup>67</sup>

The implementation of sound sustainability criteria in commodity trade finance, for example, can drive significant improvements in areas ranging from mineral extraction, anti-corruption, non-speculation on agricultural commodities, over-aggressive tax avoidance and human rights violations. With recent heat on the topic in the public debate due to spikes in commodity prices at large, and specifically in food prices, the sector is under public scrutiny. Key interest groups such as the Forum Nachhaltige Geldanlagen Switzerland (FNG CH) are fostering debate via specific events, leading consultants such as onValues are publishing respective studies,<sup>68</sup> or Swiss players such as LGT are looking at innovative options for sustainable commodities trading.



### Anticipate legislation changes

Detailed and accepted criteria and structures beyond the UN PRI and PSI are still work in progress. Our interviews suggested that future progress will likely not be one-size-fits-all, but rather defined further by segment (credit, equity investment, insurance and so on). For example, the European Commission (EC) recently announced that it plans to make it obligatory for retail fund managers at the core of a market worth up to € 10 trillion to provide information about their products' ESG approach. The EC proposal is on the Key Information Document (KID) for investment products.<sup>69</sup>

### Consolidation of ESG data-providers

Importantly, the structures to integrate ESG criteria have developed alongside the client demand: For example, the launch of dedicated ESG information platforms by both key data-providers, Bloomberg and ThomsonReuters. Furthermore, the market has seen a considerable rise and subsequent consolidation of various dedicated ESG research providers, such as Sustainalytics, MSCI, Eiris, Vigeo, and oekom research, as well as Inrate – one of the very first ESG research houses, and founded in Switzerland as early as 1990.

#### Our vision...

The successful integration of ESG factors in a broad area of financial services remains the vision, but rests also on the ability to bring a cultural change to the Swiss financial sector.

## 3.5 Investors and green and social issues

### Providing financial solutions to environmental and social issues will be driven by innovation.

Cleantech, energy efficiency, low carbon, renewable and all environmentally beneficial projects need access to capital, so do communities, social and philanthropic enterprises. And capital needs access to such projects: intermediation is the core role of the financial industry. This challenge, which is particularly relevant for the real economy on the one hand and for family offices, foundations and private banking clients on the other hand, addresses the topic of linking the needs on both sides of the value chain through innovative solutions. This requires bringing players together, creating awareness and analysing what Switzerland has and what it needs to achieve its objectives.

### A theme driven by innovation

Switzerland has a strong track record in pioneering sustainable finance (both green and social finance) solutions creating tangible impacts well beyond the boundaries of the Swiss economy. Through our dialogue and research the following concrete examples have come to light:

- Sarasin began looking at environmental factors as part of its financial analysis as early as 1989. In 1994 the bank launched the world's first investment fund to be based on an eco-efficiency concept, and in 1997 social factors were included for the first time when rating companies' performance.<sup>70</sup>

- Ethos Swiss Foundation for Sustainable Development founded in 1997 by two Geneva pension funds and Bank Lombard Odier. Since 1997, more than 130 Swiss Pension funds have joined the Foundation<sup>71</sup>
- Dow Jones Sustainability Indexes (DJSI) launched in 1999 as the first global sustainability benchmark<sup>72</sup>
- Pictet launched in 2000 the world's first thematic water fund. It remains today the largest in size (USD 9 billion) and has been managed by the same team since its inception<sup>73</sup>

Swiss asset managers play a leading role both in terms of innovation and volume raised from the private sector in development finance related areas such as microfinance, SME finance and impact investment. Following products have been launched by Swiss asset managers:

- the world's first microfinance fund
- the world's first publicly distributable microfinance fund
- the world's first microfinance collateralized debt obligation (CDO)
- the world's first certificate to finance press freedom in developing countries
- the world's first publicly distributable fair trade fund
- various microfinance private equity funds
- various pioneering impact investment private equity funds
- various private equity fund-of-funds for investments in SMEs in developing countries.

## Leading rather than following

Our interviews led us to conclude that the main challenge for the sector on the path to the Sustainable Financial Centre Switzerland is to continue to play a lead role in addressing the environmental and social megatrends, which means comprehensively discerning both the financial and insurance needs of a low carbon and resource efficient economy both in Switzerland and internationally and secondly developing innovative investment and insurance solutions fostering development finance for change in both developed and developing economies.

On the other hand, it appears that significant hurdles need to be overcome before Switzerland can aspire to becoming a recognised international hub for green and social finance. Our interviews highlighted weaknesses throughout the value chain many of which are consistent with those illustrated for some of the other challenges of this Paper notably that: there needs to be an improved level of political will and action<sup>74</sup> as an example the structure of current subsidies in the energy field is deemed by many we spoke with as unsustainable; market intelligence into what constitutes real opportunities for the financial services sector could be improved; the same with the possibilities for banks to distribute development finance products and market incentives to generate effective solutions to provide economic added value for clients.

### Our vision...

We believe that success in green and social finance will be dependent on the collaboration of multiple stakeholders in seeking practical solutions to real sustainability issues.



# 4 Five pillars for sustainability success – Our proposals

**Switzerland is well-placed to take world leadership in sustainable finance and to claim its benefits. The first step is for all interested actors to address the pillars of sustainable finance. But competitors will not sleep, so it comes down to a simple choice: act now or follow later.**

This chapter outlines how the challenges identified and discussed in the previous chapter may be transformed into five pillars for sustainability success. We detail concrete examples of translating the vision into actions, commitments, initiatives and fundamental requirements. Our proposals are not exhaustive; they have been elaborated in interviews that were a key input to this White Paper.

