Swiss Sustainable Finance

University of Zurich[UZH]

CSP Center for Sustainable Finance & Private Wealth

Swiss Sustainable Investment Market Study 2021

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Preface by Swiss Sustainable Finance

This fourth Swiss Sustainable Investment Market Study, jointly prepared by Swiss Sustainable Finance (SSF) and the Center for Sustainable Finance and Private Wealth at the University of Zurich, once again confirms the unceasing mainstreaming of sustainable investments in Switzerland. Considering the changing environment both in Switzerland and internationally, this development comes as no surprise.

The Federal Council has stressed the Swiss financial centre's important role on the path to sustainable development in its report on sustainable finance published last summer. In June 2021 the Swiss population will vote on the new CO_2 law, which specifically mentions the importance of aligning financial flows to the Swiss climate goals. These factors, along with louder calls from both private and institutional clients, have moved sustainable investments higher on the agenda of Swiss financial players. In Europe, new disclosure regulations have led to greater awareness not just among European investors, but also among Swiss financial service providers with EU-wide activities. As a result, for the first time, over 50% of all investment funds managed in Switzerland apply one or more of the sustainability approaches covered in this survey. Much as the identified growth is encouraging, the need to provide further clarity as to the different objectives of diverse sustainable investment approaches is becoming a prerequisite for client trust. With our upcoming publication on ESG transparency recommendations for portfolios, SSF is contributing to the important discussion on further clarity in this sphere.

With a total of 83 respondents, among them many of the large asset managers and asset owners, the study gives a fair overview of the Swiss sustainable investment market. This year's survey again looked at combinations of sustainable investment approaches prevalent in the market. It is encouraging to see that a growing number of investors combine three or more approaches for a credible and effective sustainable investment strategy. The next step is for actors in the Swiss market to reach an agreement on the classification of different levels of sustainable investments, and the SSF market data provides a key foundation for such discussions.

We would like to take the opportunity to thank the six main sponsors AXA, Kieger, Schroders, Swiss Life Asset Managers, UBS and Union Bancaire Privée (UBP) as well as the six supporting sponsors Amundi Asset Management, Banque Cantonale Vaudoise, Basellandschaftliche Kantonalbank, GAM Investments, Graubündner Kantonalbank and swissQuant Group AG for their valued support for this publication. The market study was again compiled with the help of an SSF workgroup, which supported the process with their wealth of experience and specialist know-how. Building on the strong support of the growing SSF community, we are convinced that sustainability will become a core element of the Swiss financial market.

Jean-Daniel Gerber
President SSF

Sabine Döbeli
CEO SSF

Preface by the University of Zurich

The last 12 months have been a unique time for everyone. One of the key lessons from the Covid-19 crisis and ensuing lockdowns has been the need for rapid response. If change for the better is the goal, there is no time to wait for the 'new normal'. This report – jointly prepared for the fourth time by Swiss Sustainable Finance (SSF) and the Center for Sustainable Finance and Private Wealth (CSP) at the University of Zurich – clearly shows how strongly this message is rooted in the Swiss financial market place, where the dynamics are particularly strong.

One notable trend is a clear shift towards impact. The ESG engagement approach ranks second in terms of volume. The category of impact investments shows the highest growth rate of all SI approaches. Asset managers and owners have an overriding priority when detecting norms violations: they start an engagement effort. This is excellent news, since all these efforts share the same goal: investors are actively seeking to encourage a change of behaviour through their investment activities. At the same time, we need to make sure that impact is not just another buzzword in the market place. This year's report includes an interview with Dr Julian Kölbel from the CSP. Drawing on recent research conducted at the center, he clearly sets out what matters for investments to achieve an impact. It becomes clear that generating additional real-world effects is not a straightforward endeavour.

Addressing questions like this and highlighting the challenges ahead of us is at the heart of the work of both SSF and CSP, driving thought leadership and outreach activities to facilitate this important journey of the finance community. We hope you find the report interesting. The results are impressive and, at the same time, demonstrate that further efforts towards classification schemes are required. We invite you to join us as we explore the implications and opportunities that lie ahead.

Professor Falko Paetzold
Initiator and Managing
Director at CSP
Assistant Professor at EBS University

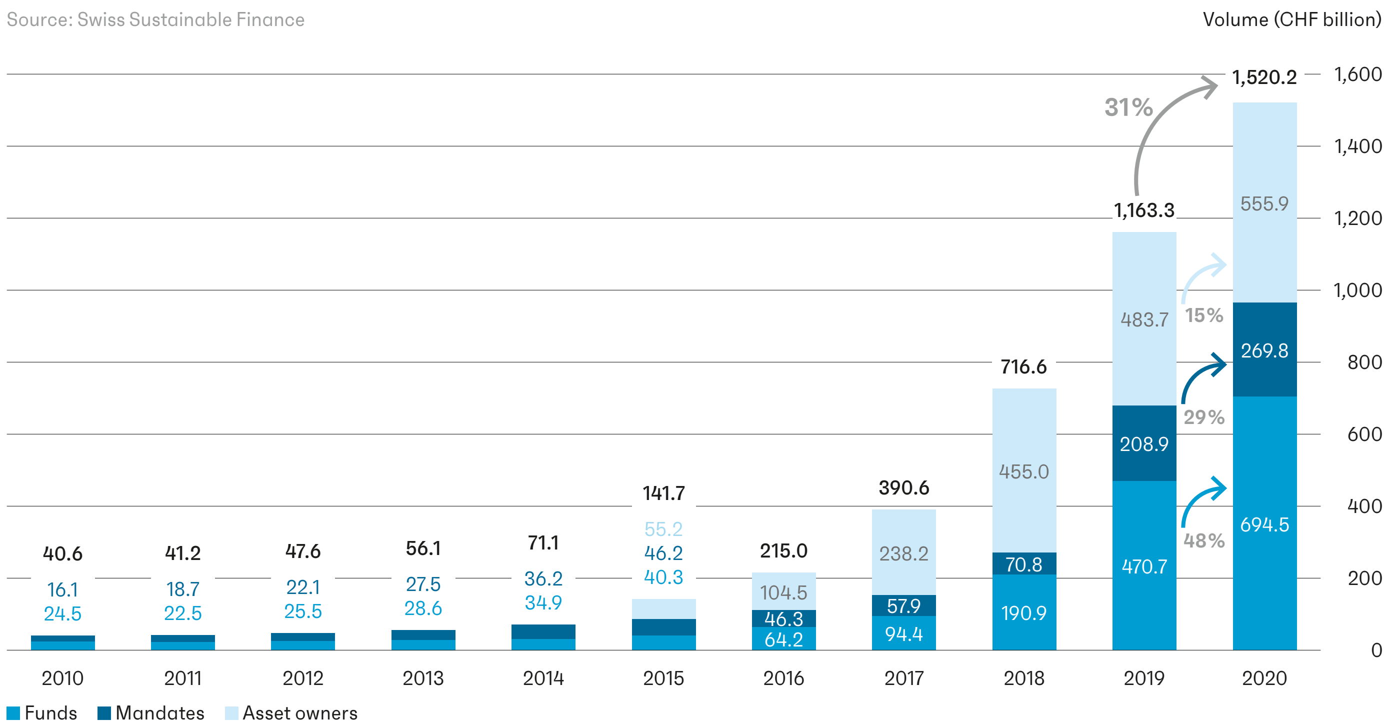
Professor Timo Busch
Senior Fellow at CSP
Professor at University of Hamburg

Executive Summary

Sustainable investment funds overtake conventional funds
The success story continues: in 2020, the market for sustainable investments (SI) in Switzerland once again experienced double-digit growth. Based on the responses to a market survey performed by Swiss Sustainable Finance (SSF), which collects data on the funds and mandates reported by banks and asset managers and internally managed asset owner volumes, SI volumes increased by 31% to CHF 1,520.2 billion. SI funds showed the highest growth rate of 48%, while sustainable mandates increased by 29% and sustainable assets of asset owners by 15%. The SI market growth can be ascribed to two main effects: a wider adoption of SI approaches and the positive market performance in 2020, which made up to about one third of the observed growth. Additionally, a minor part of the growth can be attributed to inflows into existing sustainable funds. On the level of sustainable funds, volumes increased to CHF 694.5 billion and now represent 52% of the overall Swiss fund market (compared to 38% in 2019). As such, funds adopting sustainable investment approaches now exceed conventional investment funds for the first time ever. The amount of SI reported by asset owners (CHF 555.9 billion) corresponds to approximately 33% of the total assets managed by Swiss pension funds and insurance companies. These exciting outcomes underline the progressive mainstreaming of sustainable investments.

The notion of impact is catching on
In last year's report, we highlighted that the market for SI products is entering a third era, a development that has been termed Sustainable Finance 3.0.[1] With ESG now broadly integrated into financial markets, a shift in orientation towards impacts is required and, as the results of this year's report demonstrate, the market is catching up accordingly. We see clear evidence of investors increasingly establishing a more

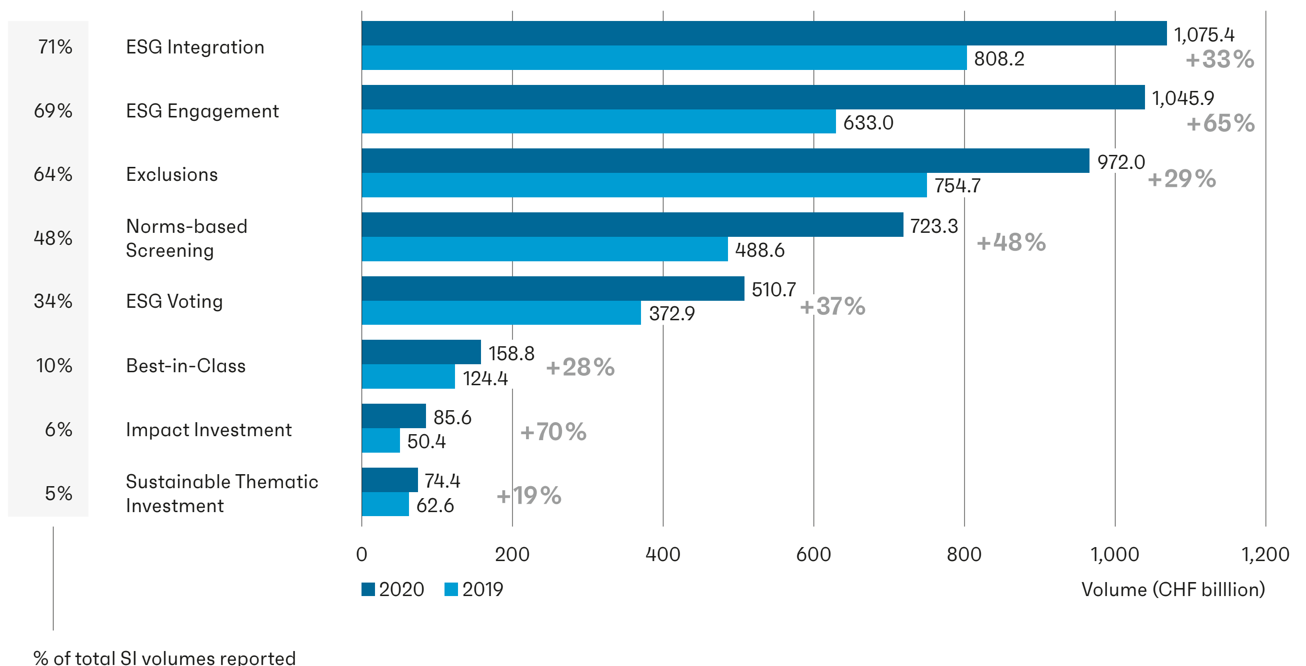
Development of sustainable investments in Switzerland
(in CHF billion)



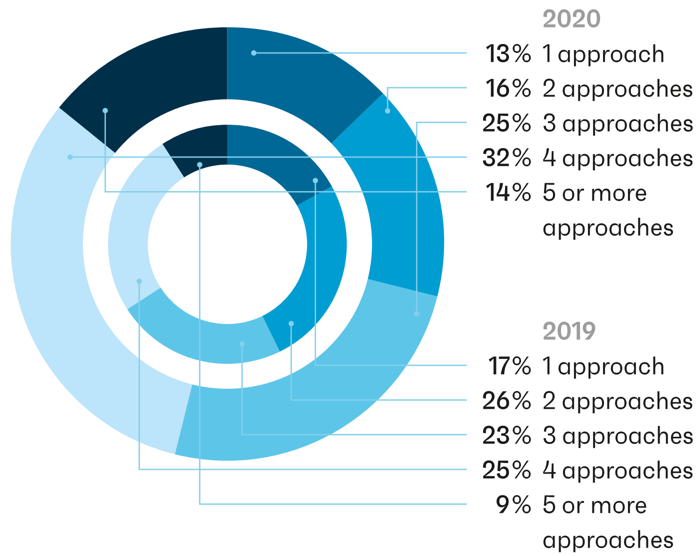
1 See Busch, T., Bruce-Clark, P. Derwall, J., Eccles, R., Hebb, T., Hoepner, A., Klein, C., Krueger, P. Paetzold, F., Scholtens, B., Weber, O. (2021). *Impact Investments – a call for (re)orientation.* SN Business & Economics 1 (2): 33. https://link.springer.com/article/10.1007/s43546-020-00033-6

impact-oriented focus: while all of the SI approaches grew in volume in 2020, the ESG engagement approach is now ranked second, up from third place last year. The category of impact investments still shows the highest growth rate of all SI approaches, at 70%. Furthermore, the fact that investors are increasingly adopting the notion of impact also becomes obvious when considering the actions that they take once norms violations are detected in investee firms. Previously, the most prominent action was to exclude the company from the investment universe. In 2020 the most common action for both asset managers and asset owners was to initiate engagement with the affected firm. This is good news, since such an active approach can contribute to changing behaviour, whereas a pure divestment strategy is often criticised for having minimal effect.

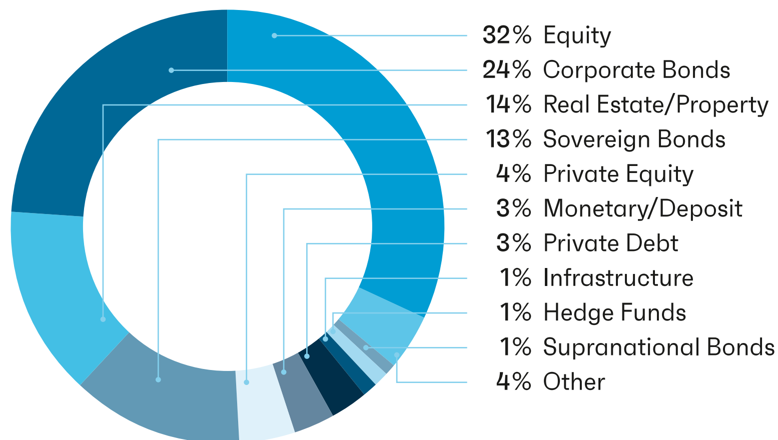
Development of sustainable investment approaches
(in CHF billion) (n=76)



Number of approaches applied (in %) (n=70)



Asset class distribution for sustainable investment (in %) (n=68)

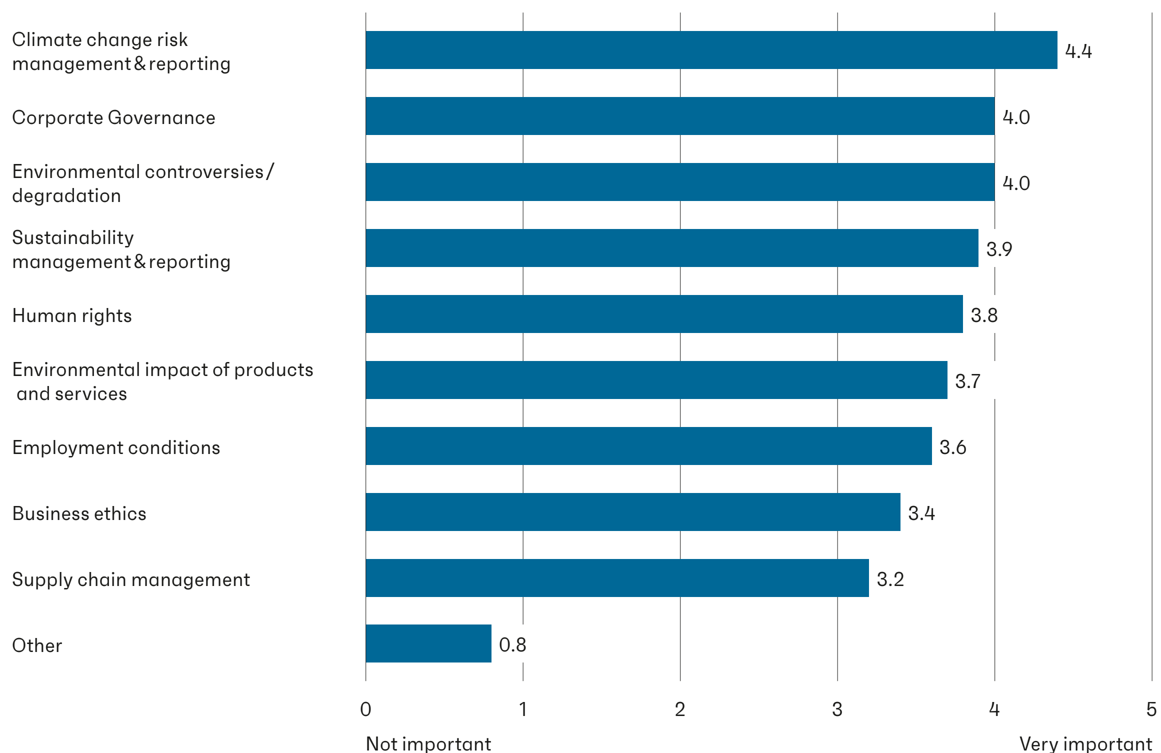


Investment practices become more sophisticated
For the second time, this year's report looks at common combinations of SI to gain a better picture of the nature and quality of reported volumes. One clear pattern emerges in comparison to 2019: investment practices are becoming more sophisticated. Overall, 87% of the total SI volumes now apply combinations of two or more SI approaches, compared to 83% last year. The volumes combining five or more approaches increased from 9% to 14%. The volumes applying four approaches simultaneously now stands at 32%, up from 25% in 2019. And there is more good news: ESG engagement – a potentially very effective strategy from an impact point of view – is very common in the top combinations of SI approaches.

