



# Clarity on Sustainable Finance

**Delivering impact  
without compromise**

June 2020







Regulation

Culture

Value

Digitalization

Credibility



# Clarity on Sustainable Finance

5	<b>Editorial</b>	Delivering impact without compromise
6	<b>What is sustainable finance?</b>	
10	<b>Key findings</b>	
<hr/>		
20	<b>Changing climates:</b>	
	<b>Integrating the cultural drivers of sustainable success</b>	
26	<b>The next generation of ESG due diligence:</b>	
	<b>from risk to strategic value creation</b>	
32	<b>Sustainability – at the core of effective stewardship</b>	
	Interview with Patrick Odier, Lombard Odier	
38	<b>The regulatory agenda heats up</b>	
44	<b>Sustainability versus returns – a balancing act</b>	
	Interview with Dr. Stefan Beiner and Patrick Uelfeti, PUBLICA	
52	<b>The voice of the next generation</b>	
54	<b>Capital as a force for good</b>	
	Interview with Florian Kemmerich, Bamboo Capital Partners	
58	<b>Removing barriers:</b>	
	<b>digitalization and sustainable finance</b>	
<hr/>		
62	<b>Definition of key terms</b>	
64	<b>Pinboard</b>	
65	<b>Contact &amp; Imprint</b>	



# Delivering impact without compromise

For a reminder of the terms frequently used in this field, please find a glossary adapted from Swiss Sustainable Finance on page 62.

ESG – the systematic consideration of environmental, social and governance factors in financial analysis – is often referred to as the ‘x-ray of finance’, revealing risks that go undetected by traditional financial analysis. The COVID-19 pandemic has exposed many such risks, such as shortcomings in employee health and safety, insufficient business continuity preparations or poor governance and crisis management. It is therefore not surprising that many firms who have given due consideration to ESG factors have been more resilient during the crisis.

Beyond the obvious business imperative, there are no signs that the pandemic will slow the sustainability agenda of global policy makers and regulators. The EU in particular is charging ahead with ambitious climate goals, and is recalibrating its capital markets regulatory framework, thus underscoring its expectations that capital markets should play a central role by funding the transition to a carbon-free economy. This could sound the bell for the most extensive regulatory wave since the 2008 financial crisis. Consequently, regulation is a dominant driver of change in sustainable finance, and is likely to remain so for the foreseeable future.

Although financial services face huge risks as a result of climate change and its socioeconomic impacts, there is also a significant opportunity to be seized. A growing number of firms see a chance to move far beyond regulatory compliance and enhanced risk management to apply the sustainability lens not only to business operations, but to their broader roles as key players in the economy and communities. As regulation increasingly standardizes sustainable finance approaches, firms will find that culture is an enduring differentiator in the market.

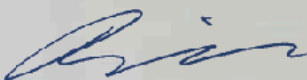
In addition to the potentially severe economic disruption (that COVID-19 is providing us a taste of), caused by the transition to a carbon-free economy, financial services firms will need to deal with increased competition, margin pressure,

open finance and digitalization. Technology can be particularly powerful at encouraging the adoption of sustainable finance programs, especially when combined with generating a compelling client experience.

Meanwhile, ESG disclosures bring certain issues into sharper focus. These include greater transparency over a firm’s treatment of employees, choice of suppliers, governance, and contributions to society as a whole. The concept of value is expanding far beyond the current definition of profit. Indeed, only firms that integrate ESG risks into their strategy may achieve lasting value. We expect one outcome of the pandemic to be that the focus of investors on firms’ ability to deal with disruptive risks will further increase. In other words, what pioneers of sustainable finance have been pointing out for years: There does not need to be a tradeoff between sustainability and long-term profitability.

Ultimately, financial services is like any other service industry: it must provide what customers want. Millennials are replacing baby boomers as the largest cohort. As they progress through their thirties, their spending power surpasses that of other age groups. Providers who cater to their ESG focus in investing and providing a digitalized client experience will be better positioned to attract increasing asset flows.

Taken together, the message is clear: Doing nothing is no longer an option. The COVID-19 crisis has shown that governments, economies and societies can stand together in the face of a global crisis and take decisive action. When one considers that the impact of adverse climate could be many times worse, it is not difficult to imagine that once the smoke of the pandemic has settled, the focus will be back onto the sustainability agenda with even greater urgency. Firms who put the topic on the backburner now may find themselves on the back foot very quickly.



**Philipp Rickert**  
Partner, Head of Financial Services



**Pascal Sprenger**  
Partner, Financial Services

## Timeline of selected milestones

1987

'Our Common Future' by the World Commission on Environmental and Development is a call for fundamental changes in our patterns of development to prevent humanity and the planet from imminent disaster.

2000

The Millennium Development Goals (MDGs) by the UN set out eight goals, including to combat poverty, hunger, diseases, illiteracy, environmental degradation, and discrimination against women.

# What is sustainable finance

**Financial services providers are under growing pressure to improve how they incorporate sustainability considerations into their operations. This pressure is being applied by a range of stakeholders, particularly asset owners and policy makers.**

**By Yannick Zwinselman, Senior Consultant, Financial Services**





## 2015

The Sustainable Development Goals (SDGs) by the UN widen the scope of the MDGs by creating 17 goals to end poverty, improve health and education, and reduce inequality, among others – while tackling increasing climate change, including the preservation of oceans and forests.

## 2016

The Paris Agreement was ratified by the UN to strengthen efforts to keep temperature rises below two degrees Celsius above pre-industrial levels.

## 2018

The EU Action Plan on Financing Sustainable Growth by the European Commission is considered a game changer for the investment management industry.

## 2019

The European Green Deal by the European Commission aims for Europe to become the first climate-neutral continent.

### Financing sustainable growth

Society is demanding increasingly urgent action by politicians and businesses to combat climate change. Policy makers' efforts to respond to sustainability concerns have followed suit, intensifying dramatically in terms of magnitude and frequency. A particular emphasis on environmental factors can be seen in Europe, while global efforts include multiple dimensions such as the UN's Sustainable Development Goals. Hand-in-hand with such strategic initiatives, investor expectations are moving towards a more sustainable investment philosophy. This is particularly evident among pension funds, which are under increasing public scrutiny to consider sustainability risk within their portfolios. With the EU Action Plan on Financing Sustainable Growth in March 2018, the EU was the first large economic bloc to acknowledge that public funds are insufficient to finance the transition towards a more sustainable/circular economic system. The plan defined ten actions that put the financial services industry front and center in the shift to a carbon-neutral economy. Further impetus has been created by regulators increasingly regarding climate change as a financial stability risk. The result is tremendous growth in the market for sustainable financial products in Switzerland and around the world. These include sustainable investment funds, green bonds, sustainability-linked loans or derivatives, and insurance policies that specifically consider sustainability-related factors.

### The role of data

Financial services firms are developing comprehensive reporting that improves transparency over the sustainability of their activities. The reporting loop is being closed by incorporating sustainability considerations into the decision-making processes and disclosing corresponding impacts. This enhanced reporting is also intended to contribute to the

prevention of 'green washing' by adopting commonly accepted standards and labels. Investors and financial services providers both have high expectations when it comes to the relevance of independent ESG ratings, ESG research or the integration of sustainability considerations into rating agencies' credit rating methodologies. Methodologies for the systematic consideration and disclosure of ESG-relevant data implemented must be aligned and transparent. In this regard, the quality, comparability and reliability of investee firms' non-financial disclosures is crucial.

### Implications for financial services providers and investees

The consideration of asset owners' ESG preferences has significant consequences for financial services providers' process landscapes. Not only does it impact the decision-making process and associated data flows, it creates an expectation for financial services providers to perform meaningful ESG engagement. Companies that follow unsustainable business practices (e.g. 'brown' companies) are thereby helped and incentivized to improve. Similar approaches are emerging as part of banks' lending activities or the due diligence performed by (predominantly non-life) insurance companies.

If Europe is to achieve its goal of becoming carbon-neutral by 2050, a large number of business models and practices will be rendered unviable, and financial institutions will need to proactively manage their exposures to impacted firms and industries. Financial institutions are most often investees themselves and held to the same standards when it comes to measuring and reporting positive and negative sustainability impacts. Expectations that they should follow the highest standards of corporate governance, corporate social responsibility and environmental protections will therefore continue to grow.

# How forces will combine to shape the future of sustainable finance

## Asset owners

Asset owners will have full **transparency** to pursue **sustainable investment approaches** by means of comprehensive reporting. A comprehensive classification scheme will enable common standards and labels **preventing green washing** (i.e. false claims regarding sustainability).



### Institutional investors

e.g. pension funds, insurance companies



### Households

## Financial institutions

Financial intermediaries are essential to generating wealth by redirecting capital that reflects ESG considerations.



## ESG data / rating agencies

ESG data/rating agencies will provide transparency to the market when it comes to robust assessments of companies' and projects' sustainability.





## Investment channels

(equity and debt financing/investing)



### Capital markets



### Direct investments

## Investments / investees

Investees (companies and projects) will report on their positive and negative impacts. Ultimately, they are supported by financial institutions to **improve sustainability** alongside their bottom line.



### Companies



### Projects

Direct engagement with investees will increase. This will incentivize firms to balance their financials with their ESG performance.



# Regulation dominates the agenda

**Regulation is likely to remain the dominant driver of sustainable finance developments for the coming years. Policymakers acknowledge the need for more substantial private sector financing to realize the transition to a low-carbon economy. With financial markets expected to play their part, fresh approaches are needed to how private capital is deployed.**







# A question of culture

**While regulation may currently dictate progress, culture is key to achieving it. Delivering change at all levels of an organization is critical, with purpose, individual accountability, remuneration and diversity being paramount. Sustainability can no longer be an add-on – it must be a central element of corporate strategy.**



# Beyond traditional value

**Embedding sustainability into corporate strategy requires a vision of 'value' beyond traditional risk and return. ESG should be viewed as a catalyst for change, moving due diligence and broader sustainability concerns from a risk focus to strategic value creation. Thereby developing a business model that has lasting relevance to a low-carbon economy.**







# Breaking barriers

**As digitalization becomes more pervasive throughout the economy, digital finance is drawing new connections between investors and sustainability. New technologies and platforms are removing barriers to attracting money into sustainable finance. As well as creating more compelling customer experiences that appeal to emerging generations of clients.**

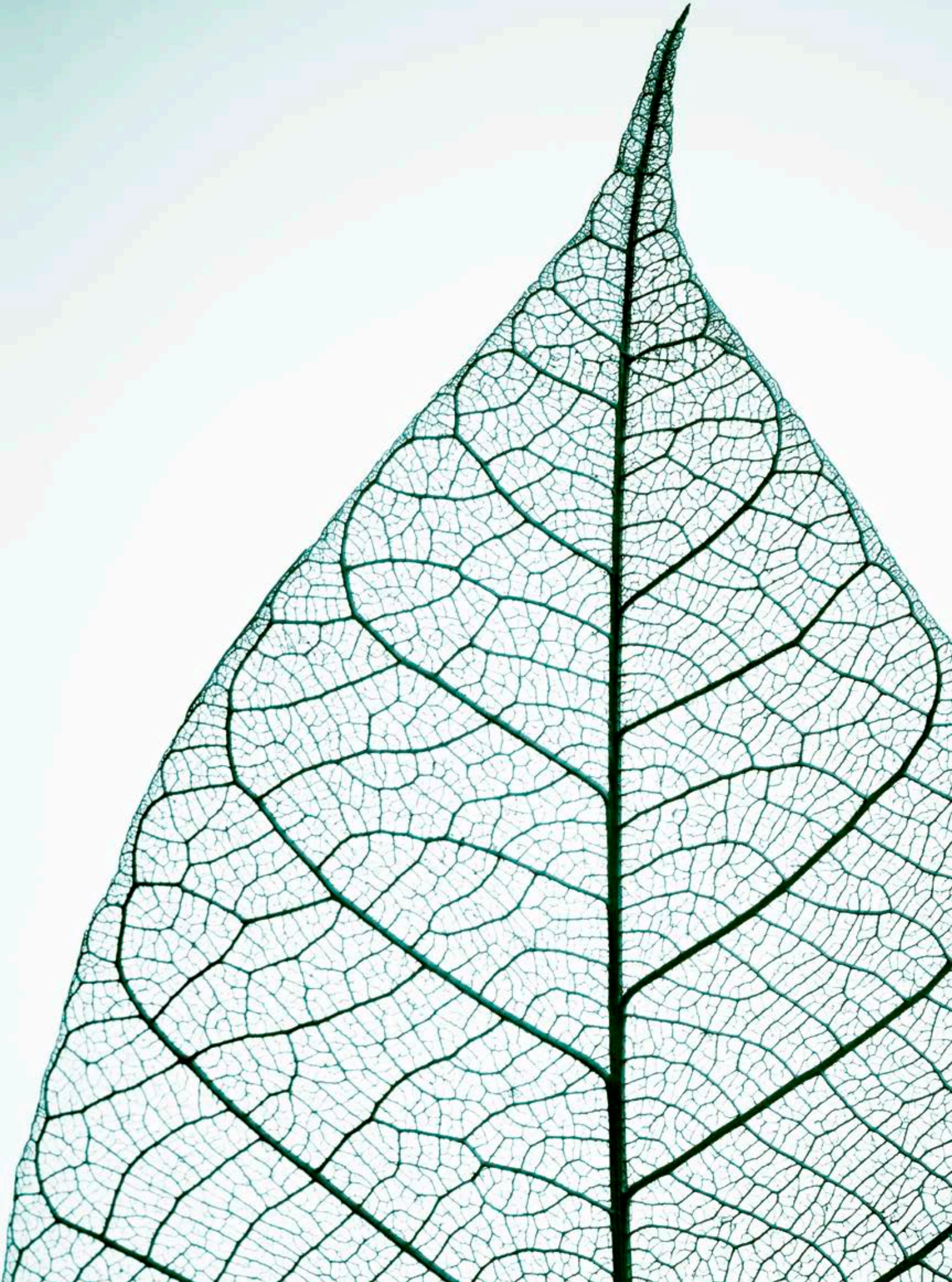






# Simply credible

**New generations of clients demand transparency – such as through apps that communicate key data on one, simple page – and easy ways to compare products and providers. But convenience must be matched by credibility. In today’s social media environment, firms that fail to deliver on their promises can find their reputation swiftly – and virally – judged.**





The background features several large, semi-transparent blue spheres of varying sizes. Overlaid on these are three large 'X' marks in different shades of blue and a thick, light blue curved arrow pointing upwards and to the right. A small circle containing a five-pointed star is located near the bottom right, at the start of the arrow.