The first two pillars of principle were identified as most critical and fundamental. These, when lived out by professionals and institutions, are the bedrock of sustainable finance and enable the three pillars of operation to be achieved.

## **Pillars of principle:**

1. Build trust through client centricity
2. Foster competition, innovation and growth within an appropriate legal framework

## **Pillars of operation:**

3. Adopt a long-term investment perspective
4. Integrate environmental, social and governance factors into mainstream business
5. Lead in green and social finance

## **4.1 Build trust through client centricity**

‘Your interest is our interest’ – this is a sustainable finance institution’s omnipresent message. To bring this pillar solidly into effect requires successfully addressing the alignment of the financial sector with its clients, we propose that this includes appropriate incentives and broader capacity building of finance professionals, transparency in the value and impact of products and services both to clients and society as a whole and strong leadership to embed values of integrity and sustainability throughout the financial sector.

**Top management takes the lead** – client centricity has to be built into business models,

and senior managers must practice accordingly. This will send the clearest message to their employees. There is hardly a CEO who does not claim clients are central. However, in practice, many other factors compete for attention.

### We propose...

that the main actors in the Swiss market ensure clear leadership statements, strong ethical behaviour from the top, accompanied by appropriate controlling and incentive systems, processes, monitoring systems and capacity building based on real case examples that effectively embed integrity into an organisation. A favourable corporate culture can clearly represent a competitive advantage.

**Products are understandable and fees transparent** – customers must understand what they buy (for example what the economic, environment and social value added is) and be told what they are paying for. Studies support the notion that utilising the power of transparency has the potential to reap significant rewards, but that it is also a major balancing act between being open and protecting commercially sensitive information. 87 % of CEOs in a study run by the Chartered Global Management Accountant (CGMA) viewed transparency as an opportunity and 13 % viewed it as a threat.<sup>75</sup> The FINMA report on the distribution of financial products<sup>76</sup> as well as the discussion around the proposed

regulation in the area of customer benefits of financial services<sup>77</sup> addresses the topic of transparency.

### We propose...

that the sector formally addresses the issue of reducing complexity and enhancing transparency of products. This is a requirement not only for private but also institutional clients. Fee structures need to be simple enough to be understandable. Such explanations must be honest and accurate, and also comprehensible. Therefore, sufficient, intelligible information is key.

**Know your investments – values and labelling** – just as financial institutions should know their customers, so should they also enable customers to see the ESG impacts of their services and products as a characteristic of the financial risk and reward tradeoff. A large number of industry sectors have seen the introduction of sustainability-related labels and quality assurance systems in recent years. Some recent niche examples in the financial sector include the transparency label for funds of European Sustainability Investment Forum (Eurosif), the Novethic SRI label and Responsible Investment Association Australasia (RIAA) certification program. Zürcher Kantonalbank has developed a sustainability indication scale for its funds which it discloses alongside the risk rating scale to its

clients in order to support their decision making.<sup>78</sup> Eurosif also advocates the need for retail investment disclosure on ESG issues in the investment process, as a natural complement to extra-financial disclosure by companies.<sup>79</sup>

### We propose...

that financial institutions could and should offer more transparency on the impact of their products, be it through impact measures or 'labels' that make contents and impacts comparable, alternatively an appropriate quality assurance system could be developed.

**Customer-aligned incentives in compensation** – commissions and bonuses need to encourage outcomes that are best for clients, in the long-term also best for a wider group of stakeholders and ultimately for sustainability of the industry. Research demonstrates that trusted financial service advisors are far more likely to have client satisfaction metrics as a key part of their remuneration and compensation structure.<sup>80</sup>

### We propose...

that financial institutions should have regular client satisfaction surveys embedded in their appraisal systems, to monitor the principles that we know clients value – reliability, assurance, responsiveness, empathy, tangibles.<sup>81</sup> Ultimately the right incentives, underpinned by timely and fact-based feedback, strongly encourage values-driven, responsible behaviour within an organisation.

**Competence** – employees need the skills to understand the full needs and expectations of their clients. The future might see advisor

certifications, covering the topic of assessing sustainability-related risks and opportunities, that follow professional curricula proposed by the industry and approved by FINMA. Employees will also have to deal with more extensive partnership arrangements with different stakeholders and will have to respond quickly and gain trust in unfamiliar market conditions, distribution channels and cultural preferences.<sup>82</sup>

### We propose...

that knowledge of how to assess sustainability-related risks and opportunities should be built into professional curricula – to grow the trained workforce organically. Although training incurs cost, having more competent staff on a broader range of impacts of products and services (including environmental and social impacts) can reduce operating costs, increase revenues<sup>83</sup> as well as allow businesses to become more sustainable.

## 4.2 Foster competition, innovation and growth within an appropriate legal framework

Competition should be fierce, but fair, allowing support for new market entrants while also fuelling innovation and growth. Our proposals include enhancing transparency and disclosure and critically building bridges across actors in the sector to shape together an effective risk and regulatory framework geared to supporting the development of the

**Sustainable Financial Centre Switzerland. We feel that through the design of an effective risk and regulatory environment, many of the specified goals of the other pillars in the White Paper may be strongly catalysed.**

Political and regulatory stability is one of Switzerland's competitive advantages. Going forward, we feel that the regulator has the responsibility to set the right guidelines accounting for both risk and reward such that all five pillars of this Paper can be effectively taken on board for the good and prosperity of a broad number of stakeholders above the self-interests of either individuals or single organisations and without weakening the international competitiveness of the country. Therefore, Switzerland must take into account the evolution of the regulation of its main partners, notably the EU, in order to safeguard a fair and appropriate access to their markets (both in the financial services sector and non-financial sector).

