KPMG

ESG Regulatory Essentials Switzerland

03/2024

The second instalment of our ESG Regulatory Essentials Switzerland sheds light on the most recent publication by FINMA regarding nature-related financial risks and the new Ordinance on Climate Protection released for consultation by the Federal Council.

Transparency

Non-financial Reporting based on the Code of Obligations

Public interest companies that meet certain size thresholds (more than 500 FTEs and either CHF 20m balance sheet or CHF 40m sales revenue) are required to disclose non-financial information such as environmental concerns, social & labor concerns, respect for human rights and anti-corruption measures. It is worth noting that for financial institutions, the FTE threshold is often the deciding factor on whether a report is mandatory or not.

These amendments to the Code of Obligations have entered into force on 1 January 2022, the first non-financial report for in-scope companies must be published for the FY 2023.

Ordinance on Climate Reporting

The Federal Council has already specified through the Ordinance on Climate reporting that for climate-related issues, the industry is advised to use the well-known and internationally recognized TCFD standards (taskforce on climate-related financial disclosures) to fulfil their non-financial reporting obligation on climate concerns (part of the environmental concerns of the general non-financial reporting obligation based on the Code of Obligations). Regardless of the standard used, the report has to take a double-materiality view. The size thresholds of the Code of Obligations non-financial reporting obligation apply. The Ordinance has entered into force on 1 January 2024, the first TCFD-based report will have to be published on the FY 2024. The report on climate matters will have to be published in a machine-readable, internationally accepted standard from FY 2025 onwards.

Future Amendments to Swiss Non-financial Reporting

The Federal Council is currently debating if the size threshold for FTEs should be lowered from 500 to 250 to align with European regulation (e.g. CSRD). Additionally, the introduction of a mandatory audit of the report is also on the table. The possible timeline for these changes is currently still open.

Child Labor Due Diligence based on the Code of Obligations

Similarly, the Code of Obligations also puts forward due diligence obligations regarding minerals and metals from conflict areas as well as child labor. For financial institutions, the latter being of more interest. Companies had to finalize their assessment regarding child labor risk in their supply chain by the beginning of 2023, the first report (if one is needed) is due for the FY 2023. If none of the exemptions apply (preliminary assessment, risk assessment and assessment of suspicions), the company in question would need to set up a due diligence & transparency framework on child labor. The assessments have to be documented in any case. These requirements apply to all companies with operations in Switzerland but are also subject to size requirements (more than 250 FTEs and either CHF 20m balance sheet or CHF 40m sales revenue).

AMAS Self-regulation for ESG Transparency

The AMAS Self-Regulation for Transparency and Disclosure of ESG Funds has entered into force end of September of this year. Entity-level requirements have already taken effect and now Asset Managers and Manufacturers of Collective Investment Schemes are preparing for product-level

requirements which will become mandatory after end of September 2024.

In scope are members of AMAS only, others may voluntarily join the self-regulation scheme. Products governed by these requirements are those that follow one or several of AMAS' recognized sustainable investment approaches, outlined in the Annex of the self-regulation. The only exemption to this are products that only follow an exclusion or ESG integration approach; these do not qualify as a sustainable product. If a sustainable investment approach is not in the list of AMAS, the product may still qualify as sustainable, but all deviations must be properly explained in the fund documents.

Main challenges with this regulation are its demands towards data provider due diligence and data validation, external communication and marketing as well as bringing together the product-level requirements with the reporting standards for pension assets that have recently been updated to cover sustainability-related key performance indicators. Keep in mind that this self-regulation's future is currently uncertain since the Federal Council is debating whether a government-led solution is necessary.

For more on this subject, refer to our recent blog post "AMAS self-regulation – Lessons learned".

Federal Council's Position on the Prevention of Greenwashing

The Federal Council will decide mid-2024 whether it will adopt a new ordinance and/or build on the existing self-regulations from the industry associations (AMAS, SBA and SVV). It had already laid out its general position in a publication in December 2022. Key points that will need to be reflected in the future anti-greenwashing regulatory landscape are therefore:

- Double materiality: products and services can only qualify as sustainable if they address one or several sustainability targets. Pure (ESG) risk management is regarded as part of the fiduciary duty and therefore mandatory for any discretionary money manager or advisor.
- Sustainability targets: although specific frameworks or targets are unlikely, it will be mandatory to provide transparency on the targets and how they are measured.
- Alignment and contribution: sustainable investment products need to be either aligned with or need to contribute to the defined sustainability target(s).

For more on this subject, refer to our recent blog post "The Federal Council addresses greenwashing – what now?"

AMAS Self-regulation for Environmental Indicators

AMAS has also prescribed two environmental indicators and their calculation methods for all Swiss real estate funds. These indicators will need to be published sometime between the end of 2023 and end of 2024, based on the accounting cut-off of the fund. AMAS has recently released more information regarding the calculation method and the indicators are already widely used in the industry. The requirements based on self-regulations (both from AMAS and SBA) are currently only applicable to members of those associations but give other institutions the option to join voluntarily.

The Swiss Climate Scores as Portfolio Reporting Standards

Besides these transparency-related regulations, we want to point out one non-binding standard which has garnered a lot of popularity in recent years – the Swiss Climate Scores. They provide institutional and private investors in Switzerland with comparable and meaningful information on the extent to which their financial investments are compatible with international climate goals. The Federal Council recommends that Swiss financial market players apply the Swiss Climate Scores to financial investments and client portfolios where appropriate.