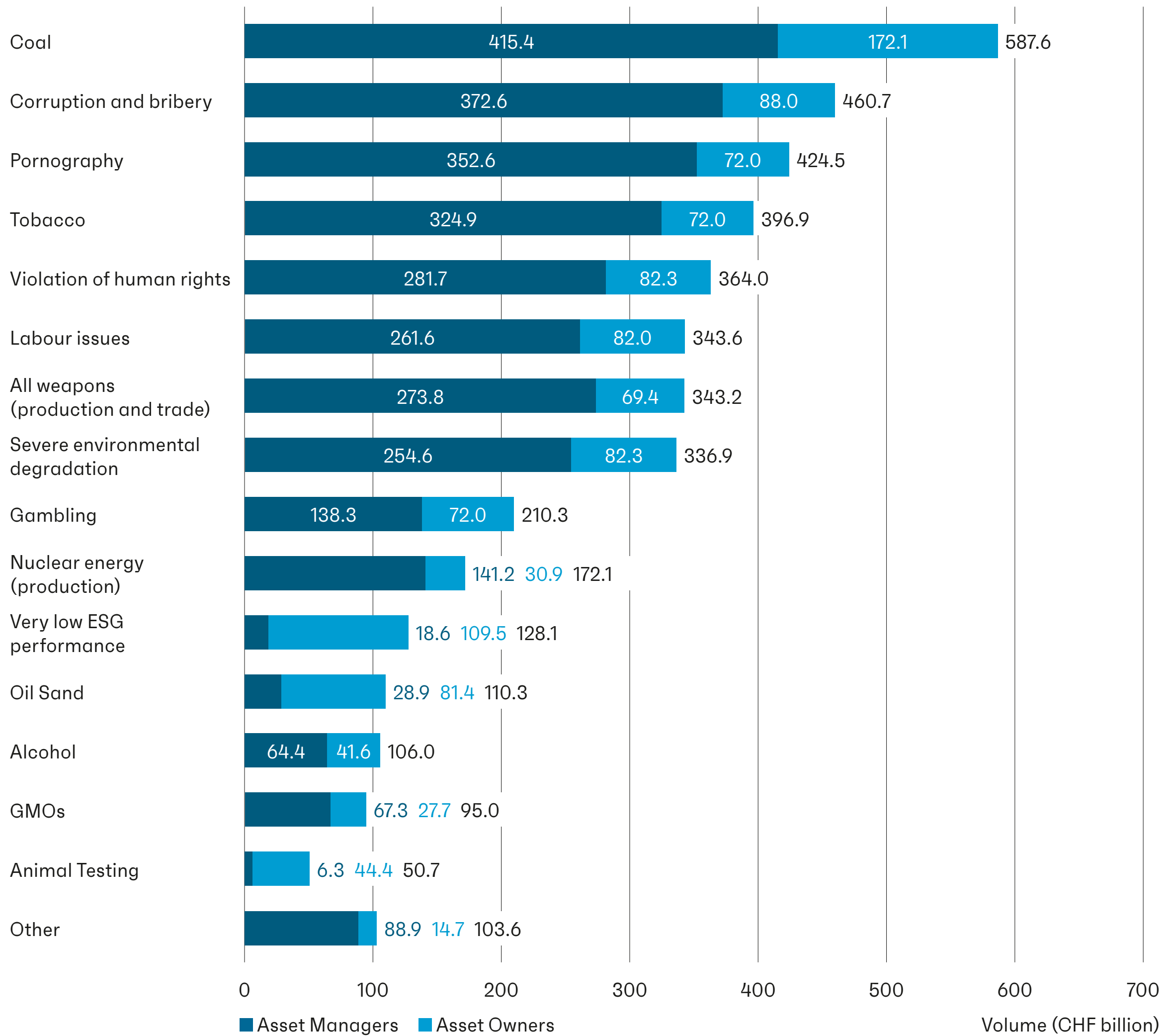
Importance of asset classes remains stable
The asset allocation distribution for SI has barely changed compared to 2019. Equity still ranks first, with about a third of all volumes, followed by corporate bonds at roughly a quarter of all investments. While this picture reflects overall asset class allocation, at the same time it shows that SI solutions are now being applied to all relevant asset classes.

Climate change: a dominant theme
Several results of the survey confirm that climate change is the dominant theme within SI. First, climate change risk management and reporting ranks first among all ESG engagement themes. Second, activities in the coal industry are now the highest ranked exclusion criteria for the definition of investment universes. Third, clean energy remains the top Sustainable Development Goal (SDG) that asset managers look to address with their financial products.

Main ESG engagement themes (in average level of importance) (n=56)



Applied exclusion criteria for companies (in CHF billion) (n=54)



Third-party certification more relevant

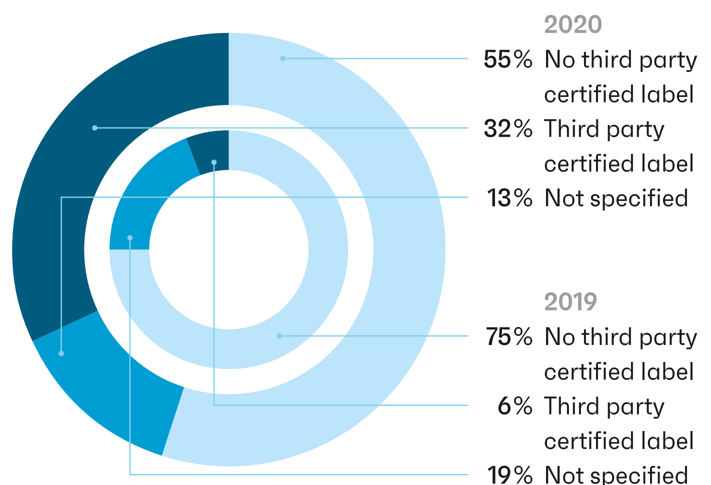
While in 2019 only 6% of the reported SI were subject to third-party certified labels, this year's result shows that asset managers now use third-party certified labels (e.g. FNG-Label, GRESB, Label ISR, LuxFlag) for 32% of their SI volumes. This is an interesting outcome, highlighting the increasing relevance of third-party certification as a means of transparency and reliability.

Similar to the trend in previous years, both private and institutional investors increased their SI volumes in absolute terms. While institutional investors still play the dominant role in the SI field, the private segment is again gradually catching up: whereas the SI volumes of institutional investors increased by 20%, the volumes of private investors shot up by 72%.

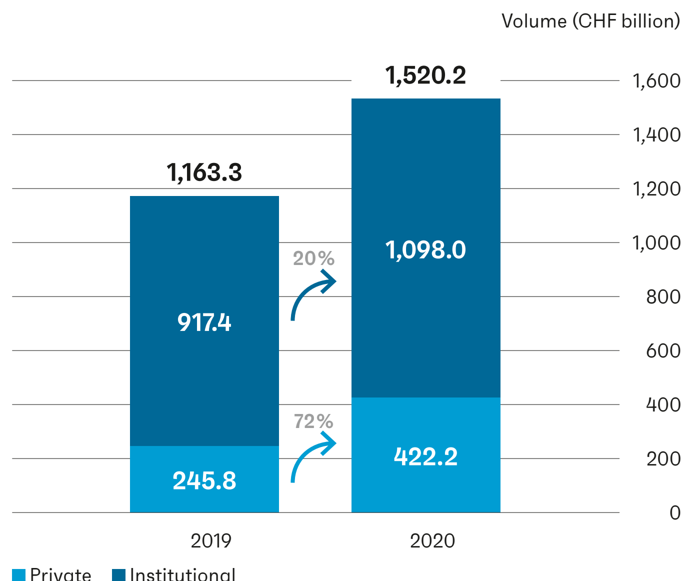
Sustainable investments as a key lever

It is encouraging to see such strong growth in the sustainable sphere in Switzerland. We conclude that the growth observed is primarily market-driven and based on rising demand from private and institutional clients. Secondly, legal developments in the EU may have a potential spill-over effect. Given this strong growth, it is undoubtedly essential to create more transparency on the level of sustainability and intended impacts – a task being tackled on both the market and governmental level. The combination of these two trends, namely market-driven growth and working towards more transparency, gives us confidence that the move towards a fully sustainable financial system is well under way.

Labelling of sustainable funds by asset managers (in CHF billion) (n=42)



Development of private and institutional sustainable investments (in CHF billion) (n=77)



01

Introduction

This is the fourth Swiss Sustainable Investment Market Study to be published by Swiss Sustainable Finance (SSF) in collaboration with the Center for Sustainable Finance and Private Wealth (CSP) at the University of Zurich. After the impressive increase in the amount of sustainable investments in Switzerland in 2019, we can once more observe double-digit growth in 2020 – a trend that has endured over the last decade. The purpose of this study is to summarise the status quo, highlight some of the recent interesting market developments and provide a deeper understanding of the topic in order to encourage further growth.

This report refers to the term sustainable investments (SI) as any investment approach integrating environmental, social and governance (ESG) factors into the selection and management of investments. As shown in Figure 1, there are eight different approaches of SI, which are all examined in more detail by SSF (for full definitions, see the glossary at the end of this report, or the SSF website[2]). Figure 2 presents a classification of these approaches. In general, we see three main motivations for investors to apply SI approaches: value alignment, risk/return improvement or generating real-world positive impact. All approaches can be categorised according to their sustainability focus or intended effect.

We observe that different approaches are often used in combination. For example, norms-based screening is usually applied in combination with ESG engagement and exclusion.

Figure 1: **Definitions of sustainable investment approaches**

Best-in-Class	Approach in which a company's or issuer's ESG performance is compared with that of its peers based on a sustainability rating. All companies or issuers with a rating above a defined threshold are considered as investable.
ESG Engagement	Activity performed by shareholders with the goal of convincing management to take account of ESG criteria so as to improve ESG performance and reduce risks.
ESG Integration	The explicit inclusion by investors of ESG risks and opportunities into traditional financial analysis and investment decisions based on a systematic process and appropriate research sources.
ESG Voting	This refers to investors addressing concerns of ESG issues by actively exercising their voting rights based on ESG principles or an ESG policy.
Exclusions	An approach excluding companies, countries or other issuers based on activities considered not investable. Exclusion criteria (based on norms and values) can refer to product categories (e.g. weapons, tobacco), activities (e.g. animal testing), or business practices (e.g. severe violation of human rights, corruption).
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.
Norms-Based Screening	Screening of investments against minimum standards of business practice based on national or international standards and norms.
Sustainable Thematic Investments	Investment in businesses contributing to sustainable solutions, both in environmental or social topics.

2 SSF (n.d.) *Glossary*. Available at: http://www.sustainablefinance.ch/en/glossary-_content---1--3077.html, accessed: 01.04.2021

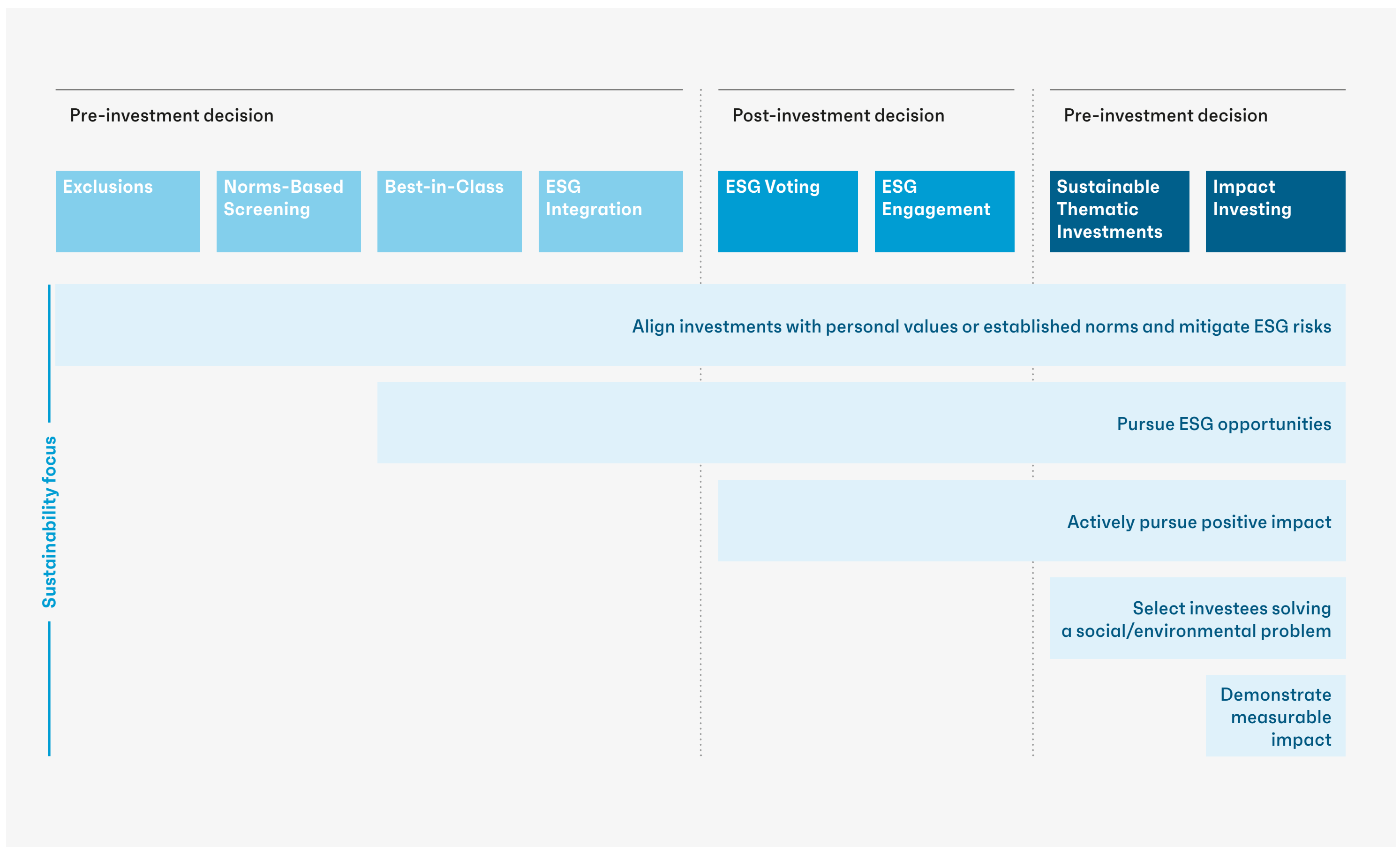
For the second time, after the introduction of combinations in last year's report, we devote a special section (see Chapter 2.3) to the most prevalent combinations in the Swiss market.

A total of 83 Swiss players (2020: 76) took part in this year's edition of the Sustainable Investment Market Study, which represents a higher participation rate than last year.[4] As shown in Figure 3, 36% are asset managers, 22% banks/diversified financials and 42% asset owners. For the rest of the report, asset managers banks/diversified financials are collectively referred to as asset managers. In 2020, the study participants included 48[5] asset managers (2020: 45) and 35[6] asset owners (2020: 31).

The main part of this report (Chapter 2) provides a detailed analysis of the results from the market survey. The main aspects of the analysis comprise general characteristics of the Swiss SI market, investor types, asset allocation, SI

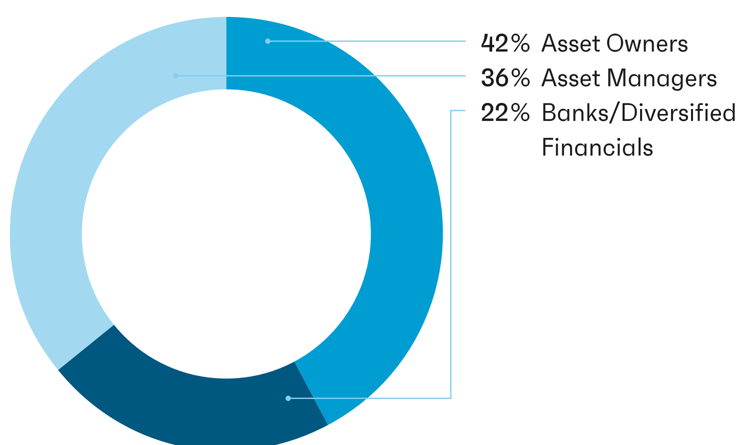
Figure 2: **Categorisation of sustainable investment approaches**

Source: Swiss Sustainable Finance[3]



3 Adapted from Paetzold, F., Impact Investing, in SSF Handbook on Sustainable Investments, 2018.
4 A list of study participants who consented to be named is provided on page 79.
5 Three asset managers participated through another company. Thus, the following analysis is based on 45 asset manager data sets.
6 One asset owner participated through another company. Thus, the following analysis is based on 34 asset owner data sets.

Figure 3: **Swiss sustainable investment market study participants** (n=83)



approaches, and combinations thereof. Other factors investigated include special topics, such as climate change and the SDGs. Following on from the main part, an analysis of market trends provides a deeper understanding of the possible drivers and barriers to further growth of the Swiss SI market (Chapter 3). Chapter 4 contains an overview of the regulatory framework in Switzerland. The core part of the report concludes with a summary of the findings and an outlook (Chapter 5).

Chapter 6 contains additional market insights, including two interviews: a conversation with government representatives provides insights into the overall strategy of the Swiss government on sustainable finance. In a dialogue with an academic we further shed light on the key topic of impact generation. To conclude, we highlight the topic of Private Asset Impact Funds (PAIF), based on a report from specialists on this topic.

Methodology

The Swiss Sustainable Investment Market Study 2021 was prepared on the basis of company data taken from organisations domiciled in, or with operations in, Switzerland that manage sustainable investments. All available data was collected, reviewed and evaluated by Swiss Sustainable Finance (SSF) and its academic cooperation partner, the University of Zurich. The gathered data is from 31 December 2020 and was provided voluntarily by the study participants. From January to April 2021, data collection was conducted using questionnaires sent out to a total of 238 asset owners and managers in Switzerland.