**Balanced regulation** – this means that regulation does not only consist of laws. A good regulatory framework is required to set clear principles and rules, to offer credible, effective mechanisms to enforce the rules, to provide guiding principles, while at the same time enabling the market to capitalise on its value creation ability and innovation potential. Furthermore, we strongly feel that self-regulation can be an effective element of a framework for long-term success too. In order to be credible, self-regulation should be developed in close dialogue with regulators and supervisory bodies, and should monitor that all actors comply with their individual commitments. A balanced regulation also implies alignment with and small deviation from international standards so as not to put Swiss market players at a competitive disadvantage risk.

**Foster dialogue** – as we illustrated, London is perceived by many as currently having the most dynamic multi-stakeholder public policy debate on sustainable finance – this includes formal public policy reviews, set-up of specific task forces and the issuance of guidance documents in support of sustainable finance. Luxembourg also provides a tangible example of how a regulatory framework, together with constructive dialogue and leadership can be shaped to support a favourable environment for sustainability-related funds (see box 7).

**We propose...**

**an on-going, facts-based dialogue on opportunities and risks of sustainable finance,**

**Regulatory environment supporting funds in Luxembourg**

**7**

A modern, innovative legal and fiscal environment is key to defending and improving the position of Luxembourg as a centre for the domiciliation, administration and distribution of investment funds. Close contacts with the regulatory authority, the government and the legislative body allow ALFI (Association of the Luxembourg fund industry) to shape regulation, to adopt European Directives or to create specific regulations for new products or services. This involves dedicated platforms which support funds throughout their entire life cycle: regulatory approval, listing on the Luxembourg Stock Exchange, order routing, registration, clearing and settlement. Moreover, the technology and expertise supporting the Luxembourg fund industry constantly evolves to accommodate new products and the ever widening global distribution of Luxembourg funds.

between financiers, regulators, politicians, industry groups, NGOs and other relevant stakeholders to underpin development of a Sustainable Finance Centre Switzerland. It can contribute to a continuous adaptation of regulation and practices to an evolving product landscape. Dialogue must be collegial and discursive. Innovators need to talk directly to regulators regularly in a facts-based, yet lively debate. The dialogue sessions organised on the back of this White Paper represent the opportunity to debate the appropriate format for future dialogue around regulation, both hard and sector driven self-regulation.

#### Dutch tax exemption for green investments

8

In 1995, the Netherlands introduced the Green Funds Scheme, a tax incentive for individual investors to put money into green projects that benefit the environment. Investing in green funds or saving money at 'green banks' earns lower-than-market interest rates. This is compensated by a tax incentive. In return, the banks charge green projects a lower interest rate.

In 2010 the Netherlands' Ministry of the Environment concluded: "The Green Funds Scheme is an undoubted success. Thousands of projects – from environmentally friendly greenhouses and wind turbines to organic farming and afforestation – have been implemented with funds provided by a few hundred thousand individual investors. All the involved stakeholders – individuals, banks, entrepreneurs and government – have started to realise that green investment is profitable for people and for the environment."

**Foster innovation** – our interviewees were unanimous in the need for a Sustainable Financial Centre Switzerland to be synonymous with innovation. We share the view with others that it is imperative that the innovation capacity of Swiss asset management is facilitated in order that the industry can continuously develop new products and product ideas to serve both Swiss and international private and institutional investors.<sup>84</sup> We understand innovation to represent any change (large or small) that creates a better business. Innovation is about execution, both leveraging and scaling existing initiatives and implementing genuinely new ideas. Pillar one of our paper looked at client centricity, and it can be argued that the most powerful innovation in the financial sector will come from first identifying customer needs and then delivering against them.<sup>85</sup>

#### We propose...

**a suitable player in the financial services sector, such as one of the academic finance institutes potentially in conjunction with other relevant stakeholders, to deepen its focus on the topic of innovation and develop good practice guidelines in innovation management practices and processes and how to embed these pervasively across an organisation. In general, closer relationships between the financial sector and academia will support the Sustainable Financial Centre Switzerland.**

**Environment for growth** – there are mechanisms for making sustainable products more attractive in the short-term. The Netherlands introduced an interesting scheme (see box 8). Setting the right environment for sustainable value creation also means disincentivising regulations, be they subsidies, reduced taxes or simple hurdles for new market entrants for example, that work against the attractiveness of



sustainable products and services. Some perceive that Switzerland does not actively use the tax incentives for R&D instrument either in the financial or non-financial sectors.<sup>86</sup> We believe that there is a need to fuel the political debate on making sustainable products and services more attractive and to analyse the potential advantages of doing so.

### We propose...

for instance, that tax exemptions can be offered for investment products focused on energy efficiency and renewable energy projects that contribute to the Swiss Energy Strategy 2050 (or other environmental and social projects). The creation of matching fund schemes could also stimulate venture capital investments and links to spin-offs from Swiss Universities could also strengthen technology transfer from world-class research.

**Enhance transparency and disclosure** – transparency requirements for clients are driven both by the regulators (for example MiFID, and the FINMA report on the distribution of financial products) that we have mentioned in pillar 1 and by shareholders and customers.