# Changing climates: Integrating the cultural drivers of sustainable success

By Celine Vayenas, Senior Consultant, Financial Services and  
Patrick Schmucki, Senior Manager, Financial Services

**While regulation will be the main force that carries the next wave of sustainable finance into mainstream finance, it is not enough by itself. Sustainability must be treated as a core element of corporate strategy if it is to be implemented appropriately and credibly. But how should you embed the cultural drivers of ESG performance in your organization to achieve the depth and speed of change that is required for lasting success?**





We carried out desktop research on 14 larger banking, insurance and asset management firms headquartered in Switzerland and Liechtenstein. Complemented by interviews with members of senior management from seven of these institutions, we addressed the cultural drivers of performance that are also a priority for international regulators. Focusing on purpose, individual accountability, remuneration, and diversity, we identified a range of good and bad practices.

Overall, only a minority of the firms approach sustainable finance from a group- or entity-wide perspective. More common is to advance the topic in specific areas – usually due to heightened client demand or regulatory pressures – then roll it out across the organization. This piecemeal approach is unlikely to achieve the required change at the desired speed.

Here, we share our insights into each of the four focus areas:

## Purpose

Beyond creating shareholder value, a firm's purpose should answer more fundamental questions around the business's *raison d'être*, long-term objectives and the problems it seeks to tackle for the common good. Such a further-sighted view must remain unclouded by short-term financial impulses. It requires a truly firm-wide orientation around the 'why', which serves as a guiding light for the 'how' and the 'what'. Crucially, however, a company's purpose must translate into concrete measures that are embedded in its corporate strategy and culture if positive mission statements are not to be empty words.

As recognized by the UK's Financial Conduct Authority (FCA) in its 2019/2020 business plan, "Purpose is a driving force in creating and sustaining healthy cultures." Exploring this connection is one of the regulator's current priorities. Short-termism and leadership changes can lead to poor culture: "There can be instances where an individual, division or group becomes focused on achieving a short-term objective without considering whether that short-term behavior is consistent with the permanently expressed purpose of the firm."<sup>1</sup>

The FCA is not alone in its thinking. The Central Bank of Ireland also recently announced a continued focus on firm culture as part of its supervisory priorities for 2020. And as part of Action 10 of the EU Action Plan for Financing Sustainable Growth, the European Supervisory Authorities (EBA, ESMA and EIOPA) launched a consultation in June 2019 on short-termism in financial markets. In their report on undue short-term pressures on corporations issued in December that year, the ESAs recommended the European Commission take legislative action to improve firms' transparency over ESG considerations and to strengthen institutional investor engagement.

This acknowledgement is not confined to regulatory bodies. The Head of Sustainability Risk of a large insurance group confirmed to us the importance and benefit of a healthy corporate culture: "Ultimately, it is still very lucrative in the financial service industry – for individuals and firms as a whole – to go around rules and controls for personal gain... Culture is the only control around morality."

## Summary observations

Most firms explain their purpose or mission in terms of what they do and how they do it; they do not address fundamental questions such as why the company exists and how it is looking to solve broader societal challenges. More than half of the firms reference profitability in their mission statements but not their impacts on environment or society. Most firms lack a clear distinction between purpose/mission and (medium-term) strategy. Most seem to focus on quarterly, annual or three-year goals rather than more constant, longer-lasting objectives that should outlast changes in leadership, strategy and business model.

The Head of Sustainability Regulatory Strategy at a banking group summarized the dangers if an organization – or entire industry – loses track of its purpose: "Fundamentally, the purpose of a bank hasn't changed over the centuries. We are intermediaries who take capital from people who have no immediate need for it and provide it to the economy where it is put to productive use, and help manage risks. This creates growth and prosperity for society. However, particularly before the last financial crisis it is hard to deny that the industry as a whole had lost its way and was more focused on the 'financialisation' of the economy rather than its core purpose. This must be avoided in the future."

## Our insights into best practices

- Clear and consistent communication of purpose. It is important to break down what the purpose and values mean for employees at all levels in their daily work;
- Leadership training that addresses senior management's role with regard to the company's purpose and values, and meaningful training for employees at other levels;
- Awards or distinctions for special contributions by employees who serve as positive role models for the company's purpose;
- Skills-based volunteering programs for employees in an area linked to the company's purpose;
- Remuneration framework in line with the company's purpose (see the remuneration section of this article) rather than the achievement of short-term goals.

<sup>1</sup> Will Goodhart, CEO of CFA UK, and Chairman of the Asset Management working group set up by the FCA to focus on the purpose of financial services firms

## Individual accountability

Maintaining a purpose-oriented corporate culture involves breaking down the long-term goals set at the top into specific responsibilities that are allocated to particular functions and individuals – and ensuring accountability for their actions and progress. As the Head of Corporate Responsibility Management of a banking group pointed out: “When it’s about culture, we are talking about the long-term impacts and the continuous development of the company.” Appropriate incentives must be used to guide this.

Individual accountability is at the forefront of culture regulation. Reflecting senior management’s importance in driving purpose and culture, the FCA introduced its Senior Managers and Certification Regime (SM&CR) for banks and insurers in 2016, expanding it to MiFID-investment firms (such as asset managers or financial advisors) at the end of last year. Many other jurisdictions are also taking actions in this area: Hong Kong’s Manager-in-Charge (MIC) regime came into effect in 2017, while Australia introduced its Banking Executive Accountability Regime (BEAR) in 2018. And the Central Bank of Ireland has proposed a new Individual Accountability Framework, including a Senior Executive Accountability Regime (SEAR) and binding conduct standards that are likely to come into force in the second half of 2020.

### Summary observations

Only one bank in our review listed individual responsibility as a company value. None appeared to have a comprehensive system of accountability rules directed at managing conduct and culture within the organization. Yet, as a bank CEO noted, a lack of accountability can lead to organizational paralysis: “A credible implementation of a sustainable finance program is an extensive, long and painful process. It requires the leadership of an organization to take position... However, my observation is that a lot of leaders are missing the long-term perspective to go all the way.”

### Our insights into best practices

- Explicit allocation of key responsibilities to individuals, for example by means of a job description;
- Establishment of a ‘value for money’ committee to assess if products deliver on their value propositions. The committee should report directly to the Chairman;
- Managerial staff leaving the firm are required to prepare a comprehensive handover protocol to their successors;
- In-depth due diligence on new hires in managerial positions to avoid ‘rolling bad apples’;
- Comprehensive feedback cycle (balanced scorecard) for the assessment of senior manager performance.

## Remuneration

Remuneration models have been in regulators’ sights for some time. A company’s remuneration policy must be consistent with its corporate strategy and not result in ambiguous signals or conflicts of interest. Inconsistencies hinder progress, ultimately harming the credibility and implementation of goals.

While ESG considerations may to some extent already directly or indirectly affect employee compensation, there is room for a stronger commitment to incentivizing ESG-related goals. Adjusting remuneration structures can counter tendencies towards short term-financial goals. Implemented correctly, remuneration and non-financial forms of compensation are powerful tools to steer behavior and communicate important goals to employees.

### Summary observations

While there is increased awareness of the need to integrate sustainability risks into remuneration systems, we found much scope for progress in implementation. In most cases, it is limited only to (variable) executive pay. There are also challenges around the definition of relevant ESG-related performance metrics. As the Head of Public Affairs and Policy of a banking group highlighted: “I am speaking to a number of large asset owners who are telling me that too much focus on non-financial performance does the cause of sustainable finance a disservice. There are more than enough reasons to consider sustainability risks from a purely financial perspective.” A similar view was shared by the Head Responsible Investment of an insurance group: “We are not green missionaries. The consideration of sustainability risk within our investment strategies lies at the core of what we do in insurance: measure and manage risks.”

### Our insights into best practices

- Linking a portion of executives’ short and long-term variable pay to sustainability targets. E.g. executives might be rewarded for the percentage of capital allocated to projects such as renewable energy or pollution prevention;
- Creation of incentives that include non-financial rewards such as sustainability or social responsibility awards linked to certain benefits;
- Definition and firm-wide implementation of meaningful sustainability KPIs; metrics should be clear and tailored to the nature of respective employee groups’ responsibilities and tasks;
- Transparency regarding remuneration practices and sustainability KPIs, include the weighting of the latter. Current good practice is 10–25 percent;
- Establishment of a remuneration committee with discretion to retrospectively adjust pay for desired performance after the fact, measured according to sustainability KPIs.



## Diversity

A broader spectrum of views and opinions generally promotes better decision-making and leads to improved outcomes. In its 2018 toolkit for strengthening governance frameworks, the Financial Stability Board (FSB) identified groupthink that resulted from a lack of diversity and inclusion as one of the key cultural drivers of misconduct.

Diversity and inclusion are a key topic globally. The Australian Securities Exchange (ASX) expects listed entities to set measurable objectives for achieving gender diversity at all levels of the workforce and to periodically disclose their progress towards these goals.<sup>2</sup> Canada goes further: Since 1 January 2020, publicly listed, federally incorporated companies governed by the Canada Business Corporations Act must provide information at shareholder meetings regarding the proportion of women, aboriginal persons, members of “visible minorities” and disabled persons. In Switzerland, legislation is underway to require female quotas for the board of directors and management of listed companies.

### Summary observations

The mission statements and/or stated goals of almost all companies under review included the promotion of diversity and inclusion. While the proportion of women in the board of directors and management positions among the firms differed greatly from company to company (we noted ratios varying between 16 and 66 percent), the average proportion of women in executive positions is around 20–30 percent. Some have signed the ‘Women in Finance Charter’, committing them to support the progression of women into senior roles and to publicly report on progress.

Diversity is a prime example of a governance topic that can damage trust if a firm does not live up to the standards it promotes in its function as an investor or underwriter. As a bank CEO put it succinctly: “Culture is the fundament of our sustainability strategy. If my staff and I are not living up to our promises, we will never be credible in the eyes of our clients.”

### Our insights into best practices

#### *Board-level*

- Setting of concrete targets for diversity (e.g. of skillset and gender) and periodic evaluations;
- Periodic refreshment of board composition to allow for a new mix of ideas.

#### *Enterprise-level*

- Founding of diversity and inclusion councils;
- Establishment of internal diversity programs to promote an inclusive culture;
- Granting of team diversity awards;
- Creation of skills-based volunteering programs;
- Carrying out of ongoing diversity and inclusion assessments.

<sup>2</sup> ASX Corporate Governance Principles and Recommendations, 4th edition, February 2019, Recommendation 1.5. KPMG note: While these recommendations are not binding, the „comply or explain“/„if not why not“ approach makes it unattractive for firms not to adhere to these standards

# Laying the groundwork for success

## Outlook



As the pressures of globalization, digital disruption and climate change come to bear, financial institutions may find that culture is one of the few lasting competitive advantages that cannot be easily copied or imitated.

The COVID-19 pandemic is causing this point to hit home more forcefully. The crisis is shedding light on how companies treat employees, and is weighing on social considerations. We may see increased investor attention directed toward the “S” of ESG in general and enhanced scrutiny of factors such as dividend payments and executive pay amid social and economic turmoil. Equally, businesses must demonstrate flexibility with working from home solutions and prioritize employee wellbeing in order to retain and attract the people it needs to succeed. All of this reinforces the need for strong governance, which ensures that a holistic view is adopted and the right message spread, in both words and actions: A values-drive, sustainable purpose guides the way, a diverse board helps the company to strike the right tone, and individual accountability helps ensure that the necessary steps are taken. Remuneration, especially at executive level, may be used to express solidarity – e.g. reducing or foregoing bonuses - or to reward extraordinary efforts.

It therefore stands to reason that leadership should take culture seriously, actively measuring and developing it. Measurement can look at how client-centric an organization is, how it looks after its people, the extent to which leadership gets involved in culture, and the focus on performance and results. We found that most firms are only at the beginning of undertaking the demanding work of pinning down the key determinants and drivers of their culture, and putting results against them.

With regard to integrating sustainability considerations into a business, we observe that it tends to be developed within a specific part of the business and then rolled out to other parts of the business or adopted entity-wide. Most often, this is sustainable investing due to increased client demand in recent years. Only a minority of firms take a top-down approach by defining strategy in the light of upcoming challenges with regard to sustainable finance and breaking it down into the organization’s different business areas. In addition, most approach sustainable finance from a chiefly commercial and risk perspective, e.g. the management of risk and preservation of profits is a key driver behind integrating sustainability risks into operations.

Sustainable finance touches upon a wide range of cultural matters such as a firm’s commitment to its long-term goals, broader role in society, attitude towards personal gain, and credibility in the market. It is therefore not surprising that investigation into the topic reveals areas for significant improvement that financial institutions should address now if they are to lay the groundwork for future success.



# The next generation of ESG due diligence: from risk to strategic value creation

If there's a lesson to be learned in the current pandemic situation, it is that the next devastating, as-yet-unnamed outbreak is not a matter of 'if', but of 'when'. In light of this, ESG due diligence (ESG DD) becomes of the utmost importance in any deal process to identify areas of risks and above all the ability of one business to recover and deliver value in a new normal. To what extent are ESG considerations incorporated into your deal process, if at all? What is the primary focus? Here, we explore how to take ESG DD from a pure risk due diligence standpoint to a strategic due diligence that does not simply protect value, but actively helps create it.