In order to avoid double counting, SSF provided clear guidance on the data to be reported and participants were encouraged to respect the defined scope of the questionnaire. In alignment with the methodology of the Eurosif market reports, asset managers were asked to list all assets managed by their organisation within Switzerland for national and foreign clients. Asset owners were asked to provide details of their self-managed assets and separately provide information on assets managed by asset managers on behalf of their organisation.

Since not all participants answered the questionnaires in every detail, the total quantity (n) of respondents per question is indicated for all figures. A list of the participants who agreed to be named can be found on page 79.

Volumes in foreign currency (euros and US dollars) were adjusted by means of exchange rates in Swiss francs (CHF). The year-end exchange rates applied for 2020 were CHF 1.0827 for one euro and CHF 0.8988 for one US dollar.

For Figure 10, the volumes for institutional and private investors were extrapolated to total reported SI volumes, since a small percentage of SI volumes managed by asset managers were not attributed to institutional or private clients explicitly.

All study participants received guidelines, including the underlying definitions and detailed information on how to answer the questionnaire. In order to provide an accurate picture of the Swiss sustainable finance market, all data and information were checked for consistency. In case of any anomalies in the data, the respective participants were contacted and potential issues resolved.

02

Swiss Sustainable Investment Market

2.1 Overall Market Size and Characteristics

Figure 4: **Development of sustainable investments in Switzerland** (in CHF billion)

Source: Swiss Sustainable Finance

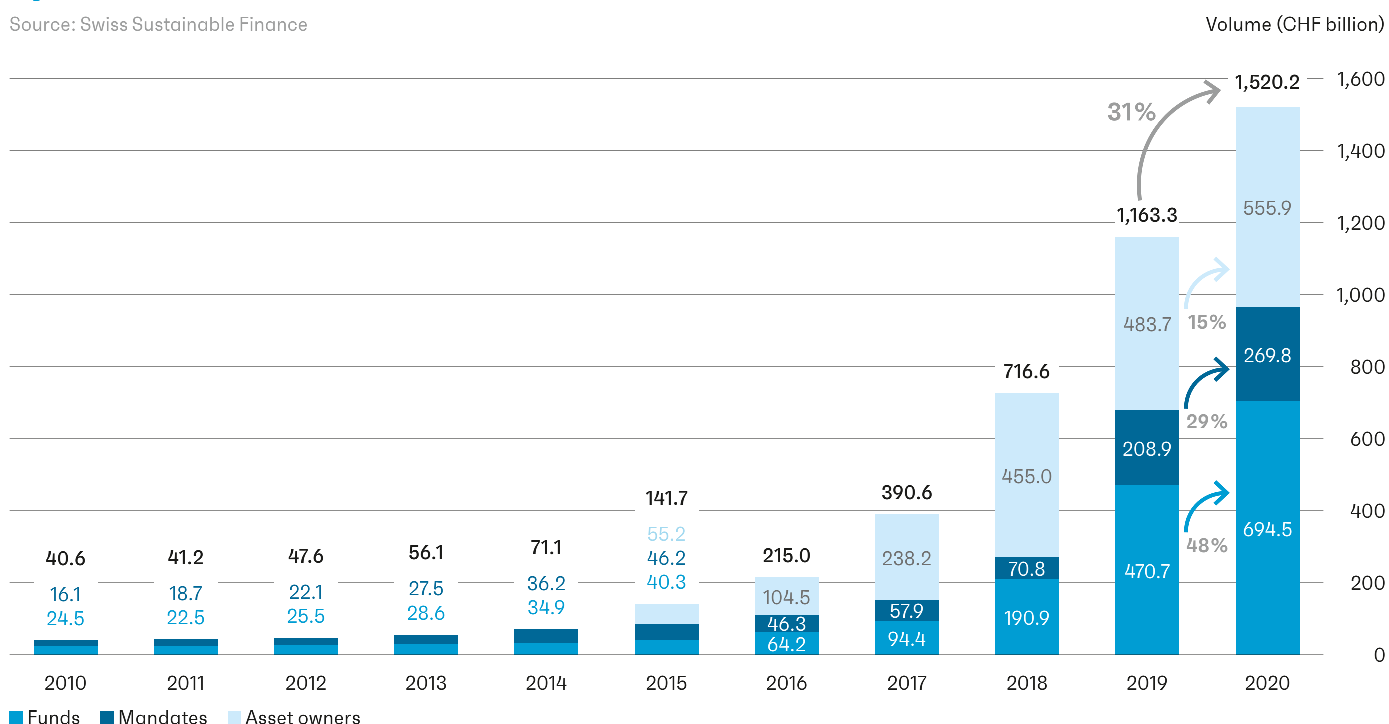


Figure 4 shows the development of the market volume of sustainable assets in Switzerland from 2010 to 2020. As of 31 December 2020, the total Swiss SI market was worth CHF 1,520.2 billion, taking into account sustainable funds, sustainable mandates and sustainable assets of asset owners. This represents a growth rate of 31% compared to the previous year. Funds showed the highest growth rate with 48%, followed by mandates with 29%, and finally asset owners with 15%. The SI market growth can be ascribed to two main effects: wider adoption of SI approaches amongst participants over a larger portion of their assets and the positive market performance in 2020[7] (approximately 10 percentage points of observed growth).

For asset managers, the growth mainly arises from existing participants' mandates and funds (Figure 5). Only 15% of the growth stems from new participants' funds and mandates. The continued high growth rates observed in 2020 can be attributed to two main factors: wider adoption of SI approaches and the positive market performance in 2020 (for mandates and funds approximately 12 percentage points). Additionally, a minor part of the growth can be attributed to inflows into existing sustainable funds.

For asset owners, Figure 5 shows a similar picture to the asset managers. The growth of 15% mainly comes from existing participants, although 28% of the growth is due to new participants' assets. The growth rate of asset owners' sustainable volumes is lower than for asset managers' volumes, but is still faster than last year (6%).

In addition to the supply of funds and mandates, asset managers and banks have been building up other services and products to help sustainable investments become more accessible and visible to end-clients. Through deeper conversations with our network and information provided this year,

7 The performance effect is calculated by applying a given performance to the previous year's volumes of the four major asset classes. For the performance of equity, corporate bonds, sovereign bonds and real estate investments, the indices MSCI World Index (USD), Bloomberg Barclays Global Aggregate Corporate Bond Index, S&P Global Developed Sovereign Bond Index and MSCI World Real Estate Index (USD) were used, respectively.

we see that many participants also offer advisory services to help clients better understand ESG investments and thereby indirectly steer volumes into sustainable products. Moreover, some Swiss banks have modified their fund platforms to either more visibly differentiate between sustainable and non-sustainable products, or to even fully eliminate non-ESG products from their product offering, leaving clients no choice but to make the switch. The volumes linked to such activities are difficult to estimate and therefore out of scope of this study. However, we do think it is worth mentioning that Swiss players continue to adapt and adopt methods to push sustainable investing, beyond traditional funds and mandates.

Since 2010 the compound annual growth rate for sustainable funds and mandates has been around 37%. However, the period before 2015 experienced a much lower growth rate (16%) than the period after 2015 (62%). This development highlights the mainstreaming effect: sustainability is no longer a niche topic. This trend reflects the greater regulatory attention the topic has been given internationally in most recent years, not to mention the Covid-19 crisis, which can be seen as a further driver for sustainability. Asset owners were included for the first time in the market survey in 2015. Since then, the compound annual growth rate of their assets has been about 59%.

A comparison of the developments in the SI fund market with the overall growth of the asset management market in Switzerland underlines the relatively high growth rate of SI. As of 31 December 2020, the overall volume of the Swiss fund market stood at CHF 1,325 billion.[8] This represents a market increase of about 7% compared to the previous year. The reported sustainable funds amounted to CHF 694.5 billion, which corresponds to a growth rate of 48% compared to the previous year, while the majority of this effect is due to existing funds applying SI approaches for the first time. Sustainable

Figure 5: **Sustainable investments of existing vs. new study participants** (in CHF billion)

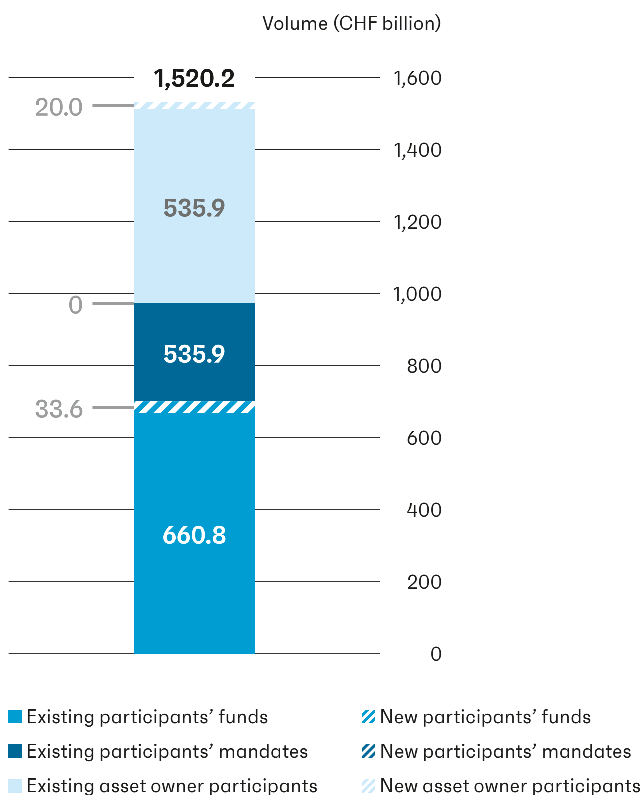


Figure 6: **Proportion of sustainable funds in the overall swiss fund market** (in % of total funds market)

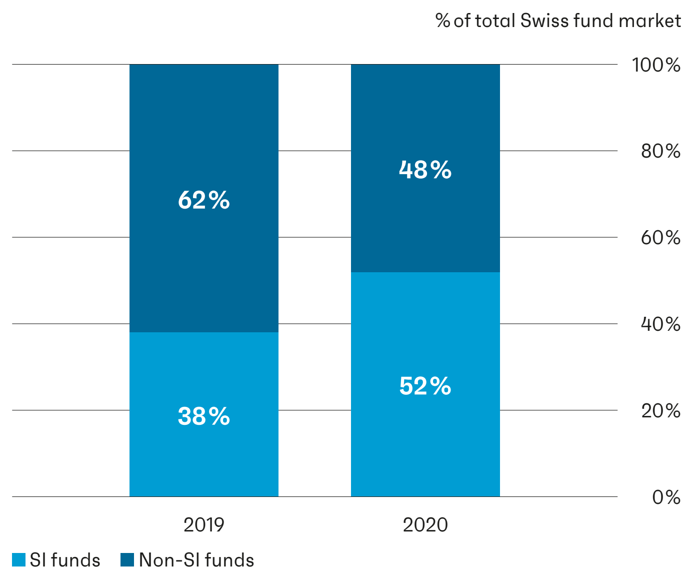
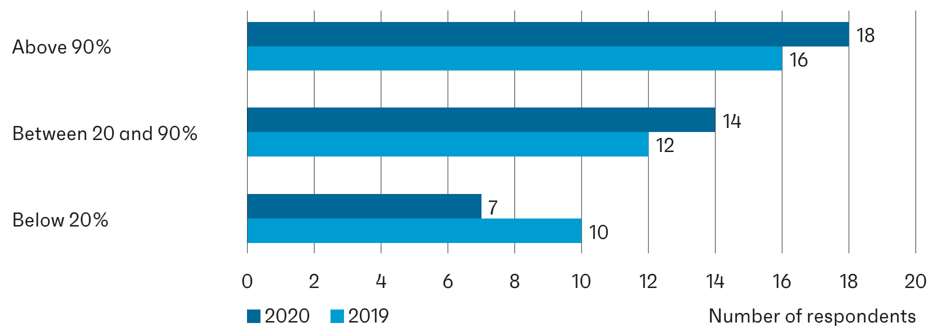


Figure 7: **Ratio of SI volume compared to total AuM for asset manager** (in number of respondents) (n=39)



funds now represent 52% of the overall fund market in Switzerland (Figure 6), compared to 38% last year. This means that 2020 marks the first year where over half of the total fund volumes apply one or more of the sustainable investment approaches covered in the survey.

A comparison of asset owners' SI volumes compared to overall Swiss pension funds' and insurance companies' assets underlines the high penetration of SI. The assets of Swiss pension funds and insurance companies are estimated to be in the region of CHF 1,705 billion.[9|10] The reported SI held by asset owners amounted to CHF 555.9 billion, which corresponds to roughly 33% of the overall investments of Swiss pension funds and insurance companies. This figure is most likely an underestimation of the total share of sustainable assets held by Swiss asset owners, as sustainable mandates outsourced to asset managers were not counted towards asset owners' volumes, because the main scope of this study was about sustainable assets managed in Switzerland.

Figure 7 shows the proportion of SI held by asset managers compared to their total assets under management (AuM). It highlights that both types of firms are well established in Switzerland – specialised SI companies as well as those offering SI – while the main focus is on traditional products. The trend for more non-specialised companies to have over 20% of their AuM invested sustainably was confirmed in 2020. Additionally, close to half of respondents now report over 90% SI volumes, which is a trend we expect to continue.

8 AMAS (2021). *Swiss Fund Market Statistics – Month-End Analysis 31.12.2020.* Available at: https://www.swissfunddata.ch/sfdpub/fundmarket-statistics, accessed 01.03.2021.

9 Willis Towers Watson (2020). *Global Pension Assets Study 2020.* Available at: https://www.thinkingaheadinstitute.org/en/Library/Public/Research-and-Ideas/2020/01/Global-Pension-Asset-Study-2020, accessed 31.03.2021.

10 FINMA (2019). *Insurance Market Report 2018.* Available at: https://www.finma.ch/en/documentation/finma-publications/reports/insurance-reports/, accessed 31.03.2021.

Figure 8: **Marketing of sustainable products by asset managers** (in CHF billion) (n=45)

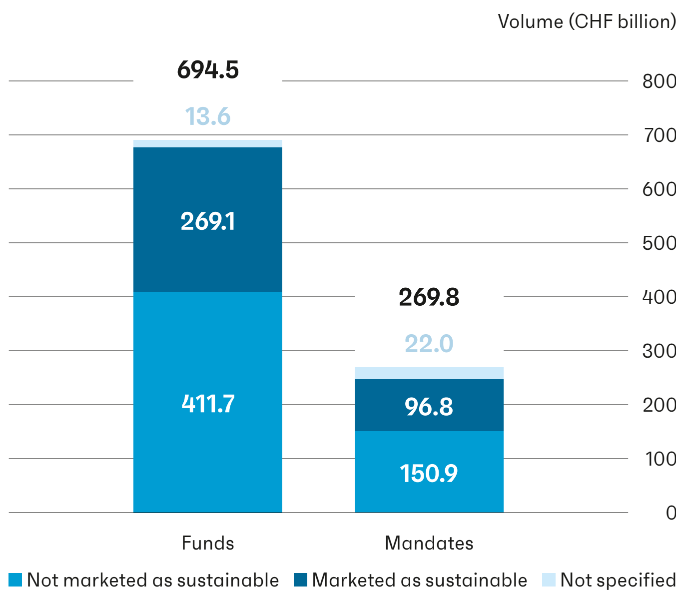


Figure 9: **Labelling of sustainable funds by asset managers** (in % of total funds reported) (n=42)

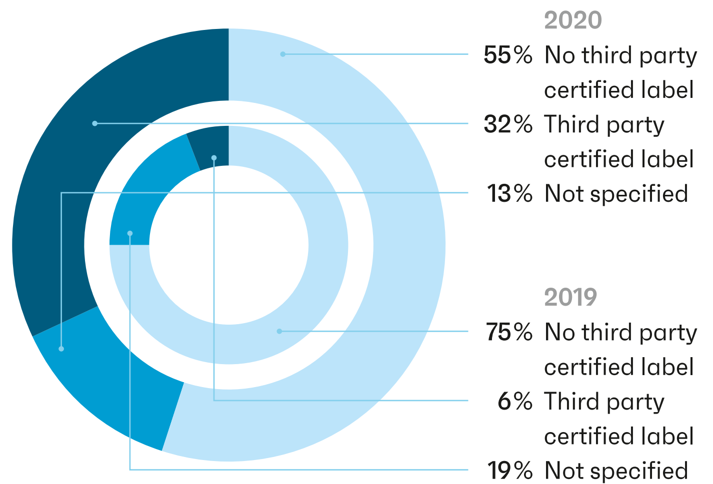


Figure 8 shows that asset managers market about one third of their reported SI funds and mandates as sustainable products. This goes hand in hand with the mainstreaming effect: not all products are marketed as sustainable, but an increasing number of products take ESG criteria into account. Figure 9 shows that an increasing number of the reported SI funds have a third-party-certified label (e.g. FNG-Label, GRESB, Label ISR, LuxFlag). At 32%, the share is substantially bigger than in 2019 (6%). In the future, it will be interesting to see how the share of SI marked products evolves; notably, with respect to the new Art. 8 or 9 product standards in the context of the EU Sustainable Finance Disclosure Regulation (SFDR).[11]

11 Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32019R2088

2.2 Investor Types

Volumes of SI by both investor groups, institutional as well as private, contribute to the high overall growth of SI (Figure 10).[12] Institutional investors are still more prominent than private investors in the Swiss SI market (72% of the total SI volume). However, private investors' involvement is increasing fast, with a growth rate of 72%. This is best explained from both a demand and a supply perspective: an increasing number of private investors are interested in SI. At the same time, there is a trend induced by asset managers' mainstreaming of sustainability, who now offer a broader range of ESG products, or even have fully integrated ESG factors in their fund management, actively advise clients on SI products, or have even made sustainable investments the default for their clients.

As Figure 11 shows, insurance companies are the largest group of institutional investors, similar to 2019. 51% of the total SI volume of institutional investors can be attributed to insurance companies. Further key players are public and corporate pension funds, which make up another third of the total volume.