### We propose...

that a clear expectation on transparency and disclosure should be developed by the industry for Swiss financial services organisations taking into account recommendations from recognised international institutions and think tanks exploring best practices in corporate governance (including the topic of executive compensation), risk management, compliance, climate change and resource efficiency, as well as supply and value chain

management. To ensure authority, expectation can weigh on international initiatives promoting disclosure such as the PRI/PSI, the Global Reporting Initiative (GRI) and the International Integrated Reporting Council (IIRC).

## 4.3 Adopt a long-term investment perspective

**The disproportionate focus on short-term performance by both investors and corporate executives leads to sub-optimal value creation at the level of the whole economy and is a major impediment for a better integration of environmental, social and governance issues in finance.**

An investigation by Antia, Pantzalis and Park<sup>87</sup>, for example, reveals that shorter CEO decision horizons are in fact “associated with more agency costs, lower firm valuation, and higher levels of information risk.” Research by Graham, Harvey and Rajagopal<sup>88</sup> shows that “firms are willing to sacrifice economic value in order to meet a short-run earnings target... 78% of the surveyed executives would give up economic value in exchange for smooth earnings”. This excessive short-term orientation is driven by two main mechanisms: the focus on meeting or beating quarterly/annual earning estimates by corporations, and the focus on quarterly/annual fund performance by fund managers. A UK Government mandated review of these mechanisms by Prof. John Kay<sup>89</sup>, led to the following recommendations:

- Companies should seek to disengage from the process of managing short-term earnings expectations and announcements.

- Mandatory quarterly reporting obligations should be removed.
- Companies should structure directors' remuneration to relate incentives to sustainable long-term business performance.
- Asset management firms should similarly structure managers' remuneration so as to align the interests of asset managers with the interests and timescales of their clients.

This does not imply that all investors should be long-term oriented. Short-term investing can play an important role in a well functioning market. But if long-term oriented investors, such as pension funds, are caught in excessive short-term thinking and do not make use of the advantages of long-term investing, this is a big missed opportunity for pensioners and society as a whole.

### We propose...

that investors advocate longer reporting cycles to challenge the traditional quarterly reporting and short-term management cycles. This is clearly an important area for the Swiss financial services industry to look at (see box 9). Further, asset management industry should

**better align the remuneration of investment professionals to long-term financial value creation, e.g. by using multiyear milestones for performance evaluation.**

#### Action underpinned by robust research –

we believe that research on the topics of the pension fund industry and long-term investing should be sourced from both finance institutions as well as other institutions. Often scientific based institutions have a better track record in undertaking fundamental research aimed at providing solutions to identified needs. Take for example the EPFL in Lausanne and the ETH in Zürich where an applied research and start-up culture has positively supported the development of long-term economic activities and solutions. Another example is the Centre for Corporate Responsibility and Sustainability (CCRS), an institute associated to University of Zurich and specialised in research on best practice in integrating ESG aspects into corporate management and investment strategy, i.e. in real estate.

### We propose...

that the pension fund industry research the most suitable way forward around ownership, for example, assessment of the needs of

#### CEPS-ECMI Task Force supporting long-term investing and retirement savings

9

The Centre for European Policy Studies and the European Capital Markets Institute are creating a Task Force to engage market participants, together with international experts, academics and regulators, in a discussion on long-term investing and long-term saving products, including private retirement savings. The purpose of this Task Force is to

bring together a diverse group of stakeholders and deliver a list of policy recommendations to strengthen both (a) the single market for long-term savings, including private retirement savings, and (b) long-term investing in Europe, given its role in promoting growth and ensuring the provision of adequate retirement income.

**the ultimate beneficiaries, their priorities and requirements to have more decision-making power over their long-term investments. Further, an assessment of the impact of aspects – such as resource scarcity or climate change on the return of different asset classes – would also allow an informed debate on potential future asset allocations (example see box 10).**

**Active ownership** – we mentioned that the UK has introduced such a stewardship code for investors recently, initiated by the Financial Reporting Council (FRC).<sup>90</sup> The Code sets out good practice on engagement with investee companies to which the FRC believes institutional investors should aspire and operates on a ‘comply or explain’ basis. Active ownership also signifies leading by example. A few selected prominent pension funds would potentially generate change should they adopt sustainability-oriented asset allocation strategies and encourage others to do the same. In January 2013, a group of institutional investors, of consultants on voting rights and representatives from the economy presented a document setting out guidelines for institutional investors with regard to exercising voting rights in public companies. The editors of the document thus set out a clear signal in favour of a self-regulation approach.<sup>91</sup>

### **We propose...**

**all Swiss pension funds sign up to the stewardship guidelines mentioned above, commit to be active owners and take ESG aspects into account when voting.**

**Capacity building for institutional asset managers** – competent and experienced pension fund advisors and professionals are an important vehicle for meeting the long-term

needs of individuals. The level of professionalism and experience within the pension fund industry needs to improve if Swiss funds are to meet continuous challenging targets of return.

### **We propose...**

**that this capacity be built, by integrating modules on responsible investment approaches, active ownership and fiduciary duty into professional education curriculum for pension fund manager and trustees. Furthermore professionals as well as board-level individuals require effective instruments at their disposal together with an aligned performance incentive scheme to bring their experience to bear in the market.**

#### **Institutional Investors Group on Climate Change (IIGCC)**

**10**

The IIGCC is a forum for collaboration on climate change for European investors.