**By Louise Tastet,  
Senior Manager,  
Global Strategy Group**

## A traditional focus on risks

Undertaking an ESG DD is critical to providing a holistic view of all relevant risks an acquired business currently faces or could face in the future under new ownership. An ESG DD's recommendations are valuation driven, looking at potential liabilities that could affect costs, cash flows and the deal timeline. And thereby helping you to negotiate the price and terms of a potential deal.

Firstly, an ESG DD helps to assess potential deal breakers. Take the example of supply chain management. Twenty-one workers died in 2010 due to a fire in a Bangladeshi factory that made clothes for H&M.<sup>1</sup> The accident was largely attributed to poor safety standards. A clear guiding principle defined by the UN in 2011 stated that "business enterprises should carry out human rights due diligence" and that "the process should include assessing actual and potential human rights impacts, integrating and acting upon the findings, tracking responses, and communicating how

impacts are addressed."<sup>2</sup> Although Swiss laws do not currently oblige companies to carry out general, legally binding human rights due diligence, avoiding tragedies and protecting human life and rights is not merely a question of legal obligations.

While this type of deal breaker may not always exist when looking at potential managed assets, an ESG DD helps to estimate the costs of implementing appropriate standards. This may relate to current requirements such as putting a complete health, safety and environment (HSE) policy in place in a particular country, or to future considerations such as carbon pricing.

An ESG DD can help to provide a deep understanding of the potential risks the company may face in the near future. And to assess the additional costs that should be factored into the deal valuation. Crucially, however, the focus has recently grown on using ESG to highlight potential for value creation measures.

<sup>1</sup> <https://www.independent.co.uk/life-style/fashion/news/21-workers-die-in-fire-at-hm-factory-1914292.html>

<sup>2</sup> Guiding Principles on Business and Human Rights, United Nations Human Rights, 2011, page 17



A traditional ESG DD covers various aspects of a company's organization and value chain:

### **Environment**

How does the company manage its resources such as water and electricity? How sensitive is the business to the scarcity of certain natural resources such as water? What is its dependency on fossil fuels or its use of renewable energy?

### **Societal**

Does the corporate strategy include societal commitments? Where does the company stand in terms of compliance with national regulations and international treaties in each country?

### **Governance**

Are ethical business practices in place and communicated throughout the organization? How does the organization (e.g. board, executive committee) manage and oversee ESG topics? Where does the company stand with regard to its ESG policies and procedures, e.g. existence, implementation, tracking and mitigation measures executed?

### **Supplier risk management**

Are suppliers monitored? Is a supplier's assessment carried out every fiscal year? What is being monitored?

### **Products and services**

Do new products take into account sustainability, e.g. renewable materials? What are the current manufacturing processes and how do they reflect environmental considerations such as waste disposal?

### **Human resources**

What are the current guidelines for health & safety? What kind of training is held and for which employees? How is talent retention and diversity managed?

## Potential to enhance deal value

Major institutional investors emphasize the importance of ESG issues to long-term value creation and preservation. However, many directors and executives see ESG as relating primarily to risk and reputation.<sup>3</sup> This is a clear conflict of understanding: on the one hand, 43 percent of board members and business leaders said their company's ESG focus was part of normal risk and compliance activities, and 47 percent that ESG-focused companies tend to outperform their competitors. On the other hand, 79 percent of private equity general partners agree that responsible investment/ESG can increase investor returns.<sup>4</sup> No matter which statistic is used, ESG DD should look at more than just risks.

ESG DD enables you to investigate cost improvement measures or savings opportunities. This could include improved resource management such as using LED bulbs that are 25–30 percent more energy efficient. And to consider value protection such as implementing working environment measures to benefit employees and lead to higher productivity and retain key talent. Or, with regard to the environment, to assess the business model's readiness for a transition to a low-carbon economy.

We see companies that provide ESG DD services beginning to incorporate a value creation assessment in their scope of work. In practice, however, value creation measures still relate primarily to cost savings or protecting value rather than generating value and growth.

## Making broader use of ESG DD

ESG DD should not be viewed as an isolated exercise and it is not relevant only to the due diligence phase. Global private equity funds currently consider ESG at various stages of the investment process. These can range from sourcing and exclusion criteria to identifying specific mega-trend opportunities. Doing so can govern how assets are purchased, sold, or combined, or provide insights into how ESG performance affects the business's most valuable intangible assets such as reputation, brand, trust and relationships. It can also cover specific improvement measures to how acquired assets are managed, and how to update corporate communication and brand marketing.

In our experience, ESG DD is not sufficiently leveraged in exiting an investment. By carrying out a sell-side ESG DD, a seller could provide a strong base for deal value protection and readiness for future change. And facilitate a move towards more strategic thinking and realizing greater value. Sustainability is not only about compliance, it is about business strategy and growth – dealing with the present and preparing for the future.

## Turning ESG DD into strategic due diligence

An opportunity exists to leave behind the traditional vision of ESG DD and to adopt a holistic approach that uses ESG DD to assess the adequacy of the financial model, business model and operating model through a sustainability lens. Whether or not you are currently in an M&A process, understanding how your business deals with ESG is key to assessing how robust your business model is for the future. You would also be able to leverage that approach for any deal from a buy-side or from a sell-side perspective. Examples exist of companies revisiting their purpose to redefine financial and operating models based on ESG considerations, for instance.

Outdoor clothing company Patagonia, whose values are "Build the best product, cause no unnecessary harm, use business to protect nature"<sup>5</sup>, for instance committed to environmentally sustainable practices such as making fabric out of recycled plastic bottles. But the most powerful impact came from its founder, Yvon Chouinard, and his vision of business and company culture. He stated "if you want to change your company, just change the way you hire."<sup>6</sup> By recruiting and giving people full autonomy and letting them go surfing<sup>7</sup>, the company embedded ESG in its core processes.

Rhomberg Holding, an Austrian-based family company in the construction and railway business, is another example. CEO Hubert Rhomberg decided to tackle the way the construction industry consumes resources and emits CO<sub>2</sub>. He rethought the building process around the Cree concept (CO<sub>2</sub>-neutral hybrid wooden high-rise). Key features include building design that integrates the dismantling and reuse of the building's components; a timber-hybrid system that is resistant to extreme conditions; and reducing carbon footprint by using locally sourced components. The concept has been rolled out internationally by granting licensing rights. Rhomberg Holding set a sales record in the 2018/19 financial year.

The strategic shift in both cases started with visionary leadership and a strong change management approach that onboards stakeholders onto a new strategic journey. It requires an ability for design thinking and agile learning if the business model is to be successfully revisited. Successful change management can be achieved only by involving stakeholders in product design, manufacturing process, and consumer behavior. In other words, by addressing your business and operating model. The current pandemic is accelerating this requirement. As Emmanuel Faber, CEO of Danone, recently highlighted "This idea of stakeholder capitalism is going to be significantly bigger than it was before the crisis, whether you like it or not."<sup>8</sup>





What are the main hurdles on this path? Thirty-two percent of respondents to our study cited pressure to deliver short-term/quarterly results as an impediment to addressing ESG as a strategic issue in their company.<sup>9</sup> As a logical consequence, ESG DD is not current practice in the M&A industry. To deliver more value, it is time to shift the mindset. Companies that have successfully embedded ESG initiatives into strategy and operations view the integration of these initiatives as imperative to long-term value creation. We believe this needs to be reflected in the deal process as well. Not only from a risk perspective but also from a strategic standpoint.

It is particularly the time to use sustainability to identify new markets, propositions, products and customer solutions. And to imagine new operating models associated with it. Businesses will think more about running an ESG DD if they have already started to consider ESG within their operating models. ESG DD could also be leveraged in a potential acquisition to start initiating the required transformation.

A deal can be a useful catalyst for effecting change in the day to day business and operating model. Or to test a dual approach to discover new growth opportunities outside the core business. Business history has recently demonstrated that a model which has worked in the past does not guarantee success in the future. A dual approach acknowledges the complexity of running such a transformation program and helps to continually reinvent the business.

### **A long-term approach to value creation**

Current levels of technological disruption and societal shift have dramatically increased the speed of change in all industries. One consequence could be greater pressure on short-term returns, but another will be the requirement to anticipate long-term trends that will impact a business's competitive position. The 33-year average tenure of companies on the S&P 500 in 1964 narrowed to 24 years by 2016 and is forecast to shrink to just 12 years by 2027.<sup>10</sup> In addition, ratings company already announced that they will assess to what extent companies learned from the COVID-19 crisis, are preparing for the next disruption, and are implementing sustainable business practices for the long run.<sup>11</sup>

Considering sustainability through a market potential lens and in your M&A process goes hand in hand with adopting a long-term value creation approach. The average annual earnings growth for long-term oriented companies (those with a planning horizon in excess of two years) was 8.5 percent compared to 4.6 percent for short-term oriented companies over a 15-year period.<sup>12</sup> So when and how to start? Investment teams need to understand the company's approach to value creation, inquire about the long-term oriented mindset and incentives in place, investigate if different timeframes when measuring the impact of projects are being used, explore the extent to which stakeholder management is embedded in strategic planning and decision making processes, and assess the measurement and disclosure of non-financial capital (human, social, environmental, intangible) in internal and external communications.

<sup>3</sup> ESG, risk and return - A board's eye view, Audit Committee Institute, KPMG, 2018

<sup>4</sup> Responsible Investment in Private Equity – a key component of operational value creation, Capital Dynamics, 2017

<sup>5</sup> <https://www.patagonia.com/company-info.html>

<sup>6</sup> Learning from the Pros: Patagonia Founder Yvon Chouinard." JJ Ramberg, correspondent. MSNBC. NBCUniversal Media. 3 Aug. 2008. NBC Learn. Web. 11 January 2020

<sup>7</sup> Let My People Go Surfing: The Education of a Reluctant Businessman, Yvon Chouinard

<sup>8</sup> "Danone sees the pandemic accelerating the stakeholder capitalism shift," 28 April 2020, on [www.fortune.com](http://www.fortune.com)

<sup>9</sup> ESG, risk and return- A board's eye view, Audit Committee Institute, KPMG 2018. Study performs on 900 board members and business leaders from 41 countries worldwide

<sup>10</sup> Executive Briefing 2018 Corporate Longevity Forecast: Creative destruction is accelerating, Innosight, February 2018. <https://www.innosight.com/insight/creative-destruction/>

<sup>11</sup> The ESG Lens On COVID-19, Part 2, 28 April 2020, S&P Global

<sup>12</sup> Winning strategies for the long term, Global Strategy Group, KPMG, May 2019

## Takeaways to reinvent ESG DD as strategic DD on the target or your own business:

### Market trends

What is the next big sustainable trend that will impact the business and when?  
Understand not only the current trend but identify what could come next and at what rate

### Customers

What pressure does the industry currently face that is leading to distrust among customers? What are new customers' sustainable habits and behavior patterns?  
Review the current offering and communication strategy to secure customer buy in

### Competition

What are the sustainable emerging unicorns that could disrupt the business in the near future? Consider the learnings you could apply to the acquired business or your own business model

### Target business model

On which assumptions is the business's growth based? Move away from using extrapolation to predict tomorrow's results, to using a future-back strategy

### Culture

What horizon does the company use at top management and project level?  
Consider using different horizons to assess the impact of a decision or project

### Integration

How will the target be integrated within your business? Leverage due diligence learnings to revisit your business model, and consider using a dual approach (e.g. no integration of the acquired assets in the early years) to test the success of a new model

### Business plan

How much would inaction cost? Move the mindset from the costs of supporting sustainable initiatives to the costs of not doing so

### Valuation

How are intangible assets valued? Develop a deep understanding of intangible assets during the due diligence process – not only human capital (e.g. workforce), brands, technology, and customer relationships but also algorithms, innovative business processes, collaborations and partnerships, natural capital (e.g. water usage), and social capital (e.g. suppliers)

### Governance

Does the governance model apply corporate governance codes and reporting frameworks with a long-term value creation approach? Leverage codes and reporting frameworks in place in other countries such as the Netherlands and the UK



## Conclusion

Running an ESG DD delivers numerous benefits. Not only does it help identify potential deal breakers or business risks which could be costly, it also helps identify value enhancement measures that you could implement as an owner. Increasingly, it can offer so much more.

For instance, it is a way to revisit your current business model in light of sustainable market trends which are (and will be) disruptive.

Or a way to use a dual approach to try out a new business model more fitting for the future to make sure your business not only maximizes value but also sustains it in the long term.

In both cases, it requires a shift of mindset throughout the whole organization, an implementation of innovative learning processes to explore new ways of doing business and answering customers' needs, and the involvement of a broad range of stakeholders.

One thing all these have in common is that they need to be considered now. As the pandemic pushes every business to rethink their model and testing their resilience, they should start to tackle the former by focusing on ESG.



# Sustainability – at the core of effective stewardship

**What is driving greater awareness of sustainability issues within banking, and how does this translate into the development of service offerings? Patrick Odier, Senior Managing Partner of Lombard Odier, shares his insights into the motivations behind sustainability changes at the bank and its role in supporting its clients, as well as why he thinks Switzerland is well placed to help shape the global sustainable finance agenda.**

**Interview by Yvan Mermod, Partner, Financial Services and Bruno Beça, Senior Manager, Financial Services**

## **About Lombard Odier**

Lombard Odier is a leading global wealth and asset manager. For over 220 years and through 40 financial crises the Group has combined innovation and prudence to align itself with the long-term interests of private and institutional clients. Lombard Odier provides a complete offering of wealth services, including succession planning, discretionary and advisory portfolio management, and custody. The Group has also created cutting-edge banking technology, which is distributed to other financial institutions.

## **About Patrick Odier**

Patrick Odier has been a Managing Partner of the Lombard Odier Group since 1986 and a Senior Managing Partner since 2008. He has been Chairman of the Board of Directors of Bank Lombard Odier & Co Ltd since 2014. He holds an economics degree from the University of Geneva and an MBA in finance from the University of Chicago. He has devoted most of his career to the strategic management of the Group and the development of business relationships with both private and institutional clients as well as external management companies.

