Sustainable finance: a Swiss view

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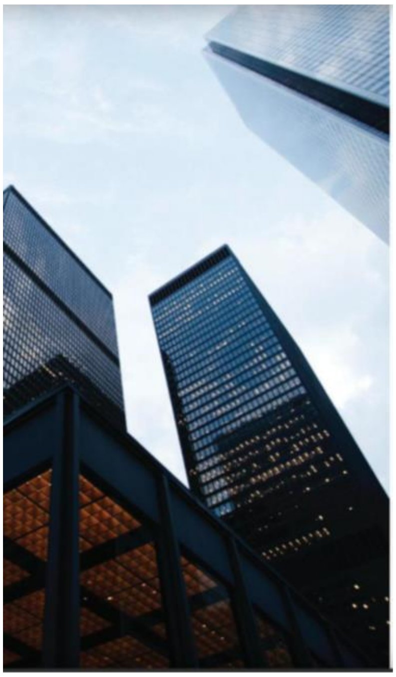
Financial institutions are willing to help investors find out companies with a more sustainable behaviour, whether old ones that are adapting their activities or new ones that are developing better products for our future.



There is something in the expression “sustainable finance” that implies that financial institutions are responsible for making the world sustainable. It is true that the Paris Agreement of 2015 has among its goals to make “finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development”.

This requires a first distinction: financial institutions as such are not a polluting industry, their activities produce little greenhouse gas emissions (e.g. official statistics attribute 0.5% of Swiss emissions to them). What is relevant are the emissions of the companies the securities of which are held by financial institutions.

This leads to a second distinction: most securities held by a bank, asset manager or insurance do not belong to them, but to their clients. A direct influence on which securities to hold can thus only be exercised on the own assets; the others require the clients’ agreement. This is not to say that a financial institution should just wait for their clients’ instructions.

For instance, Swiss private bankers, being themselves quite sustainable with their centuries-long history and philanthropic activities, take it to heart to find out their clients’ preferences with respect to sustainability, to explain to them the advantages and risks of sustainable investments and to report the rating or impact of a given portfolio on climate for instance. This requires training the client relationship managers in sustainability issues and integrating sustainable criteria in the investment processes. Clients will thus be made aware and advised on the possibilities to make their portfolio more sustainable, but in the end the decision belongs to them.

A third distinction must be made between financing and investing. The first consists in raising new funds for a company, be it equity or debt, to develop new projects, which may or may not respect sustainable criteria. Investing on the other hand is just buying securities that already exist: this does not bring the underlying companies more cash, and selling securities only means that someone else, perhaps less sustainability-conscious, is buying them. Thus, one may choose its investments, but that will not make the disliked companies disappear.

It is therefore no surprise that recent stress tests run by regulators show that portfolios on average are geared towards a global warming of 4ºC to 5ºC. This is just a reflection of the global economy. The change has to come from the industry, the agriculture, the energy production, the transportation networks in each country. The financial industry may well draw attention on the financial risks linked to climate change for instance, but it is investors that can force a shift in current practices. States may also forbid or support certain activities; in this sense taxonomies are just a statement of industrial politics.

So, how to find out which companies are sustainable? Traditionally, the only purpose of a company was to maximise profits for its shareholders. It is nowadays acknowledged that a company must care about 3Ps: performance, people and planet. Indeed, taking care of its people and of the planet that provides the resources for its business are common-sense factors of success and sustainability for a company. But it still has to remain profitable, otherwise its good practices will not last for long.

While accounting standards to measure a company's economic performance are well established, standards for the environmental, social and governance (ESG) aspects of its activities are still in their infancy. The most advanced ones relate to climate, given the threat of global warming. To assess a company's sustainable behaviour, the impact of its activities must be published and measured in the same way across all countries, so that reliable comparisons can be made.

In Switzerland, the Federal Council has decided to make it compulsory for large banks, insurance companies and listed companies to publish the effects of their activities on the climate or the environment and the resulting financial risks in accordance with the international standard defined by the Task Force on Climate-related Financial Disclosures (TCFD). The first publication will have to be made by 2024 at the latest and will cover activities in 2023. In order to determine whether a financial product is sustainable, banks need this information from the relevant companies.

Furthermore, there is still no uniform method for assessing company data. Swiss Sustainable Finance has identified eight approaches to evaluate the sustainability of an investment. For example, does it exclude certain sectors (e.g. arms, fossil fuels), does it select the best players in a sector (even if they still pollute), or are shareholders committed to improving the company's practices? This diversity explains why the sustainability ratings given by various agencies are not consistent with each other.

Greenwashing refers to practices that aim to mislead the investor into believing that a product is more sustainable than it is. In reality, this term is often used when a product does not meet an investor's expectations. For example, a fund that considers ESG criteria does not necessarily contain only non-polluting companies or companies that have a positive impact on climate change. Therefore, to avoid disappointment, it is important to explain which aspects of sustainability have been taken into account and which strategy is being pursued.

There is a growing awareness that companies are not “brown” or “green”, but that there are many shades in between. The economy needs to rethink how it works. This will take time, as new solutions are far from being developed on a large enough scale to replace all our current consumption. Many companies, such as the oil industry, are in transition, because they have realised that they must adapt if they are not to become obsolete. But not supporting them in this transition would be like going from 5G to 2G again!

In Switzerland, the main sources of CO_2 emissions are buildings and vehicles. Tens of billions must therefore be spent to improve the insulation and heating of the former and to replace the latter by electric or hydrogen-powered vehicles. We also need to develop renewable energy sources. The banks are ready to finance these projects, but the will to initiate them lies with companies and individuals, in other words with all of us.