There are currently over 75 members, including some of the largest pension funds and asset managers in Europe, representing around € 7.5 trillion.

The aim of the forum is to ensure that climate change risks and opportunities are addressed and reflected in investment practices and decisions.

The IIGCC brings investors together to use their significant collective influence to engage in dialogues with policymakers, investors and companies to accelerate the shift to a low carbon economy.

**Update fiduciary duty** – the Asset Management Working Group of UNEP FI has examined in some detail the topic of fiduciary responsibility over the last few years. We share a number of the conclusions of their work, namely that fiduciaries have a duty to consider the adoption of responsible investment strategies and that they must recognise that integrating material ESG issues into investment and ownership processes is part of responsible investment, and is necessary to managing risk and evaluating opportunities for long-term investment.

### **We propose...**

to open the research and debate on fiduciary duty within pension funds and asset managers regarding long-term sustainability issues. The debate has already started in France where the Fonds de Réserve pour les Retraites (FRR) has to account for integration of ESG factors to a special control body.

## **4.4 Integrate environmental, social and governance factors into mainstream business**

**ESG criteria need to move from their current ‘nice-to-have’ niche into the mainstream where they are applied regularly and consistently to the broadest range of decisions. There is a strong business case for doing so, empirical evidence demonstrates positive contribution to portfolio performance, and clients, investors and society at large are demanding it.**

**We propose that the Swiss financial sector actively supports and concretely builds on authoritative international initiatives that address and request the integration of ESG criteria, and the evaluation, accounting and reporting of ESG risks and opportunities.**

**Broad adoption of international criteria** – we believe that a broad adoption by different stakeholders of the Swiss financial centre of the Principles for Responsible Investments (PRI) and the Principles for Sustainable Insurance (PSI), for example, would fit well with Swiss values.

### **We propose...**

that exploring the value of applying a Swiss-finish to the PRI and PSI would be a worthwhile discussion and be coherent with the development of the Sustainable Finance Centre Switzerland – building on the aspirations and authority of the international frameworks and implementing minimum standards for the whole sector. Good business practice should not be a niche, but standard practice for the majority. Furthermore these criteria should check the ESG impact of any kind of project financed, including grey emissions and impacts from projects financed by Swiss institutions but conducted elsewhere.

**Encouragement for further research** – consistent with other pillars of this Paper we advocate closer ties between the financial services sector, academia and leading professional services organisations with the capacity and interest to analyse and publish trends and results.

## We propose...

that research must continue both in terms of the link between ESG analysis and performance such as that illustrated in the Mercer (see box 11) and Deutsche Bank<sup>92</sup> reports and ESG key performance indicators that are material to organisations (illustrated in the EFFAS study mentioned later in this section). Furthermore, research should cover the area of how to integrate ESG into mainstream banking operations and into the investment process, research which could then form the basis of training and capacity building in the sector.

**Stewardship for financial services** – we believe that financing and insuring all business activities, including those sectors with complex value chains and negative social and environmental implications, must adopt a culture of long-term value creation and broad impact thinking. It makes business sense; it's about effective risk management, creating trust with clients and other stakeholders and ultimately maintaining a freedom to operate.

## We propose...

that sector guidelines should be as broad as possible (geography, activities) and developed and promoted to spell out conditions for financing by Swiss institutions. These guidelines could be qualified by independent stakeholders such as sector initiatives (UNEP, UN PRI) or relevant NGOs.

**Systematic evaluation of environmental and social risks in commodities transactions** – we believe that by systematically evaluating ESG aspects in transactions, investors in

commodities can both reduce their risks and profit from opportunities. At the same time, responsible commodity investments contribute to the protection of natural habitats and therewith to future production capacity. WWF recently published a report on specific criteria for 10 major commodity sectors including the definition of key performance criteria for identifying responsible companies and projects.<sup>93</sup>

## We propose...

that the Swiss commodity sector develops, in cooperation with their main stakeholders, guidelines in the spirit of the PRI or PSI.

**Accounting for risk and externalities** – we believe that the Swiss financial centre needs to improve the accounting of ESG risks – including lending, servicing and securitization practices,

### Mercer Report on climate change 11

In February 2011, Mercer published results of a year-long project with 14 asset partners entitled “Climate Change Scenarios – Implications for Strategic Asset Allocation.” From a framework of scenarios, Mercer analysed global shifts in asset allocation caused by climate change. A main recommendation: diversify by sources of risks, rather than by traditional asset classes. A survey done a year later revealed that half of Mercer’s partners decided to include climate change considerations in future risk management and asset allocation. A third of them planned to allocate more capital to climate sensitive assets, and the vast majority of them increased engagement with investees and policy makers on climate change.

this would notably help investors make clearer judgments about the real value of financial institutions and set a good standard for risk management in the sector. The issue of responsible lending for example was fundamental in the recent global financial sector crisis.

### We propose...

that the financial sector should seek good practice examples both within the financial sector and in non-financial business sectors. Sustainability in risk taking requires factoring in known externalities (namely environmental or social costs not reflected in the price – and where these can be calculated) – including those expected in the future. Forward looking risk management therefore needs to be a key pillar of any sustainability strategy in the sector.

**Transparency through reporting on ESG-related risks and opportunities** – broad integration of sustainability risks and opportunities will occur only when investors have access to adequate, comparable information which has been verified. Driven in part by investors, many stock markets have raised the bar and set out clear disclosure requirements for listed companies (see box 12), this is designed to fuel access

for investors, analysts and wider stakeholders to relevant and material information affecting a company's long-term performance.