Patrick Odier was Chairman of the Swiss Bankers Association from 2009 to 2016, is a member of the Board Group of *economiesuisse* (Swiss Business Federation), and chairs Fondation Lombard Odier and the Dr Henri Dubois-Ferrière Dinu Lipatti Foundation. He is also a board member of the Louis-Jeantet Foundation and the Brocher Foundation in addition to many other Swiss and international philanthropic organizations and academic institutions.





At last year's "Building Bridges Summit & Week," there was widespread recognition that sustainable finance is an opportunity for the Swiss financial sector. What challenges do you anticipate in seizing this opportunity?

I see four challenges that need to be resolved. The first is precisely what Building Bridges was set up to achieve – fostering dialogue between parties without whom it will be difficult to find sustainability solutions. So many people have valid inputs, including regulators, civil society, industry and finance, that it's important to engage with them all to understand the different perspectives.

The second challenge is also about communication, being the need to speak the same language if you want to get things done. The idea of common agendas, common priorities and a common taxonomy to clarify what constitutes a sustainable activity will allow goals to be achieved more quickly.

The third challenge is how to strike the right balance between encouraging and obligating parties to change. For instance, some countries have implemented binding measures such as carbon taxes. Incentives, meanwhile, can be helpful in targeting particular types of investors such as institutional investors or pension funds, sending the message that there are advantages and flexibility to be gained by investing in certain areas. Or they can be fiscal, with incentives for more active investment in sustainable investments and products.

These all culminate in the fourth, and arguably biggest, challenge – how to deploy capital in the right way. Because capital is one of four crucial forces – together with regulation, technology and consumption – that determine the speed and extent of the sustainable transition. We estimate, for instance, that meeting the goals of the Paris Agreement will require investments of USD5.5 trillion per year to 2030. While this is only 17 percent higher than what might be required prior to taking climate and other sustainability requirements into account, that capital also needs to be reallocated to very different investment opportunities, such as renewables and the electrification of our economy.

Where does Switzerland stand internationally and could this be a chance to revitalize its private banking industry?

Switzerland is well placed to help lead this debate due to its exceptional cluster of competences. It is almost unique in this regard, with around 40 international organizations in Geneva alone, and across the country more than 600 NGOs, a strong financial sector, advanced industry, political authorities that are open to conversation, and a democratic process that encourages debate. The technology and research-intensive nature of our economy strengthens this position even further.

Switzerland is also one of the world's leading financial centers, managing 27 percent of the world's cross-border wealth. This presents the country with a significant opportunity to play a leading role in setting the international agenda in critical areas such as the ongoing evolution of investment best practice, as well as sustainability-related metrics, transparency and reporting. As fiduciary managers, Swiss asset managers are well versed in the need to manage risk and spot opportunity. We can use these skills to inform clients and all our other necessary stakeholders about the fundamental importance of sustainability in driving future wealth.

Speaking of business models, do banks such as yours have a role in encouraging companies to change?

Most definitely. It is fundamental to our fiduciary duty to act as stewards of the capital we manage on our clients' behalfs. Engaging in a dialogue with companies to communicate our expectations regarding the sustainability of their business practices and business model is key, but this dialogue also allows us to make more informed investment decisions by asking companies to disclose material, investment-relevant information. And it allows us to engage in dialogue for change, where we explain the economic rationale for companies to improve their practices or move to more sustainable business models. This dialogue is essential to our ability to protect and enhance the value of our clients' assets over time, both to mitigate exposure to risk, and to pursue emerging investment opportunities. It is an integral part of the investment process and to delivering clients' long-term financial objectives.



**«I believe it is critical to integrate robust, science-based analysis into the investment process, and to engage in ongoing dialogue with companies to inform this analysis if we are going to fully understand the growth potential or competitive advantage a company has.»**

Interestingly, if you look at the largest global asset management players, they are often in a paradoxical situation. They are passively invested in market capitalization-based indexes, but many of these indexes include companies that are the opposite of what we would be looking to invest in. This potentially threatens their ability to meet their objectives, but it can also contribute to systemic risk by sending the wrong signal to these companies and hindering our ability, as an investment community, to use our capital and influence to accelerate the transition to a more sustainable economy. Stewardship is arguably even more important for passively-invested assets because that is their main tool for addressing the risks and capturing the opportunities arising from the sustainability revolution, which will leave no sector, company or asset class untouched. Yet, so far, passive managers have not been effective enough, in our view, in carrying out stewardship. This is particularly important as it relates to systemic risks like climate change.

I believe it is critical to integrate robust, science-based analysis into the investment process, and to engage in ongoing dialogue with companies to inform this analysis if we are going to fully understand the growth potential or competitive advantage a company has. These are critical factors in any long-term investment decision.

**What drove Lombard Odier to develop a sustainable finance service offering, and did you do so alone?**

The days when we could clearly separate investment from social responsibility are well and truly gone. We are convinced that the transition to a low-carbon, sustainable economy is already having a major impact on the business world. We see this, for instance, in the evolving expectations and preferences of consumers and in the rapid fall of prices of new technologies such

as wind, solar, electric vehicles and batteries. On the regulatory side, the landscape is also fast evolving, with a growing number of countries, states and cities committing to net zero emission targets. These forces are already creating a wide range of investment opportunities, as well as significant physical, transitional and liability risks. Our role as investors is to manage these risks for our clients and help them take advantage of the potential upsides. We cannot do this on our own and, importantly, our clients are increasingly demanding that we integrate sustainability. In fact, just six or seven years ago, only five percent of clients had questions or expressed an interest in sustainability themes. Today it's closer to 95 percent.

Over the last two decades, we have developed a robust, proprietary, science-based approach to analyze material forward-looking transition risk and opportunity, and enhance our understanding of expected returns. This means we are better able to calibrate risk and return expectations as the transition unfolds.

We have also forged alliances with partners where we perceive them to be highly innovative leaders in their field, including in areas like impact investment and green bonds. We have had an exclusive partnership with Generation Asset Management for 12 years, for example. We also work with Affirmative Investment Managers (AIM), based in London, who are pioneering specialists in green bonds with a team that was at the center of the origin of the first green bonds.

Today, sustainability is at the very heart of our business, our portfolios, and our research focus. Because we have been pioneers in this space, we believe we are now in a strong position to align portfolios to the transition, and we are convinced this will give rise to the best investment opportunities for our clients in the long term.



## How about Lombard Odier's own responsibilities? What motivated change within your bank?

Sustainability has always been a major concern for Lombard Odier. We understand the fundamental link between meeting the objectives of our clients, our employees, the communities and environment we operate within, and our own sustainability as a firm. Since the 1990s, we have contributed to the development of new concepts such as BlueOrchard, which has grown into one of the main players in microcredit, and the Ethos Foundation, which is a leading sustainable investment organization for institutional investors.

We acknowledge the need to change the way economic models and business models are implemented. Clients, investors and the companies we invest in demand that we walk the talk. This is why we are proud to be a certified B Corp, for example, which demonstrates our alignment with sustainable development objectives. This is a leading international standard and is an important element both in our client relationships, but also in raising awareness among our employee base. Our ability to attract and retain the right talent is central to our continued ability to innovate and provide cutting-edge solutions to our clients. This same philosophy is reflected in the construction of our new global headquarters, which should set an important example in terms of our environmental footprint, enhance the productivity and quality of life for our employees, and foster better interactions with the local community.

## What approach do you need to apply in practice to effect these changes?

We have to invest in sustainability. We have developed an investment philosophy that captures the major challenges and trends that are already shaping our economy and society. Translating this effectively into portfolios requires significant investment in our people, our processes, our products and our ability to understand and interpret the transition. Importantly, we recognize the need to invest in a diverse workforce that reflects the multi-faceted and complex nature of sustainability challenges. This includes bringing in people with expertise from outside of finance,

including data science, earth engineering, lifecycle analysis, corporate governance, communications and policy making, for example.

This broad combination of expertise, a fundamental research-based process and our collaborative approach to investment decision making, is key to developing a robust analytical framework, and to understanding the top-down and bottom-up effects of the transition on regions, sectors, companies, and asset classes. This underpins our calibration of expected risks and returns in our portfolios.

## What do you see as the end game for businesses with regard to sustainable finance?

We believe our current model of growth is fundamentally flawed, and is unlikely to withstand the test of time much longer. Our current approach to production and consumption is Wasteful, Idle, Lopsided and Dirty – we call this the WILD economy. To ensure the continued viability of our system and way of life, we must fundamentally rethink the way we live, produce, act and invest. The end goal of this transformation, in our view, is an economic model that is Circular, Lean, Inclusive and Clean – we call this the CLIC economy. Achieving this CLIC model requires companies to revisit their business models and business practices, implies a decoupling of growth of its negative impact and business model, to assess whether they are fit for purpose in a more sustainable, net zero emission, and minimal waste economy. In the end, companies that do not adapt well risk disappearing completely as they lose customers and are displaced by more innovative products and/or service offerings from competitors. They will also struggle to compete in an increasingly carbon-constrained and carbon-damaged world, and will find it harder to attract and retain both people and capital.

We are looking to identify companies that understand the profound impact of the transition on their entire value chain and are making measurable progress in addressing risks and capturing opportunities. These are the companies that will benefit from sustainable growth opportunities and competitive advantage, which translates into sustainable financial returns for our clients and to positive economic, environmental and social change over the long term.



Patrick Odier, Lombard Odier





# The regulatory agenda heats up

**By Bruno Beça, Senior Manager, Financial Services**

In light of the UN's Sustainable Development Goals and the Paris Agreement, there is a growing recognition of the role private finance must play in the transition to a circular economy. As the EU recalibrates its regulatory framework for capital markets, and Switzerland's Federal Council reaffirms its commitment to responsible business conduct and prioritizes market solutions, there are many new considerations for Swiss financial intermediaries to navigate.

## The EU Action Plan on Sustainable Growth

Initially adopted by the European Commission in 2018, this is the first supranational regulatory push that complements pre-existing, national initiatives. It has the potential to fundamentally alter existing economic and financial system structures through the following actions:

- 1 Establish an EU classification system for sustainable activities**
- 2 Create standards and labels for green financial products**
- 3 Foster investment in sustainable projects**
- 4 Incorporate sustainability when providing financial advice**
- 5 Develop sustainability benchmarks**
- 6 Better integrate sustainability in ratings and market research**
- 7 Clarify institutional investors' and asset managers' duties**
- 8 Incorporate sustainability in prudential requirements**
- 9 Strengthen sustainability disclosure and accounting rule-making**
- 10 Foster sustainable corporate governance and attenuating short-termism in capital markets**

The legislative process has moved at an impressive pace, and shows no sign of slowing down although a number of other European regulatory initiatives have been pushed out due to the COVID-19 crisis with the first set of legislative measures expected to enter into force over the next two years.

These will address matters such as suitability (amendment to MiFID II), disclosure obligations, sustainable benchmarks, and a taxonomy that is a framework for identifying sustainable activities. The legislation will affect participants in the EU financial market and the sustainable financial products they offer.



## The Swiss political and regulatory agenda

While EU member states are active in implementing newly adopted EU directives, Switzerland is currently looking to answer how regulation can help achieve the Paris Agreement's climate goals.

### Political and regulatory moves

The Federal Council reaffirmed its commitment to responsible business conduct in January 2020, with the publication of its revised Action Plan on Corporate Social Responsibility (CSR) and on Business and Human Rights. The Action Plan refers to 16 measures such as the creation of a harmonized framework for greater transparency on corporate social responsibility. The Federal Council favors a coordinated approach that is aligned with international standards. Regarding duties of diligence, for instance, the Action Plan 2020–2023 refers to the OECD Guidelines for Multinational Enterprises.

Also in January 2020, the advisory board for the “future of the Swiss financial centre” submitted a strategic roadmap for financial market policy to the Federal Council. The Advisory Board believes that the Swiss authorities should focus on the creation of framework conditions that offer an attractive and competitive environment in the area of sustainable finance.

A Federal Council session in June 2019 discussed sustainable finance in Switzerland, creating a working group that will examine the implications for Swiss finance of the EU Action Plan on Sustainable Growth. It is expected that the results will be communicated by the end of June this year and that the current voluntary and industry-led approach will be reinforced.

Other items on the political agenda illustrate the pressure and expectations of sustainability issues. For example, the initiators of the Responsible Business Initiative aim to legally oblige companies to incorporate human rights and environmental due diligence in all their business activities. And the revision of the Federal Act on the Reduction of CO<sub>2</sub> Emissions would impact companies with activities directly or indirectly associated with fossil heating systems or the consumption of fossil fuels, including real estate. The Council of States meanwhile voted in December 2019 in favor of a motion to exempt green financial products from withholding taxes.

Should the motion be accepted by the National Council, a discussion would be expected on defining green financial products.

There are currently no binding Swiss federal regulations that address sustainable finance. Yet, some market participants are of the view that there is a duty to consider climate-related risks as part of sound risk management. Similarly, some believe the current fiduciary duties imply that ESG factors should be considered in asset managers' investment processes, if such factors have a material impact on performance. This would apply to pension fund managers, for instance, in reference to art. 71 of the Federal Act on the Occupational Old-Age, Survivors and Disability Benefit Plans (LOB). In the absence of a federal rule, some cantons directly amended their pension fund law to integrate sustainability requirements. For instance, the canton of Geneva integrated in its pension fund law that its activities would fall within the perspective of sustainable development and responsible investments.

It remains to be seen how far the Financial Market Authority (FINMA) and the Swiss National Bank (SNB) will stay with mostly self-regulatory and non-binding sets of rules. The impact of climate and other environmental risks on financial stability is becoming an increasingly pressing concern at home and abroad as a number of regulators in Europe and the US have published specific expectations or guidance for firms on how to treat such risks. It therefore seems likely that Swiss regulators will engage more actively with the industry around climate risk management, which may result in regulatory action.