Figure 10: **Development of private and institutional sustainable investments** (in CHF billion) (n=77)

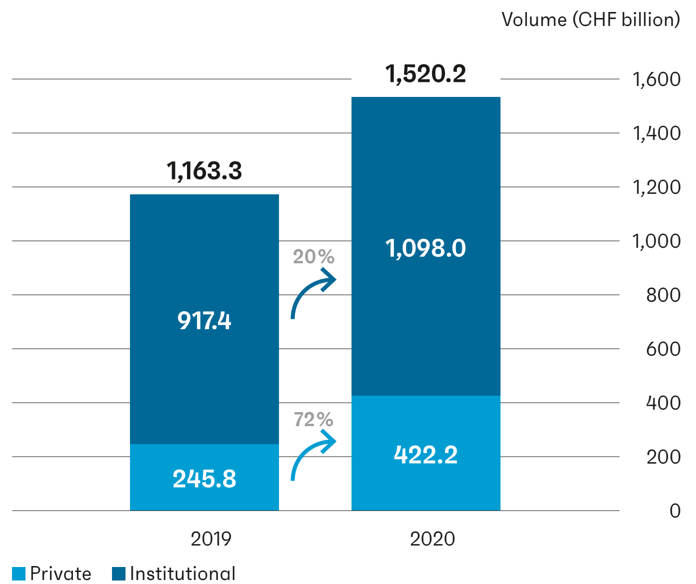
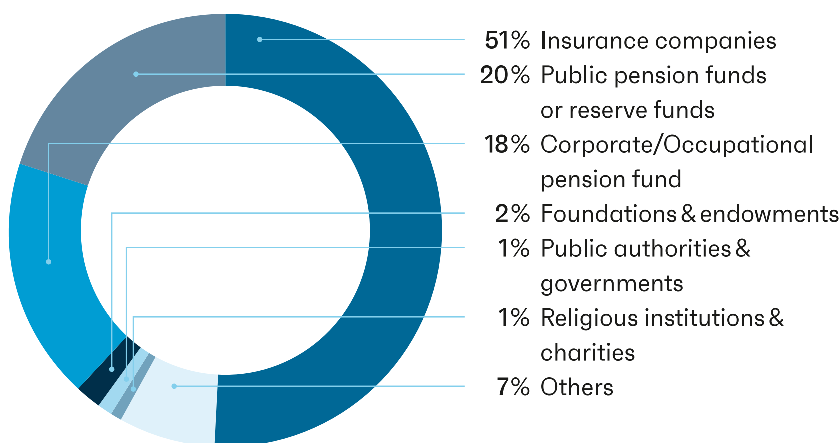


Figure 11: **Institutional sustainable investor landscape** (in % of institutional SI AuM) (n=59)



12 Since not every asset manager participant answered the questions on this topic, asset managers' volumes for institutional and private investors have been extrapolated to their total reported SI volumes for both years.

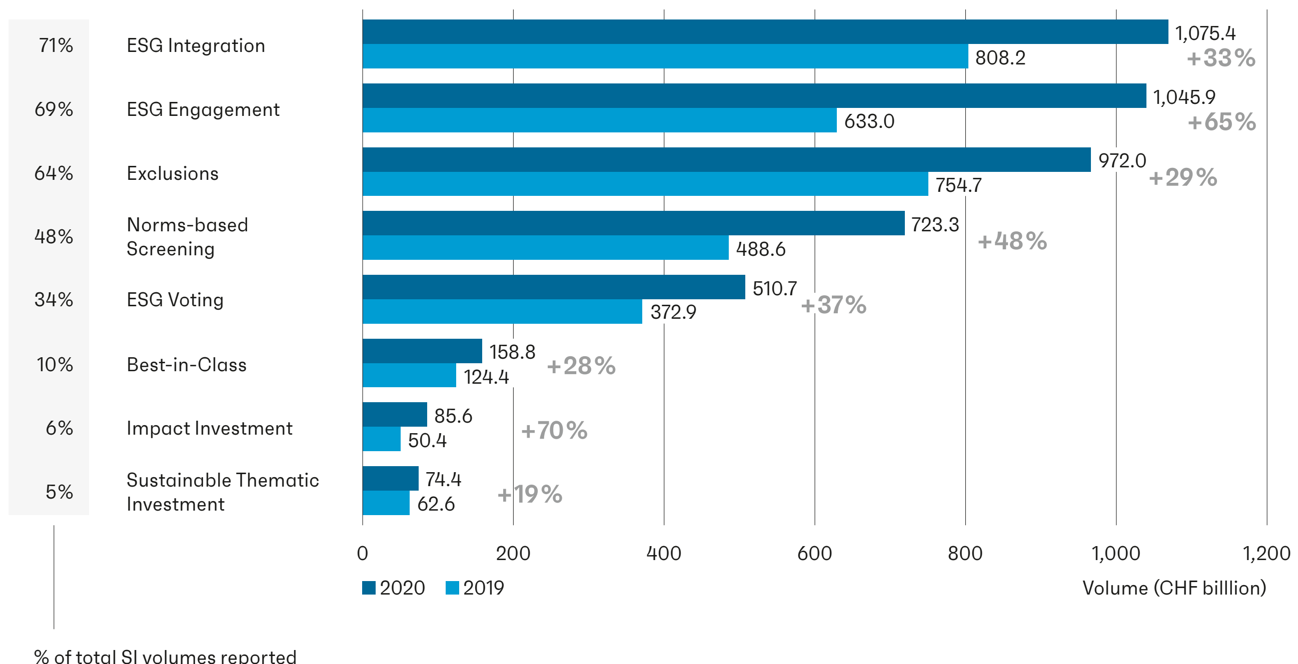
2.3 Sustainable Investment Approaches

This chapter provides a detailed analysis of the different SI approaches in Switzerland. Figure 12 presents the total volumes for each approach applied in 2020, with a comparison to 2019. These volumes include both asset manager as well as asset owner data. All approaches yet again experienced substantial increases in volumes. ESG integration is still the leading approach, as seen in prior years. The ESG engagement approach is catching up and now ranks second in terms of volumes, compared to third last year. The exclusion approach is still within the top three approaches in 2020, but has been overtaken by ESG engagement. Impact investments once again show the highest growth rate of all SI approaches, at 70%.[13] Figure 13 splits up the volumes per SI approach in funds, mandates and asset owners' assets. Regarding the asset owner data, we see that their volumes make up more or less one third of the total volumes per SI approach. Thus, we see the same order of SI approaches within asset owner data. Only a small fraction of asset owners' volumes are applied to impact investments and sustainable thematic investments. This may suggest that such approaches require more asset manager know-how and are rarely applied by asset owners to their self-managed assets.

ESG integration

ESG integration ranks first in Switzerland in terms of volumes and is applied to 71% of all sustainable assets (Figure 12). The growth rate of 33% can chiefly be attributed to large asset managers who have more recently introduced systematic ESG integration across a broad range of funds, and new asset owner participant volumes. Figure 14 shows the popularity of different systematic ESG integration approaches used by respondents as an integral part of their asset management process. By far the most popular approach was the systematic consideration/inclusion of ESG research/analyses in financial ratings/valuations by analysts and fund managers.

Figure 12: **Development of sustainable investment approaches (in CHF billion) (n=76)**



13 See chapter with detailed explanation and analysis of impact investments.

Figure 13: **Application of sustainable investment approaches differentiated by funds, mandates and asset owners** (in CHF billion) (n=76)

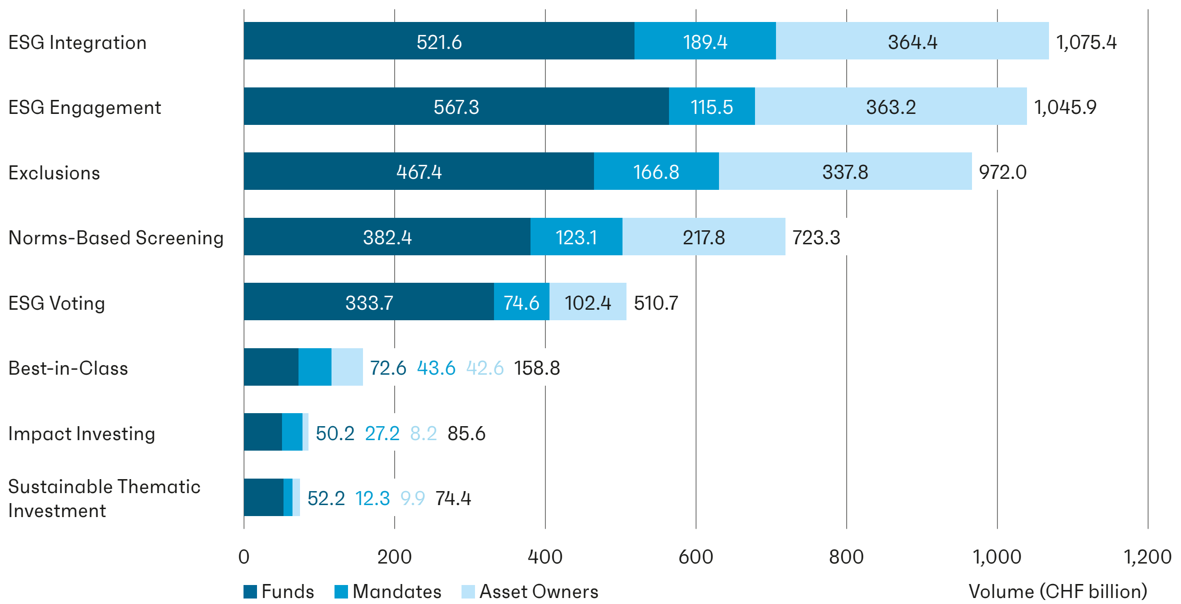


Figure 14: **ESG integration types applied** (in CHF billion) (n=44)

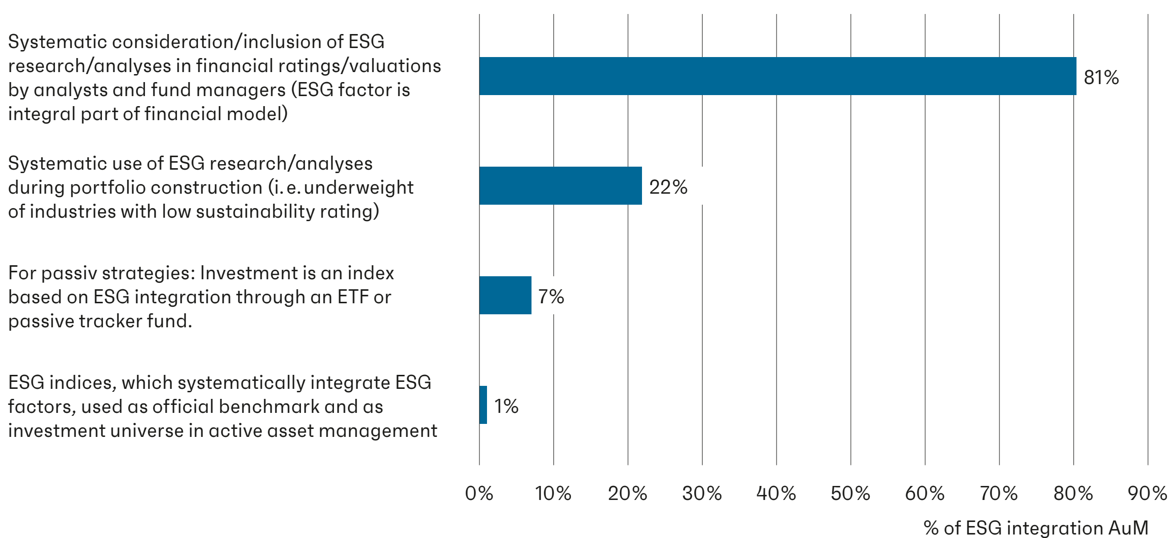
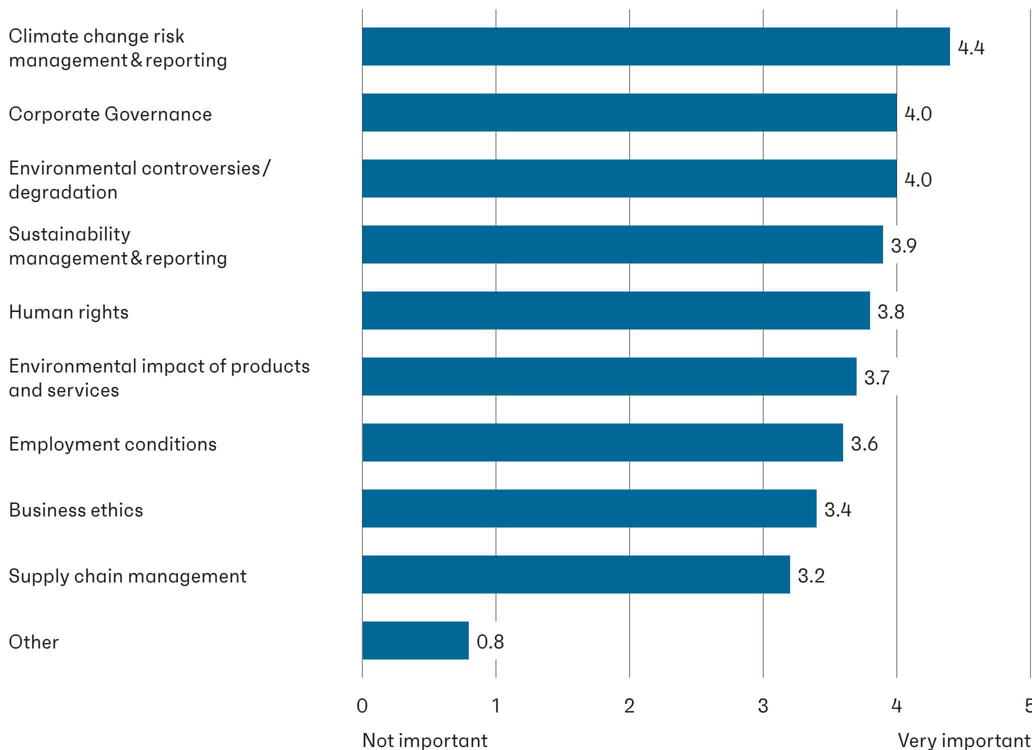


Figure 15: **Main ESG engagement themes** (in average level of importance) (n=56)



ESG Engagement

The ESG engagement approach now ranks second and is applied to 69% of all SI in Switzerland (Figure 12). Overall the volumes grew by 65%, surpassing the exclusions approach. Not only did the fund volumes further increase, but also asset owners' volumes rose substantially.

Figure 15 shows that risk management and reporting related to climate change was a very important subject to engage on. This outcome may be because climate change related risks in financial markets have become more prominent in public debates, for example through initiatives such as the Task Force on Climate-related Financial Disclosures (TCFD)[14], as well as thanks to various broader engagement initiatives, such as Climate Action 100+ and the Net Zero Asset Owner and Asset Manager Alliances.

For asset managers, around 47% of the engagement volumes are reported to be outsourced to third parties. The other 53% of volumes are engaged with internal resources.

Exclusions

The exclusion approach is applied to 64% of all SI in Switzerland (Figure 12).[15] This approach now ranks third, having been overtaken by the ESG engagement approach in 2020.

Figure 16 shows that the most frequently used exclusion criterion for SI assets was coal. This is a continuation of last year's trend, when coal moved up from tenth to fourth place as the most applied exclusion. This shows that the pressure for global carbon divestment has further intensified in 2020. While the exclusion of the production and trade of weapons stayed on the same level, corruption and bribery, pornography,

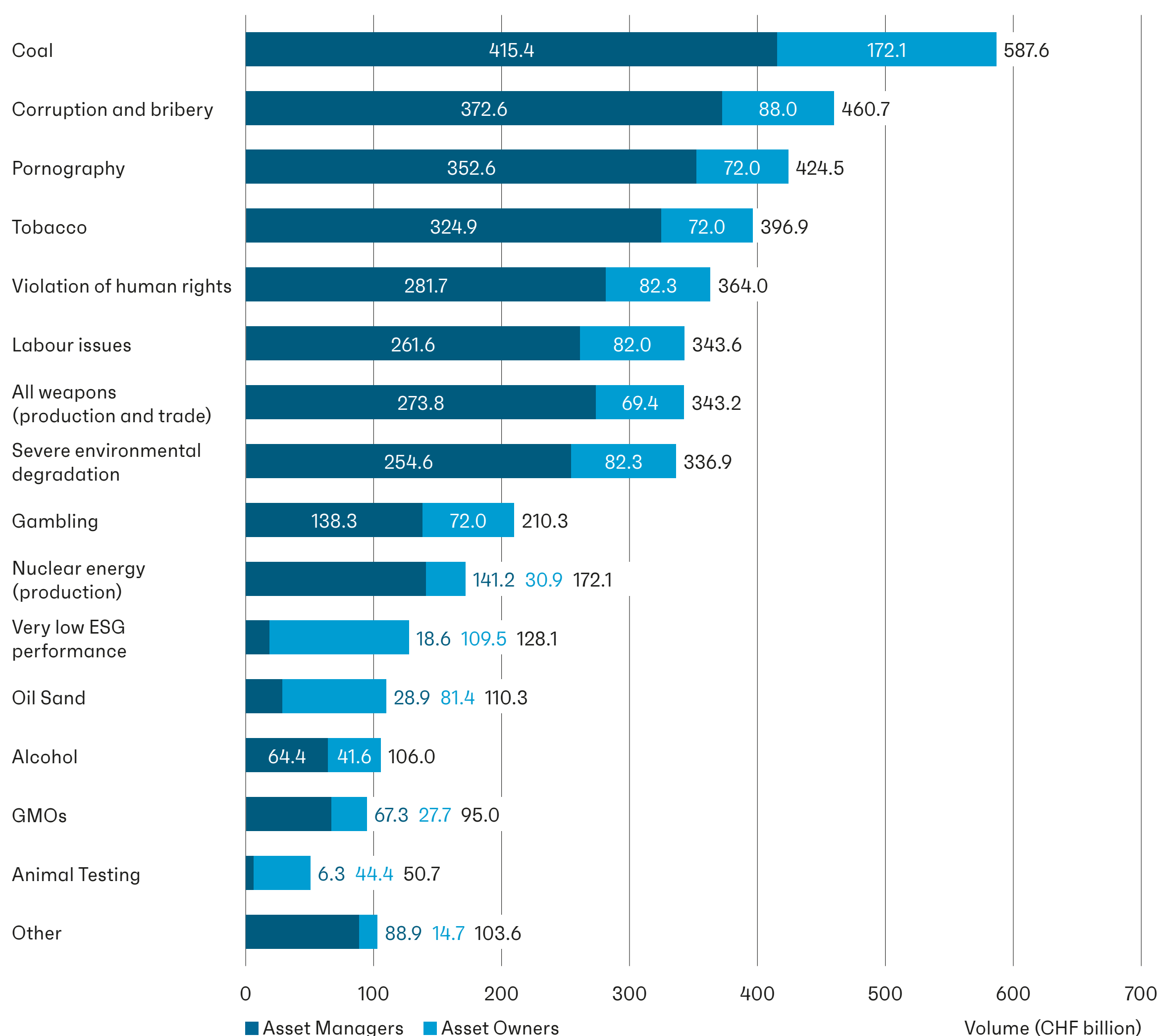
14 TCFD: available at: https://www.fsb-tcfd.org/, accessed 27.04.2021.