### We propose...

that the Swiss Stock Exchange addresses this topic. Further, the European Federation of Financial Analysts Societies (EFFAS) has issued a guideline for the integration of ESG into financial analysis and corporate valuation.<sup>94</sup> We strongly believe that the financial services industry has a vested interest in actively supporting such initiatives.

## 4.5 Lead in green and social finance

**With its cluster of over 200 organisations active in the sustainable finance space<sup>95</sup>, Switzerland is considered a leading global market in the field and also a pioneer due to its contributions to the development of sustainable finance already in the early 1990ies. The cluster is dynamic and diverse, including companies active**

### Towards standardised mandatory ESG reporting

12

You find it in Germany, France and Denmark. Brazil and South Africa have it too, and not long ago, the stock markets of Istanbul, Egypt as well as NASDAQ committed to promoting it: mandatory reporting on environmental, social and governance (ESG) factors for listed companies. Still the vast majority of listed

companies do not publish any information on sustainability though, according to a Bloomberg survey. So, at the RIO+20 conference, a group of institutional investors launched the "Corporate Sustainability Reporting Coalition", calling on Governments to make ESG reporting mandatory for all listed companies.

**in the integration of sustainability in traditional banking and asset management, in responsible investing, development finance, microfinance, cleantech investing, green infrastructure investing, carbon finance, venture capital, real assets investing, and many more. Switzerland, therefore, has excellent cards to take a leading position globally. At the same time, it needs to ensure that regulatory frameworks are favourable to the development of sustainable finance, that a level playing field with other financial markets is in place and that meaningful public private partnerships are exploited.**

This pillar is about growing and deepening the Swiss sustainable finance cluster, strengthening its innovation potential and identifying long-term growth potential. We propose that the relevant players in Switzerland come together, analyse the status quo, review the role of private versus public finance in specific areas and develop and implement a formal strategy for green and social finance in Switzerland.

In certain areas, e.g. public infrastructure, development finance, cleantech R&D and innovation, carbon finance and others, it will be important to better clarify the role of public vs. private finance. This should then lead to a better coordination of the two, to a series of targeted public-private partnerships and to the creation of frameworks that are conducive to the private financial sector taking a bigger role in these fields. The example of microfinance investing, where development banks and government organisations have shared their know-how and sometimes helped seed new investment vehicles set up by the private sector, shows how

fruitful such public private partnerships can be. The end-game is an authentic and focused strategy for environmental and social finance, well beyond the current activities of multilateral or development organisations. It should attract private investors, promote clusters of expertise and aim to trigger the development of innovative products and services (see box 13).

### **We propose...**

**that public-private partnerships, private-equity, financial sector associations, the regulators, financial companies and other finance stakeholders work together to pursue options for overcoming investment hurdles and pioneering new approaches to investing (example see box 14).**

**Build bridges for access to capital** – the ultimate role of the financial sector is intermediation. We believe that social and environmental entrepreneurs need more opportunities to meet, formally and informally, with financiers. Simple proximity can play a key role in business development. Switzerland has that proximity, is ideally

### **Financing a low carbon economy 13**

A recent WWF study entitled “Transition to a Low Carbon Economy: The Role of Banks” addresses this point directly and points to four tangible areas where banks can make a significant contribution, namely “mobilizing new capital sources; developing new regulatory risk products; setting up distribution partnerships to develop energy efficiency markets and seizing energy efficiency opportunities for banks’ real estate portfolios”.

located, has a respected and solid network of leading organisations with dedicated experience in green and social finance to ensure it can create a long-term competitive advantage in attracting professionals, ideas, and institutions.

## We propose...

that the sector and the regulator explore what regulatory environment would be beneficial to the creation of a recognised international hub for green and social finance.

**Making climate change investment grade** – the 2011 Global Investor Statement on Climate Change detailed a call for action along with concrete recommendations for both domestic governments and international policy makers to generate step change in private sector investment in low-carbon investment opportunities.<sup>96</sup> The WWF Cleantech Countries Innovation Index 2011 places Switzerland in 15th place out of 38 countries on the basis of a measure of each country's relative potential

### Generating investor return through energy efficiency in buildings 14

Susi Partners demonstrates how an innovative Energy Efficiency Fund can tackle the problem of aging real estate infrastructure. The fund will invest in retrofitting large, power-intensive buildings such as hospitals, universities, or hotels. It gives owners the opportunity to upgrade their energy infrastructure, resulting in significantly reduced electricity costs. The upfront costs associated with energy retrofitting are financed by the fund. In return, the Fund receives a majority of the energy savings over a defined time frame.

to produce entrepreneurial start-up companies and commercialise technology innovations over the next 10 years.<sup>97</sup> The study points to Switzerland's weakness in early stage venture capital financing. An interesting related government support action is the early stage venture funding in Singapore (see box 15).

## We propose...

that Swiss policy makers formally address these technical and structural barriers that can pave the way for Switzerland to play a leading role in green finance.