### Industry-driven activity

Industry associations have also been active in providing guidance and drafting standards. In early June this year the Swiss Bankers Association (SBA) published voluntary guidelines to help banks integrate ESG criteria into investment advisory and portfolio management processes. In late June, we expect the Swiss Funds & Asset Management Association (SFAMA) and Swiss Sustainable Finance (SSF) to publish their recommendations regarding sustainable investing as well as guidance from the Swiss Insurance Association (SIA) regarding responsible insurance.

## National markets recognize a need for action and a strategic opportunity

As well as being a question of ethics, some national governments see the promotion of sustainable finance as an opportunity to position their financial markets as industry leaders. This can cover a key strategic objective to foster innovation and growth in the financial sector. Recent national initiatives include:

### US

The US Commodity Futures Trading Commission (CFTC) formed a climate sub-committee of the CFTC's Market Risk Advisory Committee in 2019 to assess climate-related financial risks. Recommendations are expected by the end of 2020.

In autumn 2019, the Financial Services Committee of the US House of Representatives passed the ESG Disclosure Simplification Act of 2019, which demands new ESG disclosure requirements in the Securities Exchange Act of 1934 and the formation of a Sustainable Finance Advisory Committee. While it is considered unlikely that the bill will be passed into a new law, it illustrates the push towards greater transparency on ESG metrics.

### Nordics

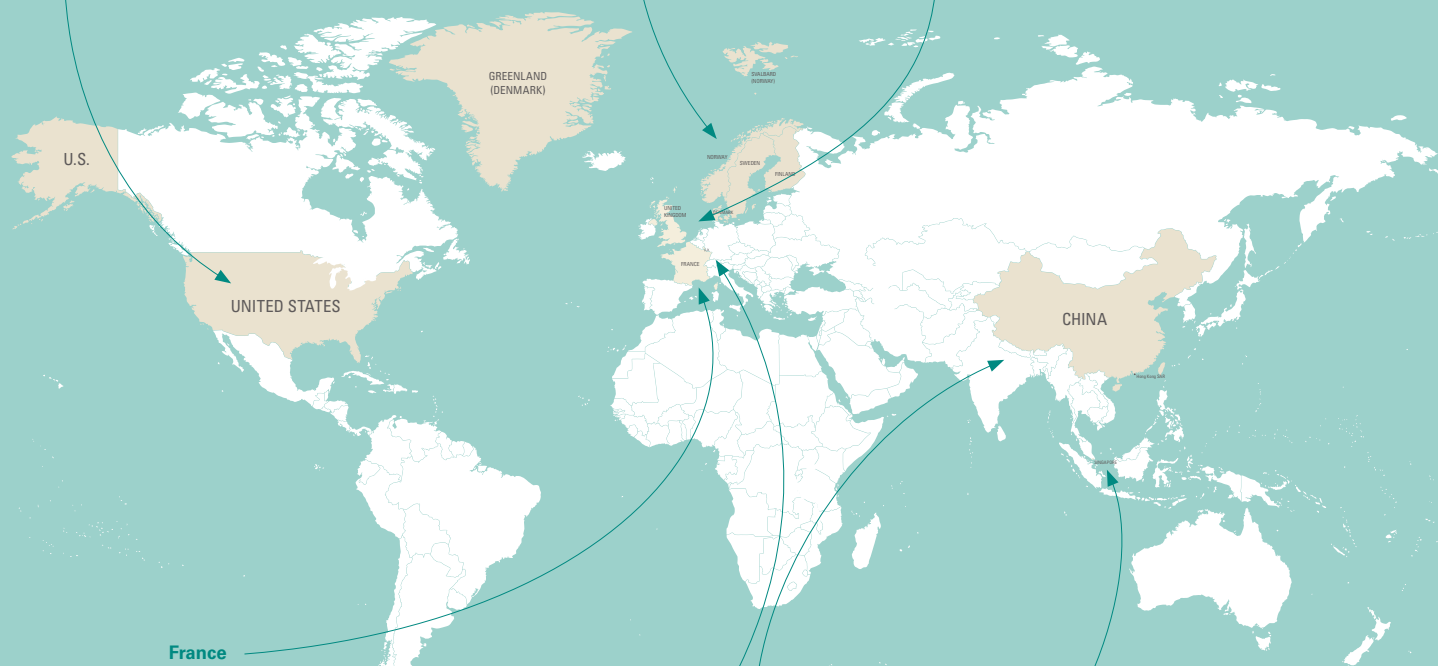
Nordic asset managers have a long tradition in ESG investing, leading the way in sustainable fund assets by volume. Existing regulation in the Nordic countries focuses mainly on ESG disclosures:

- Legal ESG disclosures in Denmark are applicable to all investor groups, from pension funds to asset managers.
- Swedish marketing and information guidelines have been amended to include a section relating to sustainability standards. This applies to marketing materials and annual reports of Swedish securities funds and alternative investment funds.

### UK

The UK government published its Green Finance Strategy in July 2019, setting out its approach to greening financial systems, mobilizing finance for clean and resilient growth, and capturing the resultant opportunities for UK firms.

Since 2019, UK occupational pension funds have had to carry out and document a risks assessment of new and emerging material ESG risks.



### France

Since 2017, institutional investors and fund management companies must report on their website and in their funds' annual reports how they take ESG factors into account.

The French Financial Market Authority (AMF) published a roadmap in November 2018 regarding sustainable finance and the role of the regulator.

The AMF conducted a review of non-financial information disclosed by listed entities in 2018. A review has also been conducted on asset management companies active in the area of ESG investments, with a focus on organizational measures, policies, procedures, methodology, coherence, disclosures and controls. The results were disclosed in 2019.

### Luxembourg

The Luxembourg Green Exchange was launched in 2016, subsequently creating a legal framework for green covered bonds.

The Luxembourg Ministry of Finance and the Ministry of Sustainable Development and Infrastructure (Department of the Environment) commissioned the Luxembourg Sustainable Finance Roadmap in 2018.

### Singapore

The Singapore Exchange (SGX) published a Sustainability Reporting Guide in connection with Listing Rule 711A which requires every listed issuer to prepare an annual sustainability report, on a 'comply or explain' basis, for reports published since 2018.

### China and Hong Kong SAR

The China Securities Regulatory Commission (CSRC) introduced new requirements in 2020 for listed companies and bond issuers to disclose ESG risks associated with their operations.

Hong Kong's Securities and Futures Commission (SFC) announced in 2018 its Strategic Framework for Green Finance, focusing on environmental disclosures by listed companies. A working group has been set up to develop Hong Kong as a green finance hub.



## Impacts on Swiss financial institutions

EU legislative developments are already impacting Switzerland's financial industry. The working group set up by the Federal Council in June 2019 is paying particular attention to the obligation to publish sustainability information and to integrate ESG criteria in the duties of diligence under the Financial Institutions Services Act (FinSA). As of today, the publication of non-financial information for entities listed on the SIX Stock Exchange

is voluntary and FinSA does not explicitly integrate ESG factors in suitability and appropriateness tests.

Besides these broader, indirect implications, upcoming EU regulations are likely to have a number of direct implications for Swiss financial institutions, depending on their business models. Some concrete examples of such impacts for firms without a physical presence in an EU member state include:<sup>1</sup>

Topic	Key impacts on Swiss financial institutions
<b>Disclosure Regulation</b> Adopted in December 2019; applicable from March 2021	<b>Banks</b> Swiss banks that provide investment advice or portfolio management services to EU-domiciled clients on a cross-border basis may not have a direct regulatory obligation to disclose information to their clients. The existence of the Lugano and the Rome I conventions, however, mean that firms will need to analyze the potential impacts on their litigation risks of not disclosing such information when servicing EU clients on a cross-border basis.  <b>Asset managers</b> Most of the disclosures relate to the investment decision process, which will impact Swiss asset managers of EU investment funds. Although the actual obligation will rest with the EU management company or Alternative Investment Fund Manager (AIFM), Swiss asset managers will likely need to provide the information underlying the disclosures.  Further, disclosures regarding the integration of sustainability risk into remuneration will need to be reflected in firms' remuneration policies, thereby also indirectly impacting Swiss managers of EU funds/portfolios.
<b>EU Taxonomy</b> Political compromise reached in December 2019; projected entry into force over a multi-year period starting at the end of 2021	The taxonomy is a framework that will ultimately develop into a collection of recognized definitions of what constitutes a sustainable investment. Over time, existing firm-specific classification systems may be replaced with the taxonomy to retain credibility.  The taxonomy will be directly applicable to Swiss asset managers managing EU-domiciled funds that are marketed as sustainable. Other Swiss firms may come under pressure to adopt the taxonomy if their products are to remain credible in the market.
<b>Integration of ESG preferences into suitability (amendment to MiFID II)</b> Entry into force not yet clear but potentially in the 2 <sup>nd</sup> half of next year	The amendments require that firms providing portfolio management or investment advice inquire about clients' ESG preferences as part of the suitability assessment.  Firms providing portfolio management or investment advice to EU clients on a cross-border basis may need to consider the requirements in order to mitigate litigation risk.
<b>Sustainable Benchmark Regulation (amendment to the existing Benchmark Regulation)</b> In force	Applying predominantly to benchmark providers, the regulation provides minimum standards for the EU climate transition benchmark and EU Paris-aligned benchmark to avoid greenwashing. The new types of benchmarks may represent opportunities for new sustainable products for Swiss firms as users of sustainable benchmarks.

<sup>1</sup> Generally, Swiss firms with an authorized subsidiary in an EU member state, or firms benefitting from certain market access regimes such as the German "Freistellung von der Bewilligungspflicht", will likely be directly in scope of the requirements.

## Conclusion

Once the dust around the COVID-19 crisis has settled, navigating the regulatory changes related to sustainable finance will again be a business imperative for the leadership of financial service providers. For Swiss firms, the regulatory environment in Switzerland and the EU will be the most relevant. As the EU appears to be moving more quickly, it is anticipated that EU standards will serve as an important benchmark for Swiss firms, and might in some cases apply directly.

It is clear that sustainability, and sustainable finance more broadly, should not and cannot be purely a compliance exercise. Firms that do not approach the topic from a strategic perspective risk burdening themselves with costs while missing out on the many potential opportunities. Now is therefore an opportune time to understand the strategic implications, and to prepare for the impacts on key processes, product and service offerings, risk management and communications/reporting in advance of what is now considered 'voluntary' becoming the minimum standard.





#### **About PUBLICA**

The Swiss Federal Pension Fund PUBLICA is an independent pension institution established under public law. It is organized as a collective institution that currently comprises 20 pension plans. PUBLICA serves around 65,000 active members and 42,000 pension recipients. With total assets in excess of CHF40 billion, it is one of the largest pension funds in Switzerland.

#### **About Dr. Stefan Beiner**

Stefan Beiner has worked for PUBLICA since 2008, initially as a portfolio manager and subsequently as Deputy Head of Asset Management. He was previously a project manager in McKinsey & Company's Corporate Finance unit. Stefan is currently a lecturer in finance at the University of St. Gallen and, since 1 January 2014, is deputy CEO of PUBLICA.

#### **About Patrick Uelfeti**

Patrick Uelfeti is Head of Portfolio Management and deputy CIO of PUBLICA. His responsibilities include portfolio management, the selection and monitoring of external managers, and the development and implementation of the investment strategy. Prior to joining PUBLICA Asset Management in 2010, Patrick held various senior positions in research at Clariden Leu.

# Sustainability versus returns – a balancing act



PUBLICA is responsible for safeguarding adequate returns to finance members' pensions well into the future. The organization is an active voice on the sustainable investment landscape and is working to embed a sustainability approach across its asset classes. Dr. Stefan Beiner and Patrick Uelfeti discuss PUBLICA's sustainability journey, the challenges involved in striking the right balance, and their plans for more transparent climate-related reporting.

**Interview by Erich Meier, Partner, Audit and Patrick Schmucki, Senior Manager, Financial Services**

PUBLICA already incorporated sustainability aspects into its investments a decade ago. How does the approach back then compare to today's standard?

**Stefan Beiner** Ten years ago, we relied heavily on index providers to decide which companies to invest in. Our approach was to diversify as widely as possible. At that time, we very rarely excluded a particular company from our investment universe. In Switzerland, we were also exercising our shareholder rights and including sustainability aspects in our real estate investments. We were certainly doing more behind the scenes than we communicated publicly.

Awareness of sustainability has increased in recent years. Today, we seek to justify every investment we make. Quantifying some factors that have the potential to affect our portfolio is difficult, however. That's why we run an ESG risk analysis process every year. The starting point is 30 to 40 risks in areas such as

water shortages, cyber risk, migratory streams, and climate change. We then analyze and work on the topics that emerge as particularly relevant to our portfolio. Our focus is on the aspects which could impact the risk-return profile. If a given factor could generate a significant negative impact, we have to reduce the exposure to that factor.

Looking ahead, what is PUBLICA's sustainability vision and how far are you on your journey?