15 Assets that solely apply exclusions of cluster munitions, anti-personnel mines and/or weapons of mass destruction, as defined in the Federal Act on War Material (WMA), are not counted as an exclusion strategy. According to the WMA, the direct financing (and indirect if used to circumvent direct financing) of the development, manufacture or acquisition of prohibited war materials (Article 8b WMA) is prohibited, which is why SSF decided not to count it as exclusions in the sense of a sustainable investment approach.

tobacco and violation of human rights became more important as exclusion criteria. Due to larger players reporting the criteria "very low ESG performance", this category was added to the chart this year. For the category "others", respondents reported exclusion criteria such as predatory lending, stem cell research, aircraft and agrochemicals.

Survey respondents were also asked about applied country exclusions, but only 19 participants, covering a small amount of SI volumes, responded. The majority of reported volumes were mainly based on international sanctions. According to the UN, sanctions can pursue a variety of goals, but UN sanctions focus on supporting the political settlement of conflicts, nuclear non-proliferation and counter-terrorism.[16] Considering international UN sanctions are legally binding, these cannot be considered as SI.

Figure 16: **Applied exclusion criteria for companies** (in CHF billion) (n=54)



16 UN (2020). *United Nations Security Council – Sanctions*. Available at: https://www.un.org/securitycouncil/sanctions/information, accessed 31.03.2021.

Figure 17: **Criteria for norms-based screening for asset managers**
(in CHF billion) (n=39)

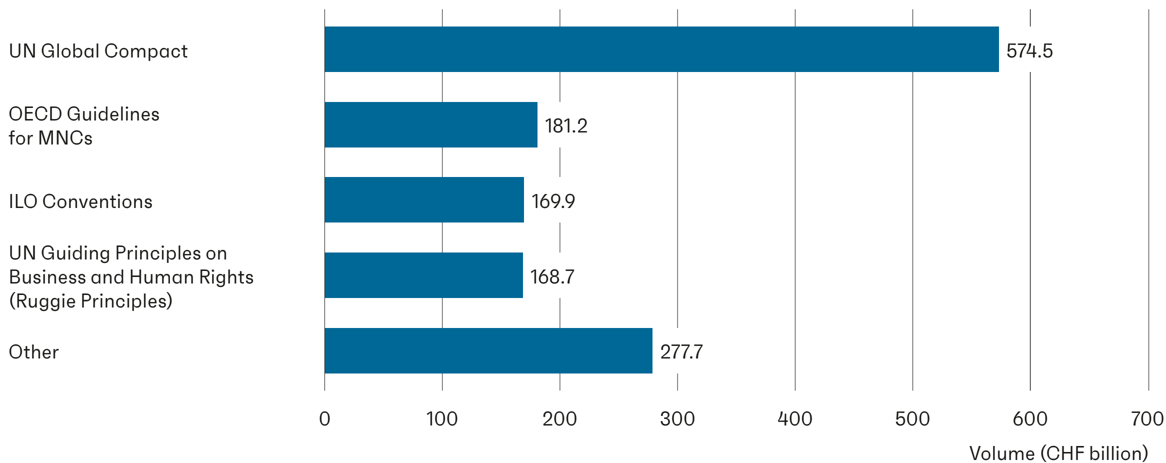
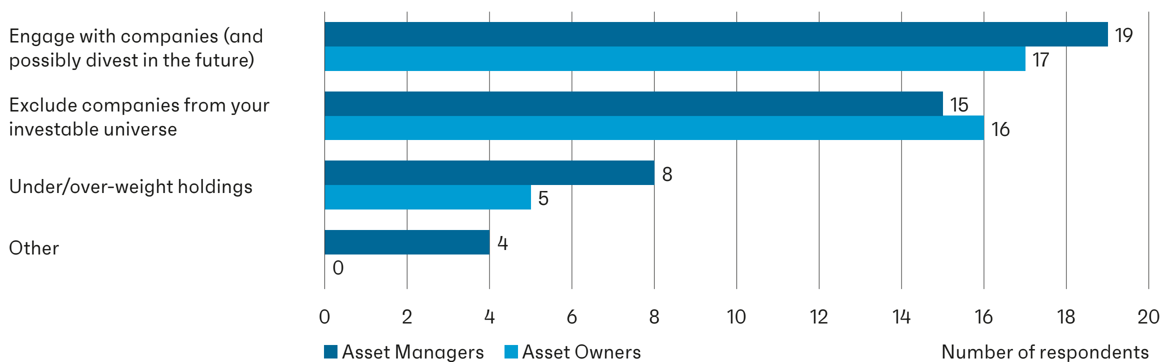


Figure 18: **Investor actions following norms violations**
(in number of respondents) (n=44)

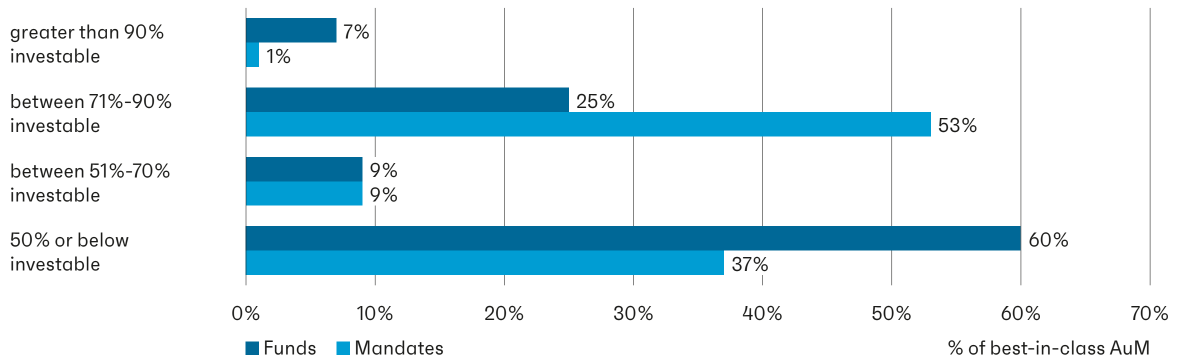


Norms-based Screening

Overall, norms-based screening is applied to 48% of all SI in Switzerland (Figure 12). The volumes managed under this approach recorded 48% volume growth in 2020. Figure 17 shows that the most important norm used for screening asset managers' portfolios is the UN Guiding Principles on Business and Human Rights. Besides the international frameworks displayed in Figure 17, asset manager respondents used several other norms as the basis for their screening, for instance the Rio Declaration on Environment and Development.

Survey respondents were also asked about the actions they take when companies are found to be in breach of one of the applied norms. Figure 18 shows that both asset managers and asset owners either take further action or exclude these companies from their investment universe, with the first approach being slightly more popular. Only a smaller fraction change the weightings of their holdings after violations. An example of an action listed under "other" is that companies are added to watchlists and monitored on a more regular basis.

Figure 19: **Investment universe reduction based on best-in-class approach for asset managers** (in % of best-in-class aum) (n=25)



ESG Voting

Active voting experienced growth of 37% in 2020 and is now applied to 34% of all SI assets in Switzerland (Figure 12). Seeing that ESG voting is not relevant for all asset classes, this represents a relatively high share of SI volumes. As Figure 13 shows, ESG voting is mainly displayed in the volumes for asset managers, to which 80% of the voting volumes can be attributed.

Best-In-Class

The best-in-class approach has experienced growth of 28% and represents 10% of all SI assets in Switzerland (Figure 12). Similar to the ESG voting approach, best-in-class is more popular with asset managers.

Furthermore, asset manager participants were asked about the thresholds of their best-in-class approach in more detail (Figure 19). The majority of funds apply the best-in-class approach in a rather strict manner. For 60% of the fund volume, the investment universe is reduced by at least 50%. For a quarter of the fund volume, the 71–90% remains investable, while only for a small fraction over 90% stays investable. Regarding mandates, either at least 50% remains investable or 71–90% of the universe.

Figure 20: **Asset allocation in impact investing for asset managers** (in CHF billion) (n=18)

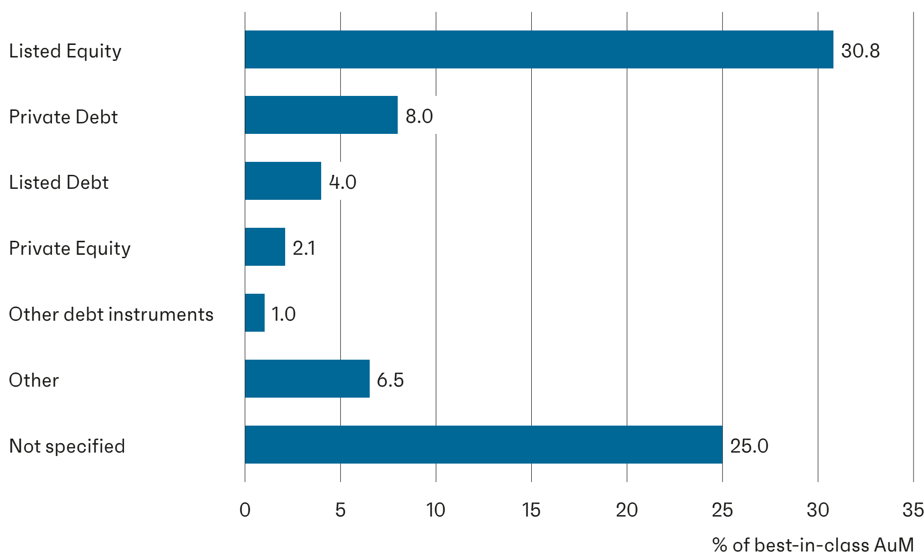
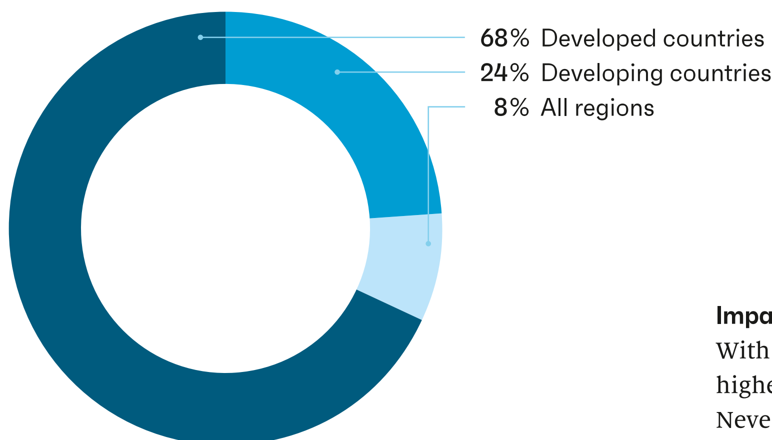


Figure 21: **Impact investment in developed versus developing countries for asset managers** (in %) (n=20)



Impact investment
With annual growth of 70%, impact investing experienced the highest growth rate of all SI approaches in 2020 (Figure 12). Nevertheless, this approach was only applied to 6% of all SI in Switzerland. As Figure 13 shows, impact investments are mainly applied by asset managers. However, based on data from by asset managers, a substantial amount of impact investments are held by institutional investors. The top five impact investment topics of asset managers are housing/ community development, water, environment, microfinance and energy.

Figure 20 indicates that the impact investment market has a strong focus on listed equity and are mainly focused on developed countries, as Figure 21 shows.

There is an ongoing debate amongst both academics and practitioners about which characteristics qualify an investment as impact investing. While such investments originally focused mainly on developing countries and private markets, an increasing number of asset managers also claim to create impact in listed markets in developed countries. This raises many questions: for example, whether we should differentiate between impact investments and thematic funds. Several investment guidelines and principles have been developed over the years that can help asset managers when defining their impact investment understanding and strategy. While commitment to these types of guidelines and principles can be expected to grow over the coming years, further standardisation is also likely. Today, the most commonly mentioned principles that impact investors adhere to are the IFC Operating Principles for Impact Management, adopted by approximately half of those reporting impact investments. Other guidelines/principles mentioned linked to impact investing products were IRIS, Impact Management Project (IMP), SDGs and PRI.

Responses to a further question illustrate that for impact-related products, very few asset managers are willing to accept a financial return lower than the market return, making impact investments far from being a philanthropic activity.

Specific indicators in the impact measurement domain are, for example: the number of female employees and the percentage of female borrowers (reflecting gender factors); the amount of clean energy produced and the CO_2 emission reduction (reflecting climate change mitigation); the hectares of deforestation avoided; the number of smallholder farmers reached; and the percentage of agricultural waste recycled.

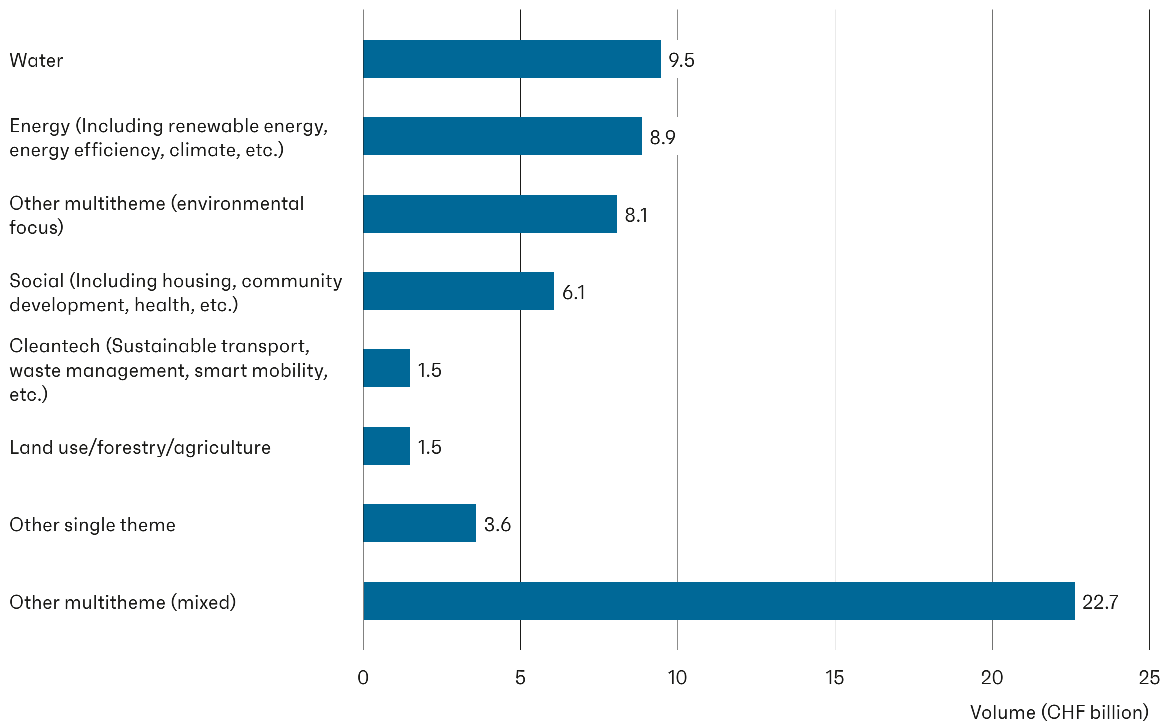
This is the first year since we started collecting data that impact investing has moved from the bottom spot. This is likely due to the increased roll-out of impact products, but also to different interpretations of impact investing amongst practitioners. We observe that large volumes of traditionally classified thematic investments also are reported under impact investments due to an expansion and incorporation of impact elements into those strategies. To deepen our understanding of the private market for impact investments in developing countries, this year we have included insights from the Private Asset Impact Fund study of Tameo Impact Fund Solutions (page 60).

Sustainable thematic investment

Sustainable thematic investments experienced growth of 19%, amounting to 5% of all SI assets in Switzerland in 2020 (Figure 12). Similar to impact investments, sustainable thematic investments are mainly applied by asset managers (Figure 13).

Figure 22 shows that the top sustainable themes in 2020 had an environmental focus (water, energy and environmentally focused multi-theme funds) followed by social themes (community development, health). Besides focusing on one specific theme, asset managers also held a number of multi-themed funds and mandates combining a broad range of the themes addressing a mix of both social and environmental topics.

Figure 22: **Main sustainable thematic investment themes for asset managers** (in CHF billion) (n=35)



Role of different combinations of SI approaches

Overall, 87% of the total SI volumes apply combinations with two or more approaches (Figure 23). The share of volumes that apply only one approach shrank from 17% to 13%. Combinations of four or more approaches gained popularity, which is a good sign, since it shows that investors are becoming more sophisticated in their holistic sustainability approaches.

Figure 24 shows the top ten combinations of asset managers. ESG integration appears in 8 of the top 10 combinations. Furthermore, ESG engagement is also represented in seven of the top combinations. For asset owners (Figure 25), exclusion and ESG integration are the most popular approaches to combine with others. Compared to the previous year, ESG integration is now the only approach that appears as a stand-alone position in the top combinations, whereas last year integration, engagement and exclusions were all listed as stand-alone positions within the top 10 combinations.