**Improved market insights and data** – the OECD has pioneered efforts to develop data and statistical information on SMEs' and entrepreneurs' access to finance in response to the G20 call for more and better data, and international benchmarks on the financial situation of SMEs. We believe that robust and meaningful data can improve our understanding of business financing needs and provide a sound basis for informed policy discussions, as well as giving the suppliers of finance a more comprehensive

### Early stage venture funding (ESVF) 15

Singapore has a scheme in which venture capital firms are co-funded by the National Research Foundation (NRF) to invest in technology start-ups, to grow those businesses and bring their innovative products/services to market. ESVF guides, nurtures and mentors start-ups. Venture capital firms must raise at least S\$ 10 million from third party investors. NRF matches S\$ 1 for every S\$ 1 invested.



assessment of their clients' needs that enables them to design better products and services.<sup>98</sup>

### **We propose...**

**that detailed analysis of current availability of data in Switzerland and data needs concerning financing needs of enterprises, in particular of SMEs, should be undertaken.**

**Measuring environmental and social impact** – a key success factor for the credibility of green and social finance will reside with the quantification of impacts. There are a growing number of robust metrics available, either input-output models or life-cycle assessments for example that accurately capture environmental and to a certain extent social impacts.

### **We propose...**

**that the value of these models to support the development of the Sustainable Financial Centre Switzerland should be formally analysed and the most appropriate models effectively utilised for the benefit of the sector.**

# 5 Outlook and next steps

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The five pillars will not build themselves. There must be a concerted, coordinated effort to put them into place and strengthen them.

It is a considerable challenge for the Financial Centre Switzerland. It can only be done convincingly by a broad group of stakeholders, namely: the private sector, both financiers and their customers i.e. asset owners; the public sector, government policy-makers and regulators; and civil society, including academia. Chapter 2 of this White Paper highlights concrete areas where other financial centres have successfully brought actors together to their benefit, Switzerland must do likewise. It needs heavyweight support and leadership from all stakeholders, from all regions, from all hubs of the Swiss Financial Centre. The money spent on this must be large so that funders will genuinely expect to see not just talk, but a return on their investment.

To maximise the odds of success and the potential return, we feel a cross-section of society should be involved in the action plan: government to set incentives and rules; academics and analysts to measure impact and guide; plus innovators, entrepreneurs and engineers to translate plans into actions.

## **How can the different stakeholders be motivated to act?**

First, the benefits of action must be made clear. Stakeholders need to come to the conclusion that sustainable finance is in their own interest. Sometimes sustainability is misrepresented as a luxury, a 'nice-to-have' addition to a privileged life. The reality is that one of sustainability's main aims is a thriving, stable economy, with rewards for everybody.

Second, the costs of inaction must be made clear. Switzerland's current finance paradigm could be more sustainable, and other regions are and will be competing for leadership. Complacency is not a feasible option.

Third, relevant stakeholders must be given a plan of action. Statements of general intent are good for starters, but these need to give way to concrete task lists and assignments. Ideally, these are to be crafted by stakeholders themselves, in discussion with each other. The dialogue sessions that follow publication of this White Paper are meant to put this into motion.

In time, an action plan may no longer be necessary. Sustainability thinking and the actions of the Sustainable Financial Centre Switzerland will have aligned themselves to the five pillars of this Paper. But for perhaps the next decade or so, explicit promotion will be needed to make Switzerland the world's leading sustainable finance centre.

Before being crystallised into tangible tasks for a specific stakeholder, our proposals need to be properly sounded, debated and challenged with a diverse set of stakeholders of the Swiss Financial Centre. This is expected to start with the release of this document and at the first dialogue sessions in the coming months.

# 6 Acknowledgements

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We would like to thank the following individuals who contributed time, know-how, intellectual curiosity and opinions. The positions have been stated as at time of interview.

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Nick Beglinger, President, Swiss Cleantech  
 Steve Bernard, Chairman and Director, Geneva Financial Center  
 Gina Domanig, Managing Partner, Emerald Technology Ventures  
 Bernard Droux, President, Geneva Financial Center  
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 Bernard Vischer, Partner, Schellenberg Wittmer  
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### In-depth interviews

Nina Arquint, General Secretary, FINMA  
 Peter Brabeck, Chairman, Nestlé  
 Marc Chesney, Professor, Institute for Banking and Finance, University of Zurich  
 Hans Hess, President, Swissmem  
 Thomas Jordan, Chairman of the Governing Board of the Swiss National Bank  
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 Urs Rügsegger, CEO, SIX Group  
 Jacques-André Schneider, LHA Geneva  
 Olivier Steimer, Chairman of Board of Directors, Banque Cantonale de Vaudoise  
 Klaus Tischhauser, CEO, responsAbility  
 Arthur Vayloyan, Head of Investment Services and Products, Private Banking, Credit Suisse  
 Thomas Vellacott, CEO, WWF Switzerland  
 Pierin Vincenz, CEO, Raiffeisen  
 Susanne Hauray von Siebenthal, Head Asset Management, Publica  
 Valentin Vogt, President, Swiss Employers' Association

# 7 About TSF / SFG

**The Sustainability Forum Zürich (TSF)** is an independent, non-profit, non-partisan association, founded in 1999 by leading representatives from business, science and public authorities from Zürich and increasingly joined by financial market players. TSF seeks to contribute to sustainable business in the dynamics of globalisation by promoting forecast, reflection and action in and through financial markets and its key players. As laid down in its statutes, TSF provides its members and partners with tailor made and multi-stakeholder based dialogue and learning platforms that enable the exchange of the most cutting-edge knowledge, experiences and opinions on challenges relevant to the financial market. Companies, experts and scientists, other financial market players, asset owners and capital market regulators are invited to:

- “Get fit”: Getting the main players fit through early recognition of financial market relevant, social and geopolitical issues and trends;
- “Challenge mind-sets” of the decision makers in financial sector with respect to their social responsibility, the resulting challenges and of the financial market players with respect to their innovation and communication capacity;
- “Promote options for actions” of the financial market players. The ambition is to improve the efficiency and effectiveness of market practices and instruments and to simultaneously create societal added-value.