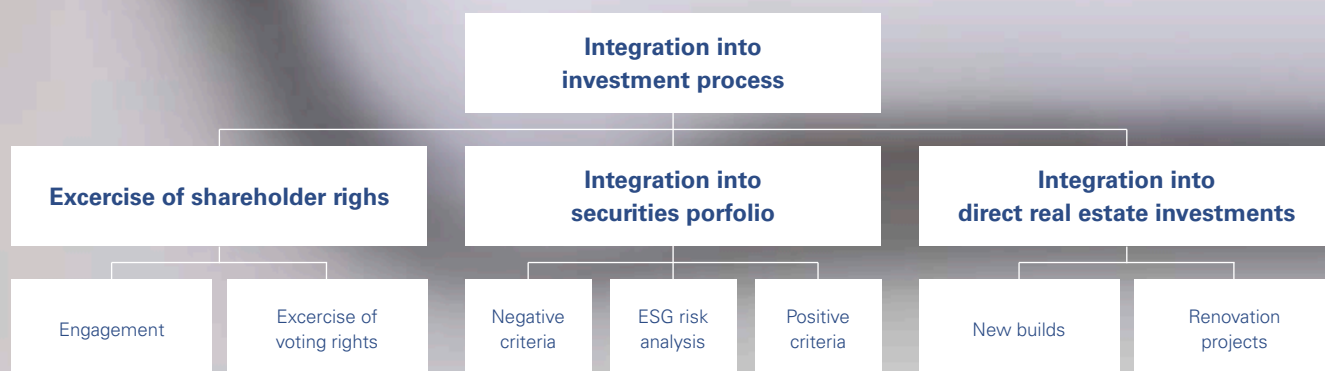
**Patrick Uelfeti** In terms of vision, we would ideally like to cover all asset classes. We have started with the most straightforward ones – shares and corporate bonds. Real estate is next on our list and we have already done quite a bit in this area in Switzerland. Standardized reporting on our activities is something else we are aiming for. Unfortunately, there is no common reporting standard available at the moment that covers all asset classes.

**Stefan Beiner** Our direction is clear: Based on our four major principles [see below], we defined our sustainability strategy to include three main pillars and seven sub-pillars. Our task now is to implement the concept step by step.

### **PUBLICA's sustainability approach**

PUBLICA's sustainability approach is defined within its responsible investment concept and is based on the following four principles:

- 1 It is formulated in a holistic fashion so that, as far as possible, all asset classes can be taken into account.
- 2 It is integrated into, and thus forms part of, the investment process.
- 3 It is based on criteria that are as objective as possible.
- 4 It is transparent and comprehensible.



Source: PUBLICA



## Why is it important to you to make such significant changes?

**Stefan Beiner** Up until about seven years ago, many people still had the mindset that sustainable investments cost more, without a related benefit. And that if this were the case, we shouldn't do it. Then there was a realization that it can actually have a positive effect on the risk-return profile. Today, sustainable investment has become an integral part of portfolio management.

**Patrick Uelfeti** We see it as part of our fiduciary duty. The question really needs to be whether there are good reasons not to do it. We have so much more information at our disposal today than in the past that we can incorporate into the definition and implementation of our investment strategy.

## What are the cornerstones of how PUBLICA implements its sustainability approach?

**Patrick Uelfeti** One major cornerstone for us is a commitment to exercising our ownership rights to the extent possible. This means actively exercising our voting

rights in Switzerland and engaging in dialogue with the companies in which we invest. We've been doing both in Switzerland for more than ten years. As co-founders of the Swiss Association for Responsible Investments (SVVK - ASIR), our international focus is on dialogue with companies abroad and on excluding certain companies from our investment universe under certain circumstances. We're also working on ways to exercise our voting rights abroad for certain companies starting the next few weeks. We have also developed a strategy for real estate investments in Switzerland which is being implemented as part of each individual property strategy across our portfolio. Fortunately, the properties in our portfolio are comparably young, so the standard is already very high.

PUBLICA is also licensing a new climate-efficient equity index that was developed in close collaboration with MSCI. The index takes into account a number of climate-relevant attributes for each company. This diversifies the various models used to assess the opportunities and risks associated with climate change, making the index overall less susceptible to errors in individual models and their assumptions.



Stefan Beiner, PUBLICA





Erich Meier, KPMG



Patrick Schmucki, KPMG

### Have national or international developments helped inform this implementation?

**Patrick Uelfeti** PUBLICA has gained a lot from exchanges with large pension funds abroad that are further along on their journeys. Scandinavia and the Netherlands are particularly relevant in this context. At the national level, we are actively involved in exchanges on various platforms, including some that are organized by the federal government. And, of course, we engage in dialogue with other institutional investors.

**Stefan Beiner** Regulatory developments abroad, especially within the EU, have supported our initiatives indirectly. However, I don't think we have done anything so far purely because it was required by a regulator. Ultimately, a deciding factor was that there could be financial risks that could negatively impact our portfolio if we do not proactively address them.

### To what extent are you able to quantify your sustainability goals and success?

**Stefan Beiner** Some success factors are easier to quantify than others. If you look at our sustainability approach, we have various ways that we implement it in practice. One example is exercising shareholder rights. It's not easy to say how a vote at the Annual General Meeting ultimately affects our return on investment though. As mentioned, we do also exclude certain companies. In that case, measuring the effect

on our overall performance is quite easy. Looking at the last two years the performance impact from our exclusion policy was positive. Our new equity index will enable us to regularly analyze the performance impact and whether we really reached the goal of improving climate efficiency by 50 percent. In addition, we are currently increasing the use of certain metrics within real estate; for instance we are currently developing a reduction path for the volume of CO2 emissions per square meter.

**Patrick Uelfeti** If you break ESG down into E, S and G, I would say that we can measure E best. S and G relate primarily to issues that we are exploring through dialogue with companies. They are not easily measured, nor is it straightforward to specify what success we achieved.

### What are your experiences regarding the performance impact of incorporating sustainability risks into your portfolio?

**Stefan Beiner** Excluding certain companies has led to a slight increase in return. Of the 8,000 to 9,000 companies, we exclude around 40; therefore, the impact is quite small.

**Patrick Uelfeti** When we first discussed this, it was important to us to highlight that our approach would incur certain setup costs. One example of a significant cost driver is access to relevant data to improve our risk management process. We never used the argument that our approach would boost returns.



**“I don’t think we have done anything so far purely because it was required by a regulator.**

**Ultimately, a deciding factor was that there could be financial risks that could negatively impact our portfolio if we do not proactively address them.”**

That would have been a promise we couldn’t keep. What we can say, however, is that our investments do not damage the risk-return profile according to the indicators available to us. Whether returns will actually improve is a hypothesis that we can only test retrospectively. Robust statements can only be made once we have observed an entire investment cycle. The last cycles tended to be longer and flatter. It’s not unusual for a cycle to last 15 or 20 years.

**How do you typically keep your stakeholders informed, for instance through reporting?**

**Stefan Beiner** We have been committed for a few years now to being as transparent as possible. It’s especially important for us because our members don’t really have a choice about investing with us. We communicate through our website, the annual report and our client magazine. We’re becoming better and clearer in how we present information. In the future, we need to consider how to show our impact on the 17 Sustainable Development Goals.

**Patrick Uelfeti** The next big step is publishing specific climate-related reporting. In 2020, we intend to publish our first report with figures as of the end of 2019. The Task Force on Climate-related Financial Disclosures initiative helps guide us in this regard.

**To conclude, could you please choose one of the options to complete each statement below and briefly explain your choice.**

Sustainability is mainly the responsibility of  
1) investors or  
2) companies?

**Stefan Beiner** Neither. As we see it, consumers are primarily responsible. But of course all stakeholders take a share in responsibility.

Deviations from benchmarks are

- 1) taken into account without limits through a refusal to invest in non-sustainable targets or
- 2) limited, even if that means investing in non-compliant companies?

**Patrick Uelfeti** We look to limit benchmark deviations because we take a holistic view of responsibility. This is something we do through dialogue. As exclusion just shifts the problem to someone else, we exclude companies only if we feel that there’s not much to discuss from a product perspective, e.g. in the case of banned weapons.

**For pension funds, sustainability is more important for**

- 1) investment (asset side of the balance sheet) or
- 2) contributions and benefits (liability side of the balance sheet)?

**Stefan Beiner** The second option is more important given the nature of what we do. PUBLICA is already quite sustainable given that we use technical parameters that are targeted reasonably fairly for the different generations.

**Implementation of a sustainable investment strategy should be**

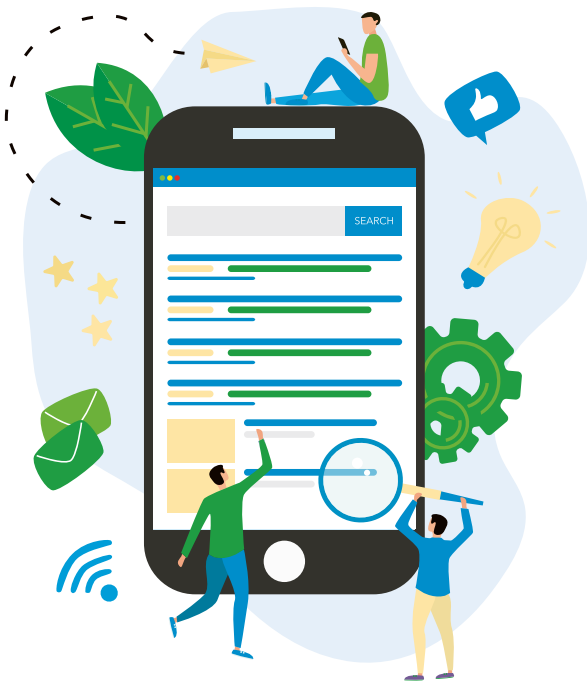
- 1) voluntary or
- 2) required by the state, otherwise not enough investors would get on board?

**Stefan Beiner** In principle I believe in a voluntary approach. A certain level of regulation or standardization in terms of reporting could be helpful though.



# The voice of the next generation

By Patrick Schmucki,  
Senior Manager, Financial Services



**Millennials (born between 1981 and 1996) and Generation Z (1997 to 2016) are widely reported as displaying very different consumer behaviors to previous generations.**

**To explore whether they are more conscious of ESG when investing, we spoke to a group of our younger colleagues.**

Our working group identified transparency as by far the most important topic. While they are willing to put in extra time to make an informed decision, they want to see all relevant information on one page, with the option of drilling down. Simplicity in the form of recognized labels or visual aids, and comparability across products and providers, are paramount.

There was a broad consensus that institutions are not trustworthy if they do not live up to the standards they promote. The quality of regulation and a firm's independence from conflicts of interests arising from harmful business interests play a significant role in reputation.

Regarding the trade-off between risk and return, our colleagues were unanimous:

They do not feel it is plausible and therefore do not wish to miss out on performance for the benefit of sustainability. However, some said they would be willing to bear higher charges for products that generate genuine and measurable impact for good.

Finally, we asked the group to design the sustainable financial product of their dreams. All ideas shared a number of common features:

- App-based products that can be operated from a smartphone;
- An entirely app-based client journey with no human interaction, from client onboarding, investing/trading, reporting to account closing;
- A quick, visually enhanced investment performance and sustainability rating in the portfolio overview. More detailed information to be available using a drill down function for each investment or issuer;
- For explicitly sustainable products, access to performance indicators that measure achieved impact as well as success stories;
- A tool to create an investor profile based on the concept of a smartmap or spider diagram known from Swiss federal elections (smartvote). Investors would be matched with an investment product that best fits their profile.

Throughout the discussions, there was a clear link between sustainable finance and digitalization. In other words, firms that wish to attract the clients of tomorrow will need to upscale their efforts in both areas.



The members of our working group attach great importance to transparency and credibility. Here are some of their quotes:



Our KPMG working group

### Transparency

- I would rather not have to deal with a flood of information and read through reams and reams of paper. Instead, my bank should provide brief and concise information that is of significance.
- The data on my investments should be made available electronically in an easy and intuitive way – ideally with an app. If I wish to know more about the investment, I would like to be able to find all the necessary information in one place.
- I want to understand where my invested money is going, what impact it has, how this impact is measured, and how the companies I have invested in are selected.

### Reputation and trustworthiness

- It is important to me that financial service providers do not engage in greenwashing. Instead, they should support sustainable finance holistically themselves and dedicate their entire corporate culture and business activities to sustainability.
- Credibility could also mean that clients who couldn't care less about sustainability will not be accepted.
- I find it difficult to trust banks with sustainable investments that are being controlled by the state fund of some oil-producing nation.
- Banks should assume responsibility if they wish to offer sustainable investments. I shouldn't have to check this.

### Risk and returns

- I would agree to pay higher costs if a product has a track record of being sustainable.
- Investing money is not the same as buying consumer goods. I want to have sufficient information at my fingertips before I invest.
- Any investor should be able to understand what he or she is investing in. To me, this also means skipping financial products that have a complex structure.

### Regulation

- Pension funds should be subject to more restrictions when it comes to investing in non-sustainable companies.
- A standard that defines what sustainability is, or a sustainability label, would help in picking the right product.
- My client relationship manager should be required to have sufficient knowledge to be able to advise me on the topic of sustainable finance.

# Capital as a force for good

Interview by Patrick Schmucki,  
Senior Manager, Financial Services

According to the Swiss Sustainable Investment Market Study 2019, impact investing remains a niche sustainable investment approach, representing only two percent of sustainable assets in Switzerland. While this may be a low volume, it is high in social impact and is a role model for what investors expect of sustainable investment products: making a positive impact while earning money.

We met Florian Kemmerich, Managing Partner of Bamboo Capital Partners, to discuss what impact investors do and what drives them. He argues that the pursuit of social and financial returns need not be a contradiction.

## What is impact investing?

Investments intended to generate a measurable, beneficial social and environmental impact alongside a financial return. Impact investments can be made in both emerging and developed markets, and target a range of returns from below-market to above-market rates, depending upon the circumstances.

Definition by  
Swiss Sustainable Finance



### About Florian Kemmerich

Florian is Managing Partner at Bamboo Capital Partners. His personal leitmotif is: "Impact Lives, Share Profits." Florian supports society and the economy by sharing his extensive background on fundraising, transactions and business transformations to invest in and build purposeful organizations. He is passionate about impact investing to help solve the world's challenges on poverty uplift, wealth distribution, economic inclusion, global warming, food security and mass migration mitigation.