Figure 23: **Number of approaches applied** (in %) (n=70)

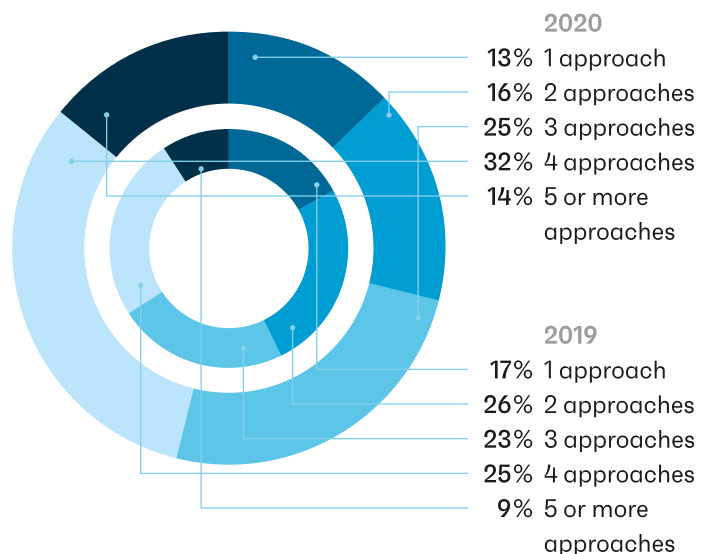


Figure 24: **Top 10 combinations of sustainable investment approaches for asset manager** (in CHF billion) (n=45)

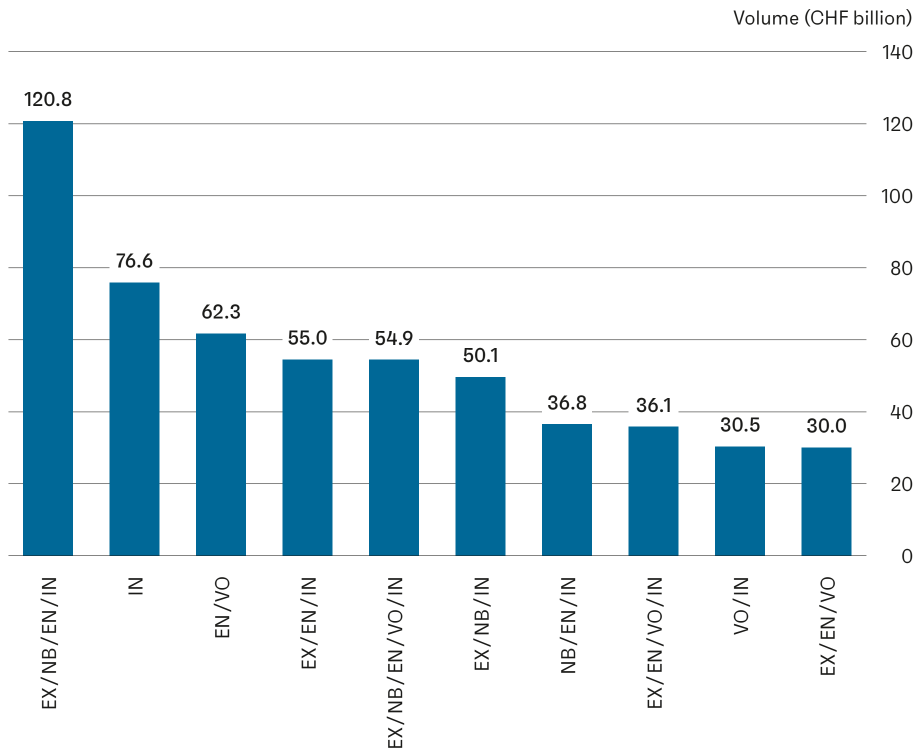
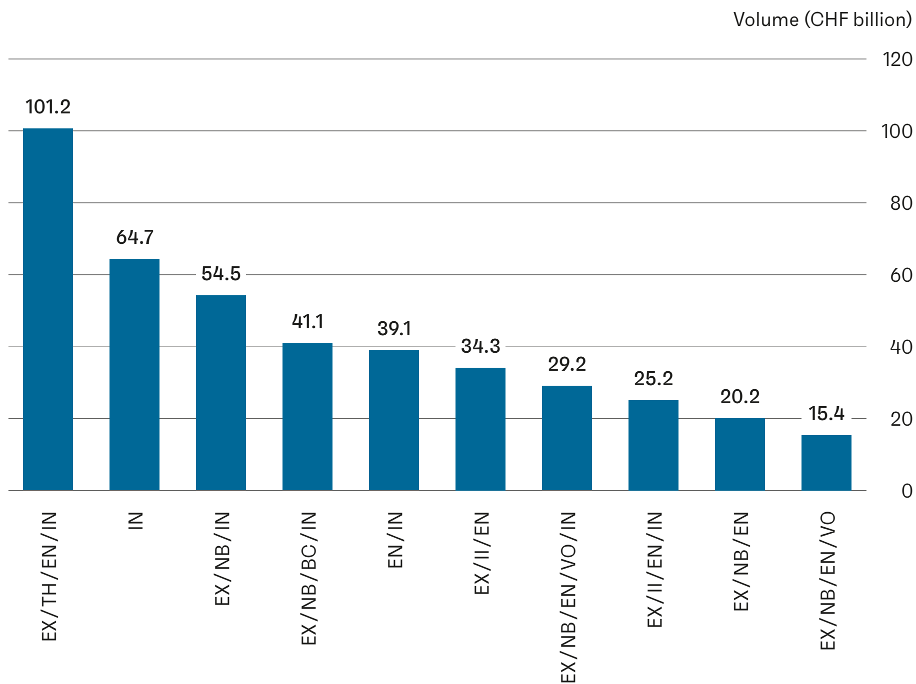


Figure 25: **Top 10 combinations of sustainable investment approaches for asset owners** (in CHF billion) (n=25)



Legend to figure 24 & 25
Abbreviations used for combinations

BC Best-in-class
EN ESG engagement
EX Exclusions
II Impact investing
IN ESG integration
NB Norms-based screening
TH Sustainable thematic investments
VO ESG voting

2.4 Asset Allocation

Figure 26 captures the development of the SI asset allocation for both asset managers and owners in absolute terms. After huge increases in 2019, almost all of the asset classes still show substantial growth in 2020. Equity and corporate bonds demonstrate the highest absolute increases. This further underlines the mainstreaming effect: asset managers are increasingly considering ESG factors for funds that have large positions in equity and corporate bonds. The asset class distribution of SI has not experienced any major shifts in 2020, while only supranational bonds and mortgages lost part of their share, although they are small asset classes.

Real estate overtook sovereign bonds to move into third place in terms of SI volumes in 2020. As Figure 29 shows, real estate is clearly more important for asset owners than for asset managers, as also reflected in the number of policies linked to this asset class. In total, 34 out of 42 respondents indicated they had an explicit ESG real estate policy in place (Figure 28). For 27 asset owners and 7 asset managers, the content of the policy focuses on renovation of properties. Furthermore, many of the asset owners (23 respondents) and also a few asset managers (7 respondents) apply internal or external standards to monitor the sustainability performance of their real estate

Figure 26: **Change in asset class distribution for sustainable investments (in CHF billion) (n=68)**

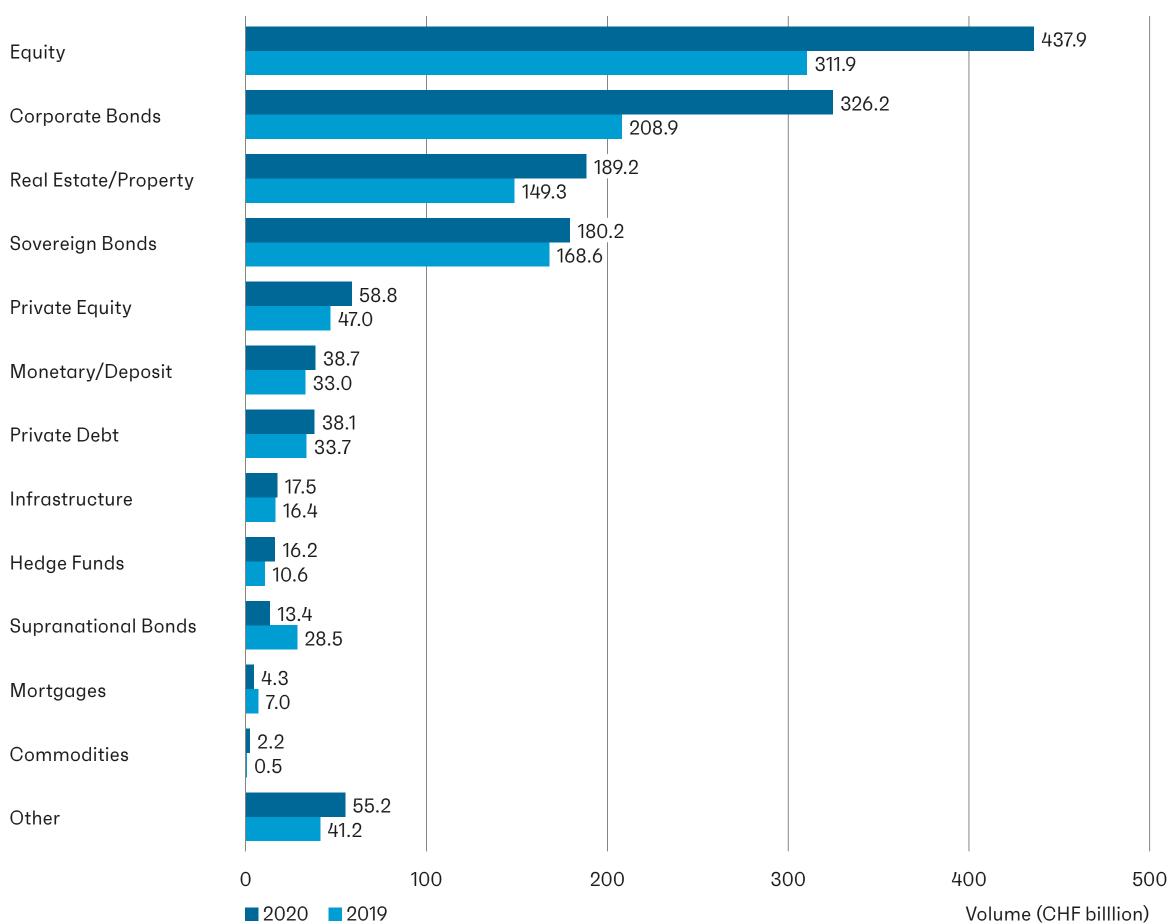


Figure 27: **Asset class distribution for sustainable Investments** (in %) (n=68)

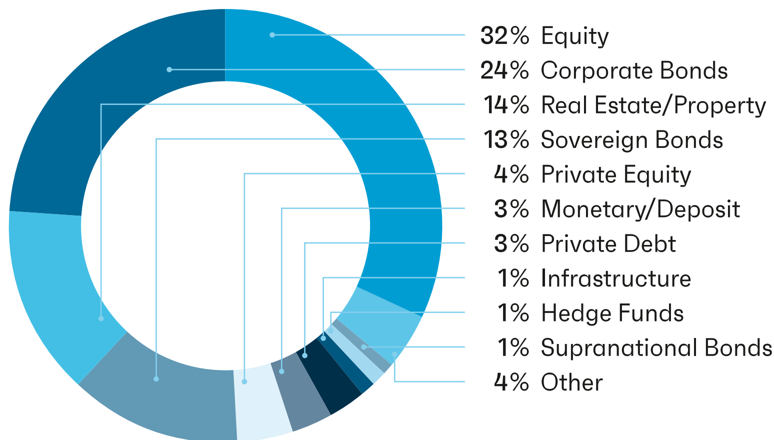
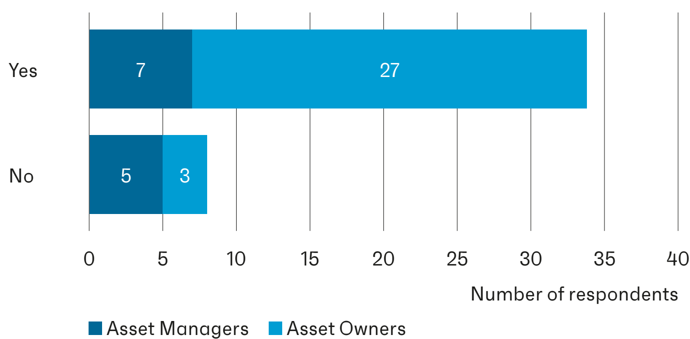


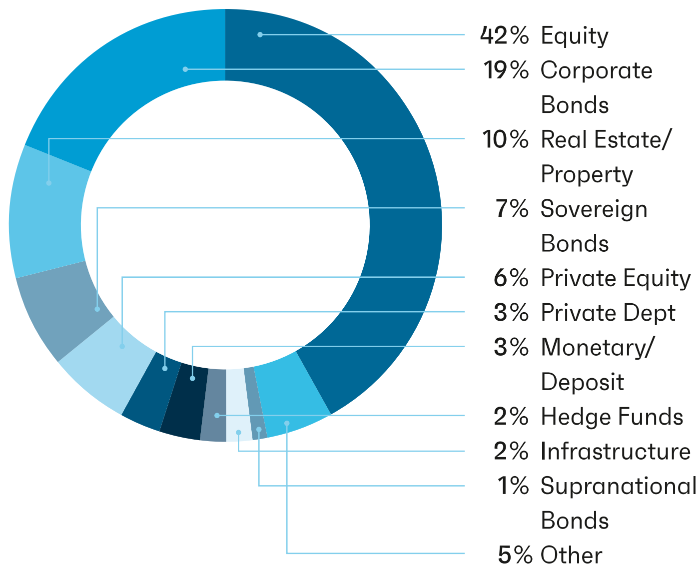
Figure 28: **ESG real-estate policy** (in number of respondents) (n=42)



investments. Within that context, the green labels or benchmarks Minergie for Swiss property (20 respondents), LEED for US property (6 respondents), BREEAM for UK property (5 respondents) and GRESB for property globally (9 respondents) were all mentioned as important.

Asset managers and owners show major differences regarding the asset allocation of their SI. These differences can be explained by the fact that both pension funds and insurance companies hold a larger proportion of bonds overall. Figure 29 shows that around 62% of the total SI managed by asset owners is allocated to bonds. It is not surprising that real estate ranks high for asset owners, as in times of low interest rates and volatile equity markets, this asset class may be seen as a reliable opportunity to achieve the minimum interest rate.

Figure 29: **Asset class distribution for sustainable investments for asset managers and asset owners**



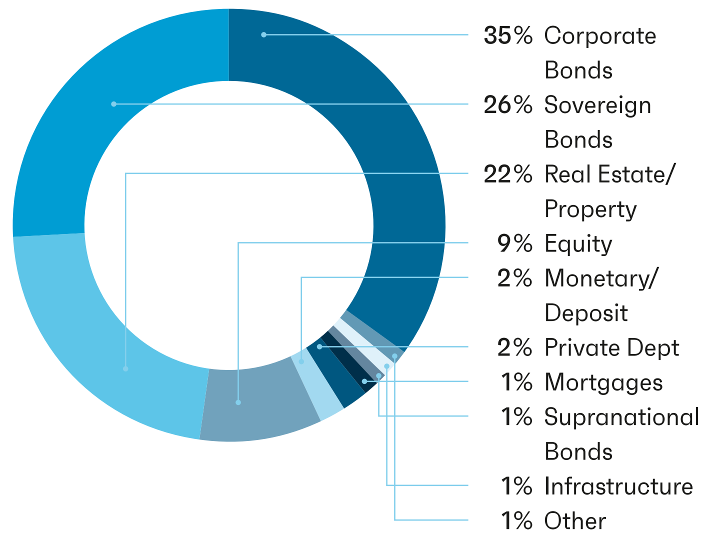
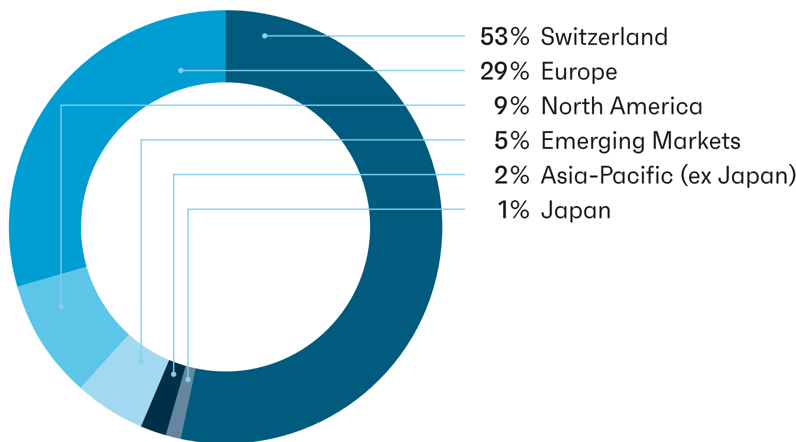


Figure 30: **Regional allocation of sustainable investments for asset owners** (in %) (n=20)



A breakdown of the regional allocation of SI assets managed by asset owners shows that the bulk (53%) is invested in Switzerland (Figure 30).[17] This home bias is partly driven by regulation[18] and partly by investor preference. Another large proportion, 29%, is invested in Europe, while 9% is invested in the North American market. Emerging markets, Japan and Asia-Pacific (ex-Japan) play a much smaller role in SI for asset owners.[19]

17 This data is based on a volume of CHF 219.4 billion of SI assets. It represents about 40% of the total volumes reported by asset owners.
18 Ordinance of 18 April 1984 on Occupational Old Age, Survivors' and Invalidity Pension Provision (BVV 2) (status 1 January 2020), Art. 55e. (Available at: https://www.fedlex.admin.ch/eli/cc/1984/543_543_543/de)
19 Regional breakdowns are not available for asset managers, as the assignment of the reported SI funds and mandates to a specific region is too difficult to report.

How Swiss asset managers and asset owners integrate sustainability into their policies

For the bulk of this report, we focus on the specific application of the various eight SI approaches to funds, mandates or asset owner volumes. At the same time, most asset managers and owners have defined formal investment policies that are ultimately applied to their full asset ranges. While formal policies represent a company-wide understanding of how specific approaches are generally relevant, these policies do not reveal any product-specific information to customers.