For more information on TSF see [www.sustainability-zurich.org](http://www.sustainability-zurich.org)

### **Sustainable Finance Geneva (SFG)**

enables the development of skills that will be essential to the Swiss financial center of tomorrow.

SFG is an association of investment professionals. Their objectives include:

- SFG Communities: raising the awareness amongst professional investors about responsible investment solutions which can reconcile economic development with social and environmental concerns;
- SFG Global: promoting the Swiss and Geneva financial centers as major actors of sustainable finance. SFG believes that Switzerland's unique position as a center for international organizations addressing global challenges, for sustainability-focused businesses and for many financial services firms, makes Switzerland the ideal place to promote this new direction of finance;

By covering not only the topics of Socially Responsible Investing (SRI) and microfinance but also impact investing, philanthropy, social entrepreneurship and Environment, Social & Governance (ESG) research, data and rating, SFG provides its members with a unique exchange platform enabling a broad overview of the industry.

SFG is the only initiative in sustainable finance that is intended for individuals working in finance, bringing together the expertise of the main practitioners in the region be it in SMEs, NGOs and IOs or within financial institutions.

SFG was initiated in October 2008 by 15 professionals at the forefront of sustainable finance who saw in the organization the opportunity to exchange views and create better understanding among people working in the different sectors of sustainable finance.

For more information on SFG see [www.sfgeneva.org](http://www.sfgeneva.org)

# 8

## Appendix

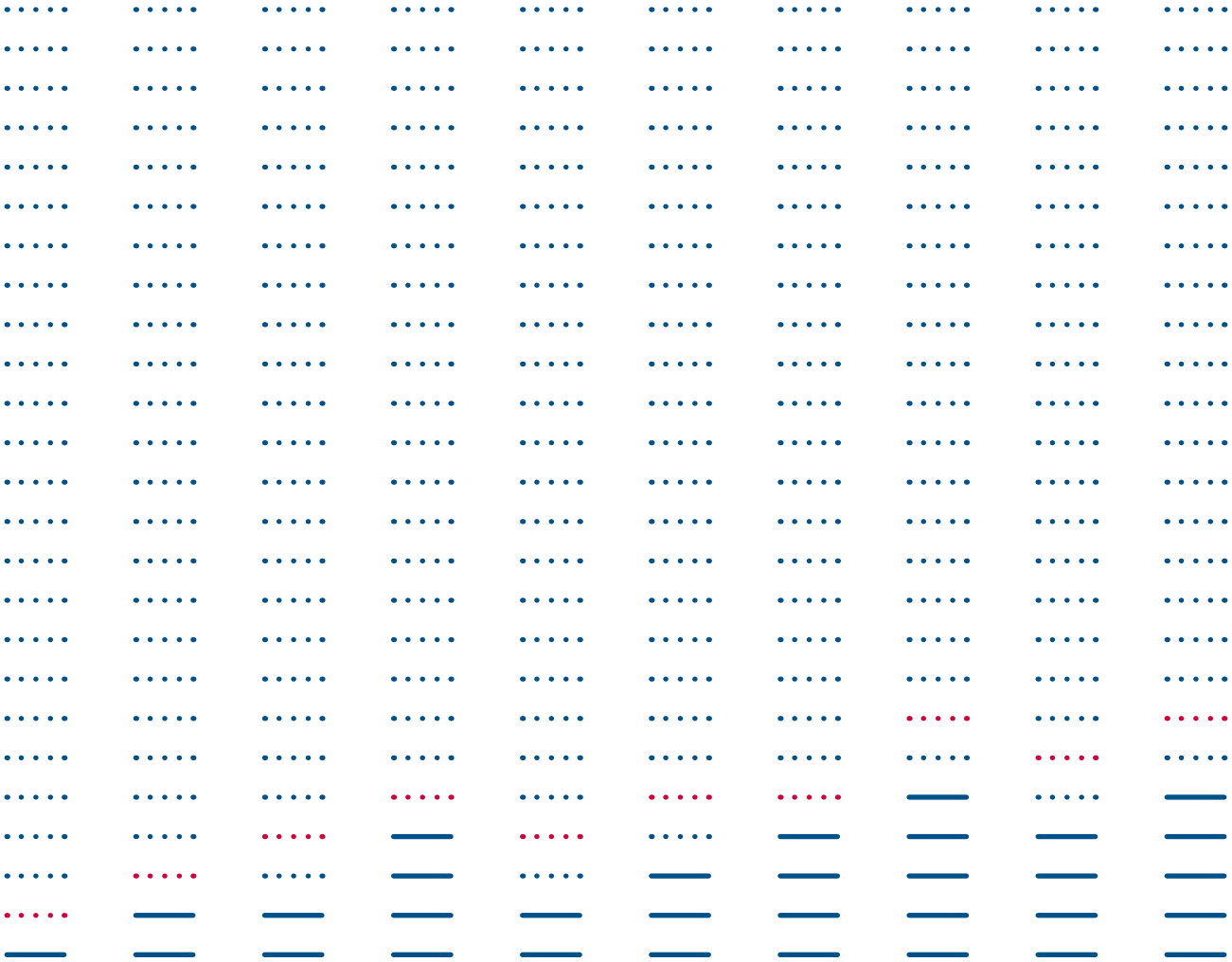
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