### About Bamboo Capital Partners

Bamboo Capital Partners is an impact investing platform founded in 2007 by Jean-Philippe de Schrevel, which provides innovative financing solutions to catalyze lasting impact. Bamboo bridges the gap between seed and growth stage funding through a full suite of finance options – from debt to equity – which it activates unilaterally or through strategic partnerships. Bamboo aims to generate lasting impact and improve the lives of the world's most marginalized communities while delivering strong financial returns. Since its inception, Bamboo has raised over USD400 million for developing countries, positively impacting over 184 million lives and supported over 45,000 jobs, including 15,900 jobs for women, through its investments in over 30 countries. The firm has a team of 30 professionals who are active across Europe, Latin America, Africa and Asia.

### What is your understanding of impact investing?

The concept of impact investing has become very fashionable but people often use the term wrongly when they mean ESG or sustainable investing. Impact investing today is about using capital as a force for good. It's about investing for profit in companies that address and resolve the major social or environmental issues of the world. Another aspect is scale. Your capital helps the investee to grow significantly, thereby increasing the scale of the impact. The other difference is the way we report to our investors. Besides financial returns, which our investors are of course interested in, we also measure impact.

I'd say that for us impact investing is using capital to generate positive impact at scale, together with financial returns. Positive impact can be poverty reduction, improved food security, better livelihoods, and a fair chance to participate in the real economy.

### How does Bamboo Capital set itself apart from other players in impact investing?

Our sweet spot is the rural population in emerging markets, and we're investing in companies which service that population affordably. We aim to support commercial companies that benefit the low-income population to resolve access to, and the affordability of, basic goods and services. These typically include access to money for financial inclusion or credit, energy, healthcare, education and affordable housing. We also empower the population to be productive, mainly through investment in agriculture. We have invested in over 30 countries and we invest in emerging or frontier markets, the least developed countries in Africa, Asia and Latin America.





Our investors are roughly one-third family offices, one-third pension funds, and one-third fund of funds. But this has changed in the last three years as we have pivoted from our own funds – fully set up and run by Bamboo – to an impact investing platform where we partner with other large institutions. With the new structure of funds we have catalytic first-loss capital in the funds protecting the senior investors. Therefore, the yield of these funds is adjusted. So the money is less expensive and doesn't target such high returns because it's protected. It still offers attractive returns for private for-profit investors. But we are able to go into areas where others cannot invest. Within private debt, we focus on the so-called missing middle, that area beyond microfinance and below where the banks lend. We do early stage investments. A lot of our money goes into tech: fintech, clean tech, agritech, medtech, health tech. We target those technologies that enable access to essential services for underserved populations. Investing in these solutions is even more vital today, as they can play a significant role in helping developing countries respond to, and recover from, the COVID-19 crisis. We strongly believe that impact investing will contribute to the building of more resilient societies that are better prepared for future crises.

### How have investor attitudes changed in recent years and how does Bamboo Capital address these shifts?

The pattern we've all come to expect is that as risk increases, investors seek higher returns. Investors doing venture capital want to see 20 percent or even 30 percent IRR. They hope there'll be a massive IPO that makes the fund pay off. This doesn't work where we operate. You might occasionally have an IPO, but you certainly cannot count on it. The result is a perception of higher risk for an investor but not higher returns. Another issue is ticket size. Impact investing is about taking risk and going in early. So you can, by the very nature of what we do, invest only a small amount of money. You can't put 50 million into a growing company and then claim that this is impact investing. Some do, but we don't believe this to be impactful in the way we define it. To really lift people out of poverty and to support SMEs as the backbone of a nation's wealth and as its main job creators

we have to go in early. Traditionally, that has been difficult because institutional investors want to put in large tickets. You need a lot of people to run a large fund with lots of small tickets, to deploy the capital. Naturally, costs are then higher as it's more expensive to invest and manage the money. That's how things were done in the past and sums up the difficulty of our investment model from an old-world perspective. We weren't able to offer a high IRR doing small tickets because the risk-reward was not there.

This has all changed with our new funds, where we have a layer of protection in the form of catalytic first-loss capital. Here, investors actively want to be catalytic. They're deliberately putting in one dollar and raising up to four dollars privately on top to do investments. It's very interesting. The first-loss investors are keen to invest in opportunities that drive progress towards the Sustainable Development Goals (SDGs) and have data to measure their impact. Of course they want the financial returns but they also want to see that their investments are actually resolving problems. They're asking: What does my money actually do? In the current context, SDG-aligned investments also means solutions that will help limit the backslide effects of the COVID-19 crisis on poverty, food security, or gender equality.

### How do you find the right balance between the traditional financial measures and the impact indicators that people want to see?

In the past, impact investors were stuck between two worlds. You had the financial investors who were purely interested in the money aspect. For them, we were akin to tree huggers. They'd say "you say you do money, but really you want to do social good." On the other side, you had the philanthropists, and they'd be looking at us, saying "you say you do social good, but you are just sharks in disguise." Then the discussion took a different turn and people acknowledged that there is no tradeoff – you can make the same returns with impact investing as when you focus purely on money. Today, there's an understanding that investments come with a risk-reward profile. If you invest in emerging markets and go rural, the risk profile is higher than when doing impact investing in Europe or in the US. But ultimately, you invest capital as a force for good.



### What opportunities will emerge over the next few years?

As we write these lines, the COVID-19 outbreak has demonstrated that we live in an interdependent world. The poorest countries will most likely be hit hardest in terms of the crisis's socio-economic effects, and this could have a knock-on effect for the rest of the world. The development challenges that existed before the crisis are now even more acute. For instance, global poverty could increase for the first time in three decades. Not all of these challenges can be addressed through impact investing of course, but we believe that the impact investing industry has a historic opportunity to help developing economies address and recover from the crisis, especially by investing in SMEs that provide solutions to increase access to essential products or services. The crisis is also showing that businesses integrating technology in the core of their service or delivery models, such as telemedicine, fintech, or remotely monitored off-grid energy systems, are best positioned to weather this storm and future disruptions. But what I find intriguing is the combination of not-for-profit capital, the grant giving sector, philanthropy, philanthropic impact investing, and for-profit impact investing. New structures where you align the same mission, the same theory of change.

### Assuming the momentum holds, ever more money will flow into impact investing. Will you need new structures to achieve the same impact?

Definitely, yes. My understanding is that impact investing is becoming mainstream due to the fourth industrial revolution. It's the data revolution we're living in, which means connectivity. Take millennials for example. They get their financial information online, through social media, through connectivity. When you have that information, your awareness is different than in the old days where you had some local news on TV but not necessarily access to what was happening globally. In this case technology is a blessing because the

data and connectivity makes measurements possible but also inexpensive and easy. I also think we'll see more from the trends in crypto currencies and blockchain technology for digital ledger and smart contracts. The second aspect is that the old poles of philanthropic money and pure financial investment are now changing because of the connectivity and information flow. Nowadays, you can have a major impact even with just a small amount of money. The downside to that is that storytelling becomes more important than real facts in today's world. That is a risk with impact investing. I think impact investing was particularly successful initially because of the rigorous way of measuring what was happening on the ground and reporting it, rather than just storytelling. On the philanthropic side, it's more about emotions, the storytelling around poverty, tugging at people's heartstrings to get donations. But this is not what we do in impact investing. Because of the connectivity and post-truth era we're in as part of the fourth industrial revolution, there are real risks.

### A number of impact investors are based in Switzerland. What do you think are the opportunities for Switzerland as a domicile for impact investors?

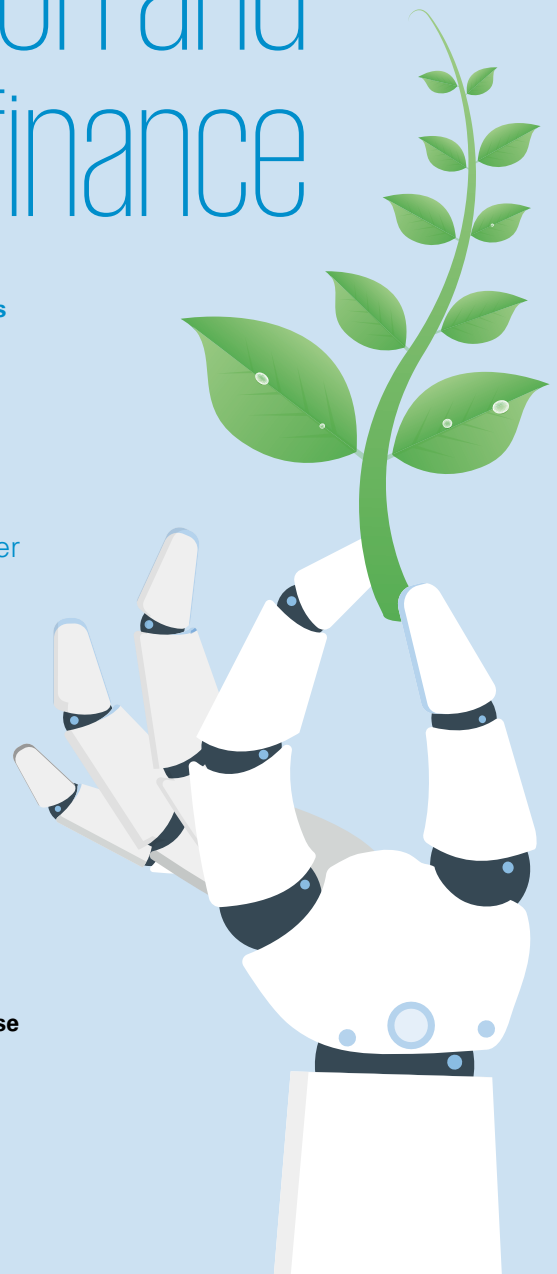
In the past it was a niche market. In Switzerland you had the private banks and then the UN so it made sense for us to be in Geneva. You also had the big asset managers, all the hedge funds or their trading platforms. And until now none of them were talking to each other – they operated in completely different silos. Today we're seeing an incredible opportunity as different forms of capital start collaborating with the same purpose: to be profitable and resolve issues in the world. In this context, Switzerland, with its mix of large private banks, asset managers, insurance companies, pension funds and international organizations, is a prime location as these silos break down and the different players begin to collaborate.

# Removing barriers: digitalization and sustainable finance

By Oliver Oehri, Founding Partner  
CSSP – Center of Social and Sustainable Products

Digitalization plays an increasingly important role in various aspects of our work and lives. This includes a growing number of digital tools and platforms aimed at environmental and social concerns. The effect is to reduce or remove barriers to greater money flows into sustainability initiatives. But which technologies are of particular use in this regard, and how are they being applied?

**It is estimated that an additional USD1 trillion in clean energy investments is needed annually to limit global warming to below 2°C, and USD5 trillion a year to achieve the SDGs.<sup>1</sup> Amid widespread acknowledgement that a boost in private sector financing is necessary to achieve these goals, digitalization is moving to the fore as a facilitator and connector between investors and sustainable finance.**



## About CSSP

CSSP is an independent provider of standard and customized ESG and carbon investment reporting and controlling solutions. CSSP helps to assess and better understand the ESG and climate-related risks and opportunities in investments providing a range of reporting and advisory services. yourSRI forms part of CSSP and is the leading database and research engine for ESG and carbon reporting, monitoring and controlling.

At KPMG, we combine our deep experience in process design, financial risk management and regulatory assessments with yourSRI's data and reporting capabilities. This allows us to offer our clients an end-to-end approach to define and implement a successful ESG strategy.





### Barriers to mobilizing greater sustainable finance

Significant barriers exist in various forms. The G20 Green Finance Study Group<sup>2</sup> highlighted an inadequate internalization of environmental externalities; maturity mismatches; lack of clarity of sustainable finance definitions; information asymmetries; and a lack of adequate analytical capabilities by financial institutions to understand the opportunities and financial risks associated with sustainable investments.

The question is how these barriers can be overcome. Digital finance is part of the answer. Making information available more cheaply, more quickly and more accurately helps to inform better financial decision-making. Digital tools can also promote financial inclusion and further unlock innovation.

### The technologies and players promoting digital finance

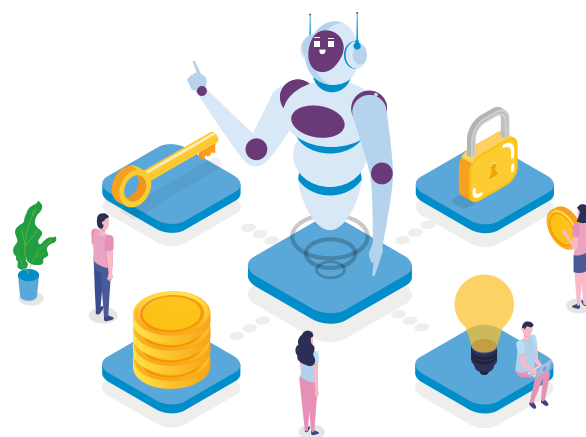
Key technologies include big data, machine learning and artificial intelligence (MLAI), mobile technology, web-based financing applications such as peer-to-peer platforms and investment crowdfunding platforms, distributed ledger technology (DLT), blockchain, and the Internet of Things (IoT).

A number of international alliances and programs are considering how such technologies can be best applied in order to develop sustainable financial management:

- The **G20 Sustainable Finance Study Group** is exploring how to apply digital finance to sustainable finance across capital markets, private equity and venture capital;
- The **Financial Centres for Sustainability (FC4S)** is a network of over 20 financial centers that share a mission to exchange experiences and take common actions to accelerate the expansion of green and sustainable finance;
- the **International Finance Corporation's (IFC) Global Innovative Retail Payments Program** aims to increase access to banking services through developing innovative and sustainable retail payments services as a point of entry for low income populations;
- The **UN Secretary-General** has mandated the establishment of a Task Force on Digital Finance for the SDGs;
- The **Sustainable Digital Finance Alliance** is a Swiss-based public-private partnership, co-founded by UN Environment and ANT Financial Services to harness the power of digital finance for sustainable development.