Asset managers most often have policies for exclusions and ESG integration, while for asset owners the two most common approaches are exclusions and ESG voting (Figure 31). All SI policies listed in Figure 31 show that more respondents now have respective policies in place than in 2019.

Figure 32 shows that asset owners see two main reasons for adopting or incorporating sustainability into investment practices: (1) aligning investments with national and/or international norms or company values and (2) fostering a long-term sustainable economy and society. In other words, asset owners clearly emphasise the responsibility they bear towards society and the environment.

Figure 31: **Formal sustainable investment policies** (in number of respondents) (n=73)

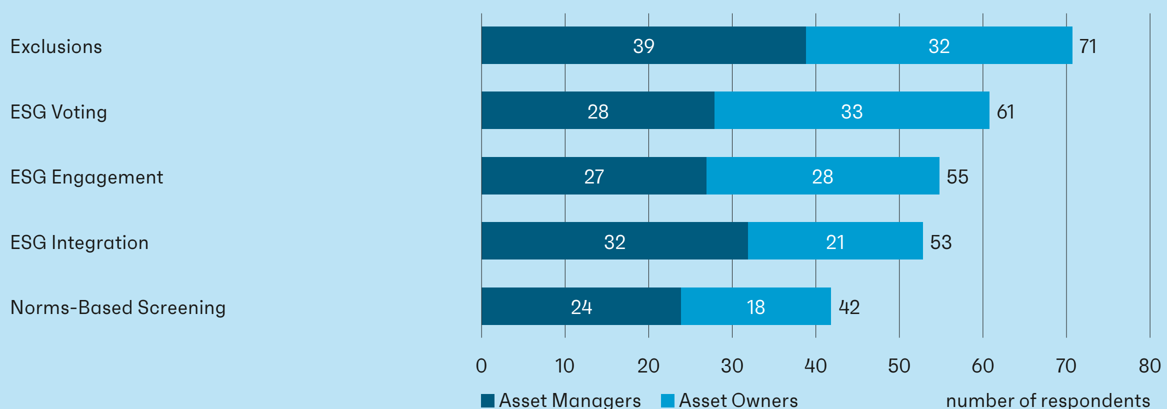
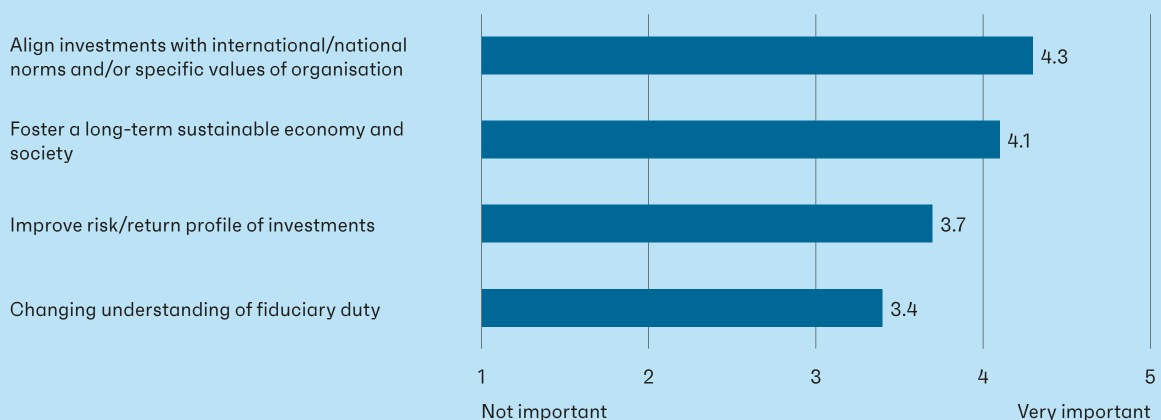
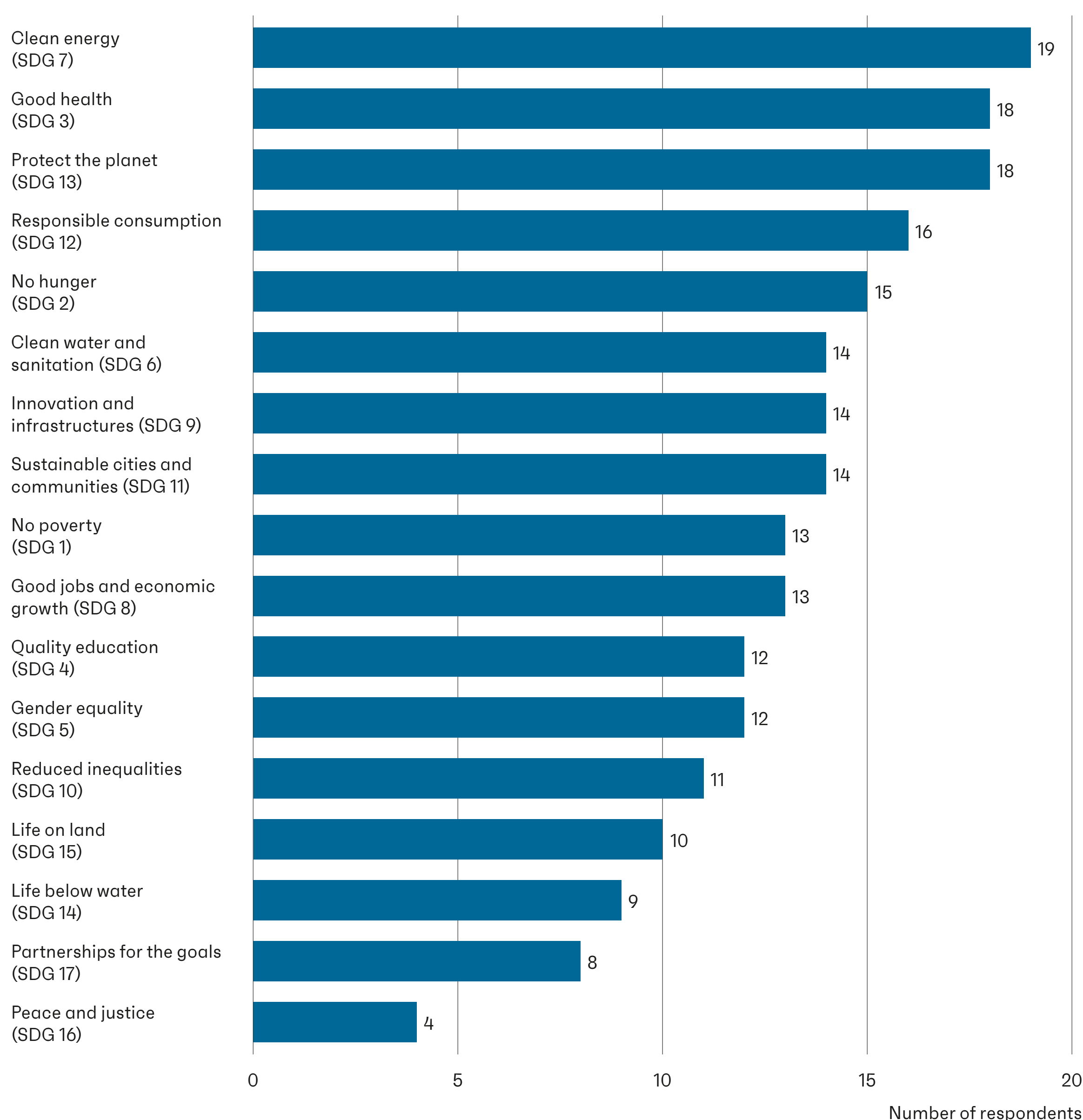


Figure 32: **Main motivation of asset owners for adopting sustainable investment policies** (in average level of importance) (n=32)



2.5 Special Topics

Figure 33: **Specific SDGs addressed in financial products of asset managers**
(in number of respondents) (n=21)



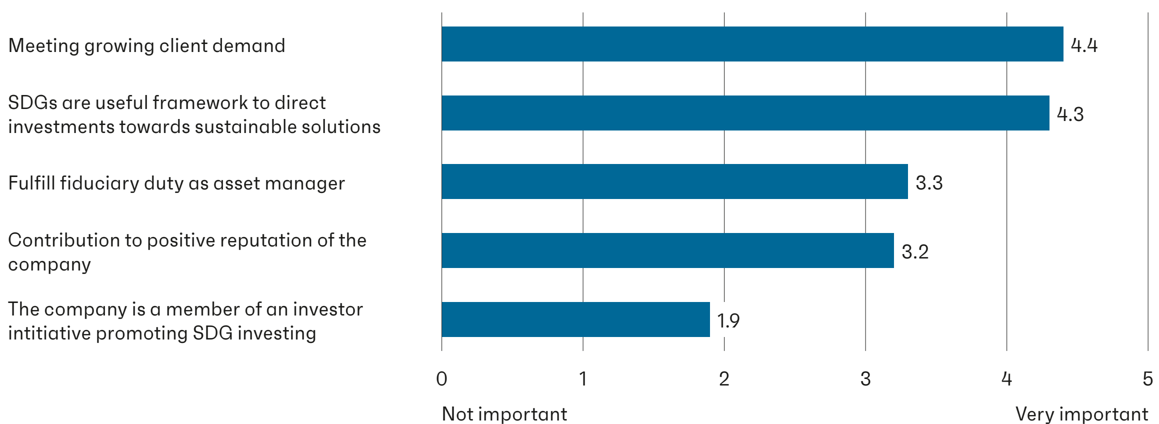
The role of sustainable development goals for investors
At the UN Sustainable Development Summit in 2015 the UN adopted the 2030 Agenda for Sustainable Development and formulated 17 SDGs. The goals reference a wide array of basic needs and global sustainability challenges, such as eradicating hunger and poverty and improving access to education, water or clean energy. Reaching these targets will require additional financial means, which was estimated by the UN as an annual investment gap of USD 2.5 trillion, at current levels of investment in SDG-relevant sectors.[20] Seeing the increasing importance of this topic for investors, this study also includes some specific questions on how SDGs are considered within the SI approaches of asset managers.

Figure 33 illustrates the 17 SDGs and their prominence in asset manager data. Clean energy, good health and planet protection are incorporated by most of the respondents, while partnerships for the goals and peace and justice seem less pressing. Compared to last year, good health has risen substantially in prominence, which might be a reflection of the Covid-19 crisis.

In order to determine an investment products' specific contribution to the SDGs, several options were named. The answers suggest that most asset managers do not use a standardised evaluation scheme, but an in-house solution to determine their products' contribution to the SDGs. These individual qualitative and quantitative assessment frameworks make direct comparisons difficult between offered SDG-related products.

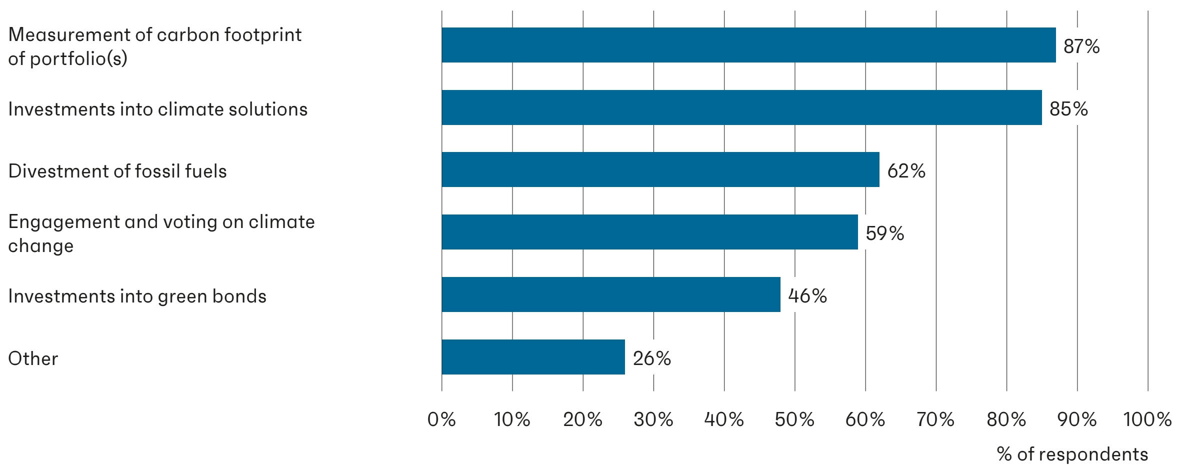
Asset managers are motivated to develop SDG-related products for different reasons. The main motivations come both from the demand and the supply side. On the one hand, growing client demand drives the development of SDG-related products. On the other hand, asset managers use SDG-related products as a framework to direct investments towards sustainable solutions (Figure 34).

Figure 34: **Main motivation for developing SDG-related products for asset managers**
(in average level of importance) (n=21)



20 UNCTAD (2014): *World Investment Report 2014 – Investing in the SDGs: An Action Plan,* United Nations Conference on Trade and Investment, New York and Geneva.

Figure 35: **Measures to address climate change within investments for asset managers** (in number of respondents) (n=39)



Climate change

The ambitious goal of the Paris Agreement[21] – keeping a global temperature rise well below 2, or ideally below 1.5 degrees Celsius – requires economy-wide efforts to mitigate greenhouse gas (GHG) emissions and pave the way for new low-carbon technologies. This creates different risks and opportunities for financial markets. In total, 39 out of 45 asset manager participants indicated that they explicitly address climate change. Almost 90% of those respondents measure the carbon footprint of their portfolios and invest in climate solutions (Figure 35).

Despite the importance and the greater awareness of climate change and its impact on the economy, only 17 respondents said they publish information on their climate change strategy, up from 15 last year. Even though there is a steady increase in the number of respondents in this study who say they publish their climate change strategy, this outcome remains an area for improvement, since only through comprehensive reporting and disclosure practices will the knowledge and quality of the strategies to tackle climate change improve. With TCFD reporting now required by PRI signatories and the Swiss Federal Office of the Environment providing asset managers and owners tools to measure portfolio alignment with various climate scenarios, not to mention increasing activities of pressure groups, the motivation to publish accurate and transparent data in this area is increasing.

21 UNFCCC (n.d.). *The Paris Agreement*. Available at: http://unfccc.int/paris_agreement/items/9486.php, accessed on 02.04.2021

03

Expected Market Trends

3.1 Market Trends – Asset Managers

The market survey covers both asset managers and owners. An analysis of their opinions is discussed separately in the following section.

The forecasts for further growth in SI volumes remain positive for 2021, and stagnation or negative developments are not expected (Figure 36). Most of the respondents expect the market for SI to continue to grow in Switzerland at a rate of 15% to 30%. A smaller portion of participants also predict growth of up to 50%. However, since we have already reached over 50% penetration of SI on the fund level, we need to acknowledge that the market share is already considerably high.

Demand from institutional and retail investors, as well as legislative reasons, are seen as the key drivers for SI (Figure 37). The importance of legislation might be explained by the ever-increasing maturity of the EU Action Plan, which is an important external factor for SI in Switzerland, too, but also by the expanding activities of Swiss authorities on sustainable finance.

In addition to the driving factors, the survey also examined potential barriers to SI growth. As already seen in the previous year, the lack of conviction of client advisors and the lack of standards are still expected to be the key barriers to SI growth (Figure 38).

Figure 36: **Growth forecasts for sustainable investments in Switzerland in 2021 by asset managers** (in number of respondents) (n=40)

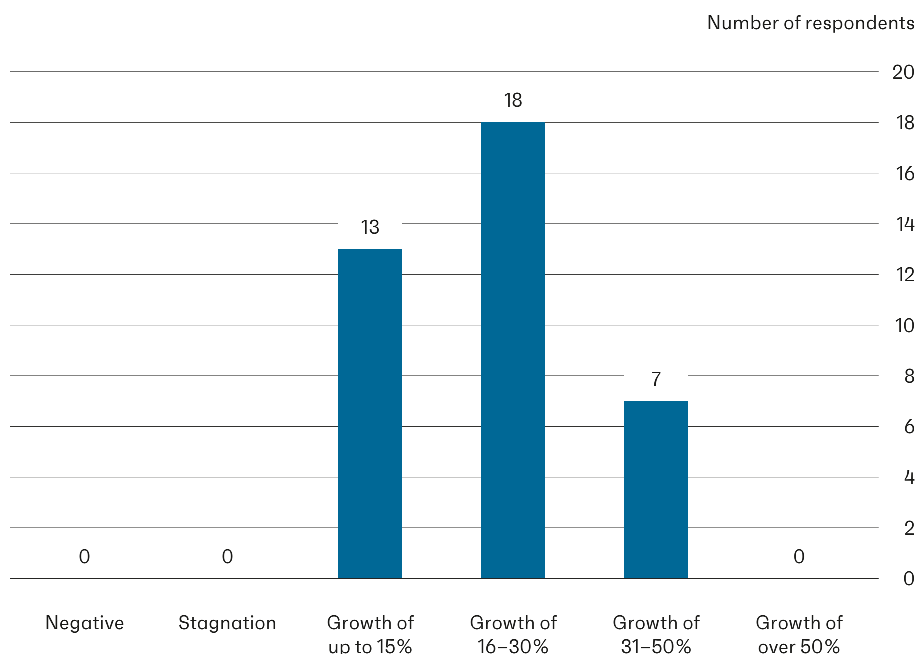


Figure 37: **Key drivers for sustainable investment demand in the next three years for asset managers** (in average level of importance) (n=41)