Climate & Sustainability Risk

On 1 February 2024, FINMA has published the circular on nature-related financial risks. The draft is based on international standard-setters, such as the Basel Committee on Banking Supervision, the International Association of Insurance Supervisors and the Network for Greening the Financial System.

The proposal will require in-scope banks and insurance companies to systematically integrate nature-related risk considerations into their overall governance structure and risk management. Scenario analysis is envisaged as a core tool to assess materiality of nature-related financial risks and how they may impact the overall risk profile of the institution. As a minimum, in-scope banks and insurance companies should apply a qualitative reasoning to these scenarios. Financial institutions with larger exposures should also include a quantitative assessment. For category 1 and 2 institutions, climate stress testing will also become mandatory.

According to FINMA, specific traditional risks that banks should re-evaluate in light of nature-related factors are credit risk, market risk, liquidity risk, operational risk and reputational risk. For each of those the circular contains more detailed requirements.

Similarly, insurers should focus on their underwriting activities, asset liability management and operational risks including reputational and regulatory risks. Insurers

with significant exposure to nature-related financial risks should also consider this in their Own Risk and Solvency Assessment.

Overall, the draft represents a balanced application of the BCBS Principles for the effective management and supervision of climate-related financial risks (June 2022) and the IAIS Application Paper on the Supervision of Climate-related Risks in the Insurance Sector (May 2021) and as such formalizes many practices that have become a standard in the Swiss market at least regarding climate risk. However, as these topics are much more nascent and require some solid groundwork, the extension of these measures to all nature-related risk represents a significant step for most financial institutions.

The new circular is due to enter into force on 1 January 2025 and will apply to banks and insurance companies (effectively including asset management companies that manage their tied assets), members of the small bank regime and small insurers being exempt. Transitional provisions of one to two years will be provided, depending on the size of the institution, to allow sufficient time to prepare for the more complex requirements such as risk integration or scenario analysis. The consultation is open until 31 March 2024.

Carbon Emissions Reduction

The Federal Council has opened the consultation on the new Ordinance on Climate Protection ("KIV") on 24 January 2024. The Federal Department of the Environment, Transport, Energy and Communications will be in the lead. This new Ordinance will be the implementing regulation for the Federal Act on Climate Protection Goals ("KIG") adopted in 2023.

The Federal Act had already set out a target for the climate-friendly alignment of financial flows. This high-level goal has now been clarified by the Ordinance. For Swiss financial institutions, the Federal Office for the Environment will organize a voluntary climate test at least every two years to determine the current state of alignment with climate goals. The general obligation to develop net-zero plans until 2050 also applies to financial institutions. The KIG has fleshed out the details of these reduction plans for scope 1 and 2 emissions. These plans will have to include calculated emission data, a description of all climate-relevant processes, information on adopted or planned technical solutions for the reduction of greenhouse gas emissions, concrete action plans to achieve the net-zero target as well as greenhouse gas emission reduction pathways with intermediate targets for 2030 and 2040. Lastly, the plan should also incorporate a build-up path for the compensation of greenhouse gas emissions to achieve the net-zero target until 2050.

The inclusion of scope 3 emissions remains voluntary, thus removing the most complex aspects of decarbonization for the financial industry (at least from a strictly legal perspective). The Federal Council has also tasked the Financial Department of Finance to adapt the Ordinance on Climate Reporting to reflect requirements for transition plans for the financial industry in line with the KIG until the end of 2024.

The consultation is open until 1 May 2024.

Investor Protection

FINMA Guidance 05/2021

On the product side FINMA has addressed greenwashing in a guidance released back in 2021. Although the AMAS self-regulation on ESG transparency (mentioned above under Transparency) regulates similar topics, the FINMA guidance is very relevant for all asset managers, due to its official character. FINMA has provided the industry with a number of scenarios which it considers greenwashing. It has also suggested suitable organizational principles for fund managers with ESG products in their portfolio such as sufficient specialist expertise, sound and well documented investment decision making and risk management processes.

SBA's Guidelines on ESG Preferences and ESG risks application starts

The SBA's Guidelines for financial service providers on the integration of ESG-preferences and ESG-risks into investment advice and portfolio management – in short, the SBA Guidelines on ESG integration – cover greenwashing risks at the point of sale. Member institutions of the SBA need to ask their clients for their ESG preferences when engaging in investment advice or portfolio management activities and then reflect those preferences in their services. These guidelines are closely aligned with FINSA and expand on the existing investor protection framework. The self-regulation is already in force and in scope institutions should be prepared to meet the requirements from the beginning of 2024 onwards at the latest.

SBA's Guidelines for Mortgage Providers

Furthermore, the SBA has also set in place guidelines for providers of mortgages to promote energy efficiency. Here, member institutions are mandated to discuss the topic of energy efficiency and what funding options are available with clients. Notably, this only applies to private individuals and when financing an owner-occupied property. The self-regulation is already in force and in scope institutions should be prepared to meet the requirements from the beginning of 2024 onwards at the latest.

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Contact

KPMG AG
Badenerstrasse 172
PO Box
CH-8036 Zurich

kpmg.ch

Patrick Schmucki
Director, Co-Lead FS
Climate & Sustainability,
Financial Services

+41 58 249 27 35
pschmucki@kpmg.com

Owen Matthews
Director, Co-Lead FS
Climate & Sustainability,
Financial Services

+41 58 249 75 28
omatthews@kpmg.com

Alexander Jahn
Senior Consultant,
FS Climate & Sustainability,
Financial Services

+41 58 249 60 27
alexanderjahn@kpmg.com

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