<sup>1</sup> The money is there to fight climate change, World Economic Forum, 2017

<sup>2</sup> G20 Green Finance Synthesis Report, 2016



## Applying technologies to digital finance in practice

The possibilities are wide-ranging. One of the latest and most comprehensive UN studies<sup>3</sup> on the topic has developed a method of classifying digital finance applications in the field of sustainable finance. The authors identified four areas where innovation can help:

### Green financial decision-making

Digital finance can leverage big data and MLAI technologies to 'green' investment decision-making. This enables data to be made available more cheaply, quickly and accurately. In turn, allowing improved pricing of environmental risks and opportunities, while also reducing transaction costs such as the cost of searching for information.

**Example:** yourSRI enables asset managers and investors to create ESG and climate investment ratings, investment KPIs and investment reports for mutual funds, exchange traded funds (ETFs) and discretionary investment mandates. The platform screens more than 33,000 mutual funds and ETFs and more than EUR15 trillion AuM on a daily basis. yourSRI works with leading providers of financial data, ESG data and carbon data to automatically determine an investment's ESG score and its carbon footprint. In this way, yourSRI creates transparency over investment decision-making to more easily integrate ESG and carbon considerations. It provides 14 online investor information platforms in Europe as well as providing individualized, fully automated reporting data software for asset managers and public platforms such as fossil-free funds (As You Sow) and Climetrics (Carbon Disclosure Project).

### Incentivizing resource-efficient behaviors

Mobile and online financial services are entry points to incentivizing consumers to make more resource-efficient choices. Growing fintech services in banking infrastructure – including open banking and personal finance – can be deployed for payment, lending and deposit services to support more sustainable online shopping habits, household financial planning and crowd financing in support of circular economy projects.

**Example:** China's Ant Forest mobile application, initiated by Ant Financial Services in association with UN Environment, is the world's first large-scale pilot to green citizens' consumption patterns by using mobile payment platforms, big data and social media. The app uses a three-part approach to encourage people to reduce their carbon footprint: (a) providing individualized carbon savings data to people's smartphones; (b) connecting their virtual identity and status to their consumption of 'green energy' to reduce carbon emissions; and (c) providing carbon offset rewards through a tree planting program.<sup>4</sup> Over the first 16 months from August 2016 to December 2017, 280 million people across China chose to subscribe to this app, resulting in the avoidance of more than two million tons of carbon and the planting of more than 13 million trees.

### Unlocking new sources of finance

Crowdfunding and peer-to-peer platforms provide low-cost ways of reaching millions of users. They increase access to finance, particularly for small and medium-sized enterprises, by facilitating a new pool of bottom-up investors who can directly participate in the financial system. Matchmaking platforms have emerged to unlock new sources of finance, notably

<sup>3</sup> Green digital finance – Mapping current practice and potential in Switzerland and beyond

<sup>4</sup> Scaling Citizen Action on Climate: ANT Financial's Efforts Towards a Digital Finance Solution, 2017



for renewable energy projects. Blockchain and MLAI standardize and improve transparency over due diligence processes, while online technologies reduce the transaction costs involved in bringing together investors and project developers.

**Example:** Greenmatch.ch digitalizes the process of investing in renewable energy. It offers tools to value and assess renewable energy projects, calculate scenarios and manage project proposals on a software-as-a-service basis. This makes it easier for investors to evaluate a project pipeline more rapidly, and reduces the barriers to investing in complex renewable energy projects. It also offers a marketplace that offers projects created in Greenmatch directly to potential buyers.

### Innovating for the SDGs

Switzerland's leadership in cryptocurrency creates an opportunity to become a global green crypto-financial center, with Zug (Crypto Valley) and Chiasso (Cryptopolis) establishing themselves as internationally recognized DLT centers. A broader trend can be seen in tokenizing or digitalizing social and natural assets. Tokenizing presents a form of fractional securitization of a physical asset such as forestry, water and land rights. It can also be something more abstract that does not represent a conventional physical asset, but rather tokenizes a benefit such as renewable energy, carbon mitigation, or health consequences. Tokenizing is therefore emerging as a way to ascribe value to social and natural capital assets. It signals the beginning of a tradeable, fungible asset class listed on a crypto trading platform.

**Example:** SolarCoin, listed on the Swiss Lykke Exchange, where the token represents a reward per 1 MWh of solar electricity produced.

In insurance, blockchain technology through smart contracts could improve the market in catastrophe bonds and swaps by increasing their reliability, auditability and speed. Such contracts transfer the financial risk of a natural disaster from an insurance company to investors (bonds) or another insurer (swaps). Blockchain technology requires less manual processing, authentication and verification through intermediaries to confirm the legitimacy of payments to and from investors. Blockchain-based smart contracts automate the payout process when a triggering 'cat' (catastrophe) event occurs. These benefits would increase liquidity into the 'cat' bond market.<sup>5</sup>

**Example:** In 2018, Swiss private bank Lombard Odier bought its first catastrophe bond using blockchain.

---

## Conclusion

The financial services sector is finally taking sustainable finance seriously. However, financing environmentally sustainable growth will require significantly more investment than before. Digital finance represents an important step towards removing the barriers to sustainable financing. Promising digital financial solutions already exist, with further future-oriented digital financial solutions being continuously developed.

<sup>5</sup> Could blockchain save the planet?; environmental-finance.com, 24 April 2018



# Definition of key terms

Source: Swiss Sustainable Finance

## Carbon Neutral

This occurs when an organisation's net carbon emissions is equal to zero. The process requires measuring total CO<sub>2</sub> emissions, taking active steps to reduce emissions where the company can, and then purchasing CO<sub>2</sub>-certificates to offset CO<sub>2</sub> emissions that cannot be eliminated from a company's operations. The CO<sub>2</sub>-certificates contribute to financing projects reducing CO<sub>2</sub>-emissions (i.e. by replacing fossil power generation with renewable energy projects).

## Corporate Governance / Governance Factors (G of ESG)

Governance factors within ESG criteria in the context of investing refer to the system of policies and practices by which a company is directed and controlled. They include but are not limited to transparency on Board compensation, independence of Boards and shareholder rights.

## Corporate Social Responsibility (CSR) / Corporate Responsibility (CR)

This term refers to the commitment of an organisation, beyond what is required by law, to ensure that the social, economic and environmental impacts of their actions create a net benefit to communities and society. This is founded on the belief that all corporations have a 'duty of care' to all their stakeholders in every area of their business operations and that being a responsible citizen improves the long-term business success of a company.

## Environmental Factors (E of ESG)

Environmental factors within ESG criteria in the context of investing include but are not limited to the environmental footprint of a company or country (e.g. energy consumption, water consumption), environmental governance (e.g. environmental management system based on ISO 14 001) and environmental product stewardship (e.g. cars with low fuel consumption).

## ESG – Environment, Social and Governance

ESG stands for Environmental (e.g. energy consumption, water usage), Social (e.g. talent attraction, supply chain management) and Governance (e.g. remuneration policies, board governance). ESG factors form the basis for the different SI approaches.

## ESG Analysis

This analysis includes collecting information on how an investment target manages environmental, social and governance factors. When an investment institution wishes to track how potential investments (i.e. companies, countries and issuers) actively manage ESG risks and opportunities they carry out an ESG Analysis. There is growing evidence suggesting that companies with a strong performance in managing environmental, social and governance factors manage their risks and opportunities more effectively and have lower costs of capital. ESG factors, when integrated into investment analysis and decision-making, may therefore offer investors better insights into opportunities and risks.

## Fiduciary Duty / Responsibility

In the institutional investment context, trustees of pension funds owe fiduciary duties to beneficiaries to exercise reasonable care, skill and caution in pursuing an overall investment strategy suitable to the purpose of the trust and to act prudently and for a proper purpose. The explicit legal nature of fiduciary duty varies depending on the country of origin. While most institutional investment funds strive to create financial benefits for their beneficiaries, it is also possible for trust deeds explicitly to require trustees to consider ESG factors in investments. Against the backdrop that there is increasing evidence supporting the materiality of ESG issues, some legal experts conclude that it is part of the fiduciary duty of a trustee to consider such opportunities and risks in investment processes.

### **Governance / Corporate Governance Factors (G of ESG)**

Governance factors within ESG criteria in the context of investing refer to the system of policies and practices by which a company is directed and controlled. They include, but are not limited to, transparency on Board compensation, independence of Boards and shareholder rights.

### **Green Investing**

Investment in businesses contributing to sustainable solutions in environmental topics including investments in renewable energy, energy efficiency, clean technology, low-carbon transportation infrastructure, water treatment and resource efficiency.

### **Impact Investing**

Investments intended to generate a measurable, beneficial social and environmental impact alongside a financial return. Impact investments can be made in both emerging and developed markets, and target a range of returns from below-market to above-market rates, depending upon the circumstances.

### **Responsible Investment / Sustainable Investment**

Responsible investment (analogous to sustainable investment) refers to any investment approach, integrating environmental, social and governance factors (ESG) into the selection and management of investments. There are many different forms of responsible investing, such as best-in-class investments, ESG integration, exclusionary screening, thematic investing and impact investing. They are all components of responsible investments and have played a part in its history and evolution.

### **Social Factors (S of ESG)**

Social factors within ESG criteria in the context of investing include, but are not limited to, worker rights, safety, diversity, education, labour relations, supply chain standards, community relations, and human rights.

### **Socially Responsible Investing (SRI)**

Socially Responsible Investing (SRI) is the term previously used for sustainable or responsible investing. SRI had its origin in the Anglo-Saxon investment world, where it originally referred to investments based on exclusionary screening and later to investments with a best-in-class approach and other forms of sustainable investments. Some players still use it as a generic term for sustainable investing.

### **Sustainability Index / Benchmark**

A sustainability index / benchmark is a tool to measure the value of a section of the stock market. It is computed from the prices of stocks selected by applying a sustainable investment approach. Investors use this tool to describe the market and to compare the return on specific investments.

### **Sustainability Ratings**

Ratings reflecting a company's/country's/fund's performance with regards to environmental, social and governance (ESG) factors. Sustainability ratings enable investors to gain a quick overview of the sustainability performance of a company/country/fund and are the basis for a best-in-class investment approach.

### **Sustainability Research Provider / Sustainability Rating Provider**

Organisation providing research and/or ratings on the sustainability performance of companies, issuers, countries or sectors. Most investors and asset managers use such third-party information when preparing sustainable investment products.

### **Sustainable**

Balancing economic, ecological and social goals in such a way that the people living on our planet today can meet their needs without compromising the ability of future generations to meet their own needs.

### **Sustainable Finance**

Sustainable finance refers to any form of financial service integrating environmental, social and governance (ESG) criteria into the business or investment decisions for the lasting benefit of both clients and society at large. Activities that fall under the heading of sustainable finance include but are not limited to the integration of ESG criteria in asset management, sustainable thematic investments, active ownership, impact investing, green bonds, lending with ESG risk assessment and development of the whole financial system in a more sustainable way.

### **Sustainable Investment (SI)**

Sustainable investment (analogous to responsible investment) refers to any investment approach integrating environmental, social and governance factors (ESG) into the selection and management of investments. There are many different approaches of sustainable investing, including best-in-class, ESG integration, exclusions and impact investing.

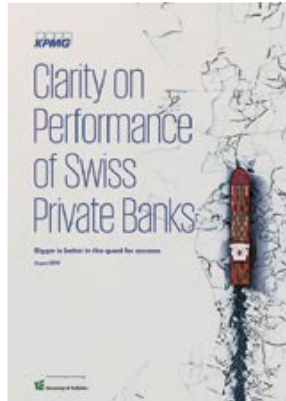
# "Clarity on" publications

This series of publications from KPMG Switzerland provides insights, analyses and studies on a range of topics. All publications are available online. For more information, please contact [kpmgpublications@kpmg.com](mailto:kpmgpublications@kpmg.com)

## Latest issues



Clarity on **Mergers & Acquisitions**



Clarity on **Performance of Swiss Private Banks**



Clarity on **Financial Crime in Banking**



Clarity on **Business Reporting**



Clarity on **KPMG Switzerland**

➞ **Clarity on**  
[kpmg.ch/clarity-on](https://kpmg.ch/clarity-on)

## KPMG Voice

Thought Leadership and insights on regional and global business issues from KPMG Switzerland's subject matter experts.

➞ [kpmg.ch/voice](https://kpmg.ch/voice)



For further information on  
**Clarity on Sustainable Finance**,  
please contact:

**Pascal Sprenger**

Partner, Financial Services  
+41 58 249 42 23  
psprenger@kpmg.com

**Patrick Schmucki**

Senior Manager, Financial Services  
Corporate Responsibility Officer  
+41 58 249 27 35  
pschmucki@kpmg.com

**Publisher**

KPMG AG  
Räffelstrasse 28  
PO Box  
CH-8036 Zurich

T +41 58 249 31 31  
kpmgpublications@kpmg.ch

**Authors**

Pascal Sprenger, KPMG AG  
Patrick Schmucki, KPMG AG  
Louise Tastet, KPMG AG  
Bruno Beca, KPMG AG  
Celine Vayenas, KPMG AG  
Yannick Zwinselman, KPMG AG  
Oliver Oehri, CSSP

**Contributors**

David Bertschi, KPMG  
Lisa Wohlmann, KPMG

**Concept, Design and Editing**

Sabine Lorencez, KPMG AG

Jan van Beusekom, van Beusekom  
design & brand solutions

Stuart Garforth, outhouse communication

We thank Lombard Odier, PUBLICA and Bamboo Capital Partners for sharing their valuable insights and experiences in the field of sustainable finance with us, and the 7 firms who kindly participated in qualitative interviews to support our desktop research.

**Articles may only be republished by written permission of the publisher and quoting the source "KPMG's Clarity on Sustainable Finance".**

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received, or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation. The scope of any potential collaboration with audit clients is defined by regulatory requirements governing auditor independence. If you would like to know more about how KPMG AG processes personal data, please read our Privacy Policy, which you can find on our homepage at [www.kpmg.ch](http://www.kpmg.ch).

© 2020 KPMG AG is a subsidiary of KPMG Holding AG, which is a member of the KPMG network of independent firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss legal entity. All rights reserved