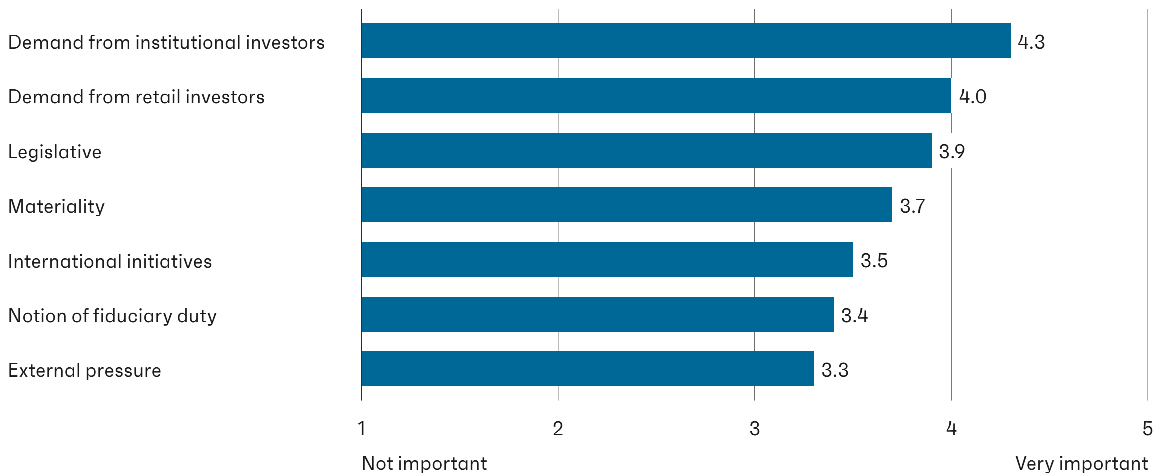
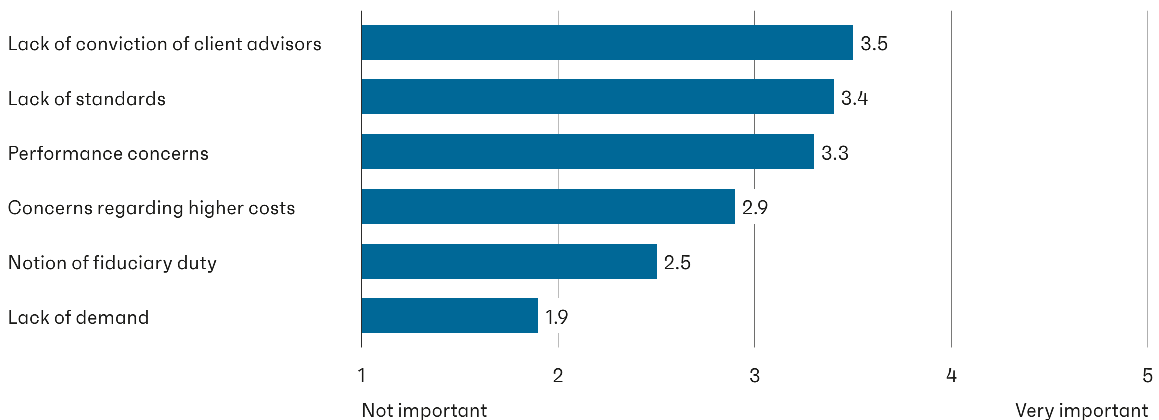


Figure 38: **Key barriers to sustainable investment growth in the next three years for asset managers** (in average level of importance) (n=41)



Sustainable investment capacities of asset managers

For the second time, we looked at SI capacities of asset managers. Out of the 45 participating asset managers, 25 said they require their employees to undergo mandatory training in the area of SI. Furthermore, organisations have varying team sizes with professionals in dedicated SI roles. On average, asset managers employed 19 professionals dedicated to SI. Of the 43 respondents, the number of SI professionals ranged from zero to 137, with only one indicating they have no employees with dedicated SI roles.

3.2 Market Trends – Asset Owners

From the perspective of asset owners, the development of SI will be positive in 2021. However, different levels of growth are expected, as displayed in Figure 39, showing a similar picture to the asset managers' forecast. Most asset owners have slightly more conservative forecasts compared to asset managers and expect continued growth rates of up to 15% or 16%-30%, while only a few predict growth of over 31%.

In terms of key drivers for the wider adoption of SI approaches, asset owners rated political pressure as most important (Figure 40). In comparison to 2019, demand from beneficiaries gained importance. This may be linked to the increased attention the topic has been given by the different NGOs throughout 2020, pushing for investor action in this field and activating beneficiaries.

Concerns regarding higher costs, performance concerns and the lack of standards are seen as the key barriers to further adoption of SI by asset owners (Figure 41).

Figure 39: **Growth forecasts for sustainable investments in Switzerland in 2021 by asset owners** (in number of respondents) (n=28)

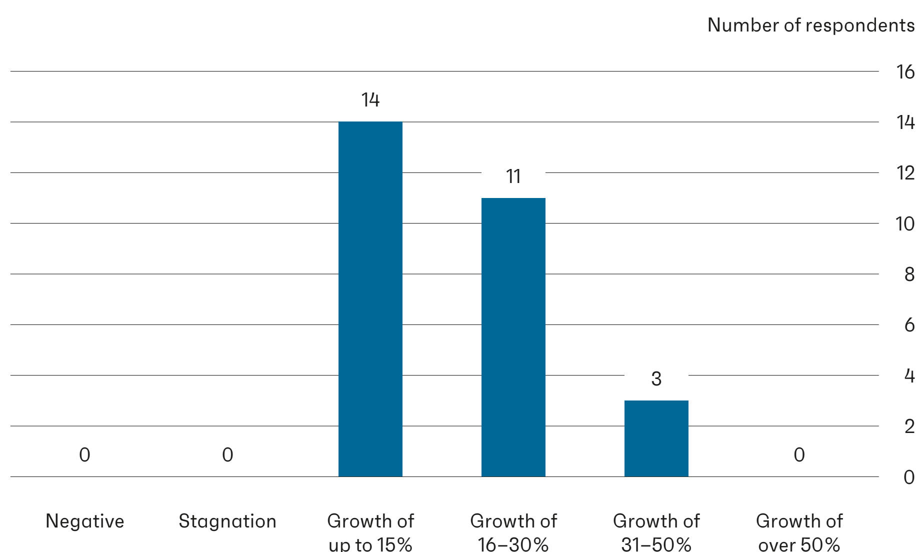


Figure 40: **Key drivers for further adoption of sustainable investment for asset owners**
(in average level of importance) (n=31)

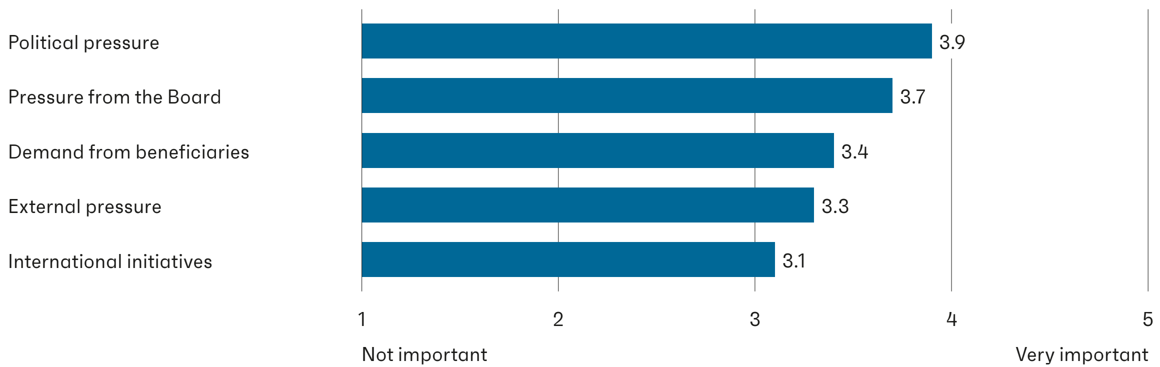
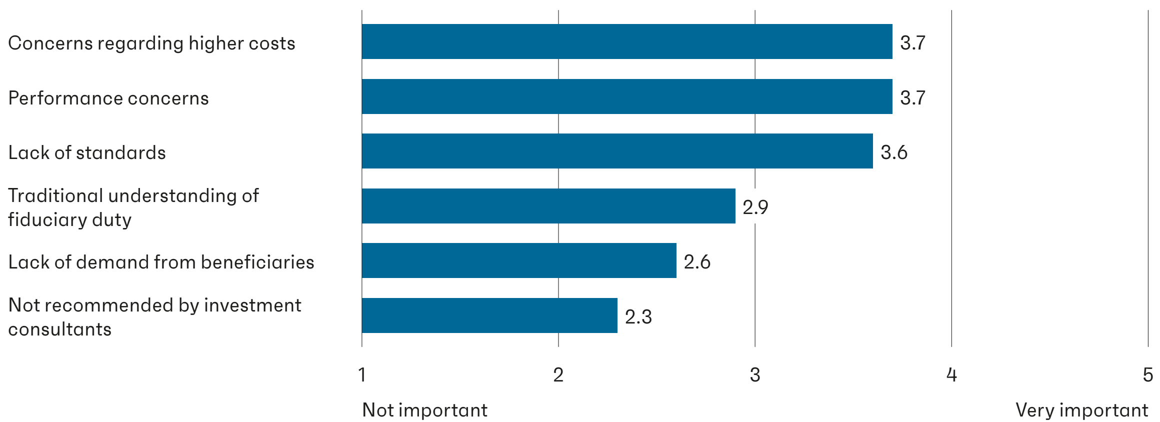


Figure 41: **Key barriers to further adoption of sustainable investment for asset owners**
(in average level of importance) (n=30)



04

Regulatory Developments

In the past year, extensive public policy measures in response to Covid-19 have dominated the regulatory agenda. Despite the tremendous scale of the government action and policy debates focused on the pandemic, it is encouraging to see there is still strong pressure to tackle other sustainability issues and promote sustainable finance. In fact, numerous jurisdictions have passed green-focused stimulus plans and further developed their sustainable finance strategies. Moreover, the Covid-19 crisis has underlined the importance of joint efforts from both public and private actors to combat the most pressing global challenges. In the field of sustainable finance too, governments, international and supranational organisations, market players, industry bodies and NGOs play an important role in making financial flows more sustainable.

The wide array of sustainable finance measures can be imposed in many forms and with varying levels of commitment, be it national legislation, supervisory frameworks, fiscal support mechanisms, market codes or industry standards. However, many of the underlying goals are generally based on one of the following three objectives: first, measures aimed at ensuring the stability of the financial system through the adequate integration of ESG risks. Second, measures targeted at enhancing transparency for clients and investors on the ESG performance of investments, thus improving market efficiency and aligning expectations. Third, measures with the objective of leveraging financial markets to support macro-policy goals and spur the transformation in the real economy by channelling investment into sustainable solutions. In addition, sustainable finance policy often seeks to increase the attractiveness and international competitiveness of a financial centre. With these objectives in mind, this chapter provides an overview of how different measures have developed in the past year.

Swiss Developments

In Switzerland, there is no overarching, dedicated legislative framework on sustainable financing. The relevant pieces of legislation on the national level (such as the Executive Pay Provision or the War Materials Act), as well as a few cantonal pension regulations, have remained unchanged in the past year. However, sustainability is increasingly a key element of the Swiss government's financial market policy. While Swiss authorities still support a market-based approach, the government has put forward a number of proposals in 2020 and 2021 to enhance the frameworks for sustainable finance. In addition, recent developments in the field of Swiss environmental policy affect the entire economy, and thus also the financial sector.

Figure 42: **Federal Council measures adopted in December 2020**

Source: Federal Council Press Release (11.12.2020)

Prepare the **binding implementation of the recommendations of the Task Force on Climate-related Financial Disclosures** (TCFD) by Swiss companies in all sectors of the economy

Assess necessary **amendments to financial market legislation to prevent so-called greenwashing**, i.e. feigned sustainable business activity in terms of environmental impact, taking into account international developments (especially in the EU)

Recommend that **financial market players already publish methods and strategies for taking account of climate and environmental risks** when managing their clients' assets, in accordance with the existing legal duties of loyalty and diligence.

Expand Switzerland's **international commitment**, focusing on the disclosure of environmental information and the internalisation of environmental cost

Government action

The year 2020 saw two milestone announcements by the Swiss Federal Council. Following preparatory work by one internal and two external working groups, in which market players were also represented, the Federal Council published a report in June 2020 that examined 13 measures for Switzerland to further increase its competitiveness as a leader in sustainable finance and ensure that the Swiss financial sector makes an effective contribution to sustainability. Based on this analysis, four concrete measures were adopted by the Federal Council in December 2020 (see Figure 42).[22]

Currently, the work on these measures is led by the State Secretariat for International Finance (SIF), which is reviewing the regulatory framework and examining possible adaptations to Swiss financial market law with regards to transparency and the prevention of greenwashing. If considered necessary, possible amendments to financial market legislations are expected to be presented by the end of 2021. In the meantime, the Swiss government has already become an official supporter of TCFD and has recommended that companies should comply with them on a voluntary basis. An additional focus of the SIF is harnessing digital technology for sustainable finance. Following a survey in September 2020, the Swiss Green Fintech Network was launched to exploit the potential of digitalisation and sustainable financial services, and released policy recommendations in April 2021 (see interview with SIF on p. 56).[24]

In other parts of the administration, the Federal Office for the Environment (FOEN) conducted its second round of climate compatibility testing using the PACTA methodology, covering a substantial portion of Swiss pension funds, insurance companies, asset managers and banks. The assessment of the 179 financial institutions showed progress compared to the 2017 round, but also identified further need for action, as the Swiss financial centre remains invested in oil and coal extraction.[25] Switzerland is also an active partner in the informal working group preparing the launch of the Taskforce on Nature-Related Financial Disclosures (TNFD), as well as a member of the Coalition of Finance Ministers for Climate Action and the International Platform on Sustainable Finance.

Public financial bodies also displayed greater activity related to sustainable finance. Under its existing mandate of fund authorisation, the Financial Market Supervisory Authority (FINMA) has started requiring ESG information for funds promoting sustainability. FINMA is also planning to introduce transparency obligations for climate risks for large banks and insurance companies.[26] The Swiss National Bank (SNB) and Compenswiss, the institution managing Switzerland's first-pillar social security funds, announced their decision to move out of coal.[28] Furthermore, both FINMA and the SNB continue to be active in the Network for Greening the Financial System (NGFS), which brings together supervisory bodies and central banks across five continents to define best practice for financial market regulators and strengthen sustainable central-bank action.

Finally, when it comes to overarching strategies, the Swiss government also raised the bar in January 2021, when it presented a new long-term climate strategy to 2050 , concretising its net-zero carbon emissions target. This long-term strategy will likely provide additional impetus to all sectors of the Swiss economy, including the financial industry, to further reduce their carbon footprint and work towards reaching the Paris Agreement.

22 Federal Council (11.12.2020). *Federal Council fleshes out proposals for sustainable Swiss financial centre [Press Release].* Available at: www.admin.ch/gov/en/start/documentation/media-releases/media-releases-federal-council.msg-id-81571.html
23 Federal Department of Finance (12.01.2021). *Switzerland promotes transparency on climate-related financial risks [Press Release].* Available at: www.admin.ch/gov/en/start/documentation/media-releases.msg-id-81924.html
24 Green Fintech Network Switzerland (April 2021). *Harnessing the Power of Digital Finance for Sustainable Financial Markets.* Available at: https://www.sif.admin.ch/sif/en/home/dokumentation/fokus/green-fintech-action-plan.html
25 2° Investing Initiative, Wüest Partner (2020). *Bridging the Gap: Measuring progress on the climate goal alignment and climate actions of Swiss Financial Institutions.*
26 FINMA (10.11.2020). *Transparenzpflichten bei Klimarisiken – FINMA eröffnet Anhörung.* Available at: www.finma.ch/de/news/2020/11/20201110-mm-transparenzpflichten-klimarisiken/?pk_campaign=transparenzpflichten-klimarisiken&pk_kwd=transparenzpflichten-klimarisiken
27 Handelszeitung (17.12.2020). *Kurswechsel: SNB steig aus Kohle-Investitionen aus.* Available at: www.handelszeitung.ch/konjunktur/kurswechsel-snb-steigt-aus-kohle-investitionen-aus and Kohli, A. (20.11.2020). *AHV-Fonds will raus aus der Kohle.* SRF. Available at: www.srf.ch/news/wirtschaft/klimafreundlich-investieren-ahv-fonds-will-raus-aus-der-kohle
28 FOEN (n.d.) *Long-term climate strategy to 2050.* Available at: www.bafu.admin.ch/bafu/en/home/topics/climate/info-specialists/emission-reduction/reduction-targets/2050-target/climate-strategy-2050.html

Parliamentary activity

In September 2020, the Swiss parliament passed the revision of the CO_2 Act, setting a milestone for Swiss climate policy. The revised law introduces a more ambitious domestic reduction target and stringent measures for multiple sectors. It also aims to align financial flows with climate targets and requires the SNB and FINMA to review micro- and macro-prudential financial risks of climate change. The new law is subject to a referendum and hence still needs to be approved by Swiss voters on 13 June 2021, but it has already received broad support from many industry players, including different finance associations that consider a clear, long-term framework for climate protection to be indispensable.

The Swiss parliament also dealt with multiple concrete sustainable finance questions, and five new parliamentary items of business on sustainable finance were filed in 2020. Although this number is lower than in the year before – likely due to Covid-19 – lively debate continues and topics such as biodiversity risks have received more attention.[29]

Finally, also on the political front, the Responsible Business Initiative[30] was put to the vote in September 2020. Although the original proposal failed to achieve the necessary majority in the popular vote, a counter-proposal will now become effective[31] and amend the Swiss Code of Obligations to require non-financial reporting for all larger companies, as well as mandatory due diligence expectations for mineral supply chains and supply chains related to goods or services with a reasonable suspicion of child labour.[32] Ultimately, the enhanced disclosure requirements are expected to improve data availability on sustainability issues among Swiss companies and will support the integration of such issues into investment and financing decisions.

Industry initiatives

The abovementioned market-based approach requires an active role of the Swiss financial industry. In the past year, a number of industry bodies have worked on the issue of integrating ESG criteria into investment and advisory processes, as well as on transparency. For example, the key messages and recommendations for sustainable asset management, published by SSF and the Asset Management Association Switzerland (AMAS) in June 2020, aim to help asset managers actively incorporate sustainability criteria into their investment processes.[33] Also in summer 2020, the Swiss Bankers Association issued guidelines with six principles for the integration of ESG criteria into the client advisory process. In early summer 2021, SSF will release reporting recommendations on ESG transparency for portfolios. Other older, but still relevant, self-regulatory instruments include the Swiss stock exchange (SIX) Directive on Information relating to Corporate Governance, and its opt-in clause for sustainability reporting, which is currently used by almost a third of Swiss Market Index (SMI) companies.

29 See Interpellation 20.3111 «Ist die Biodiversität Teil des Mandats der bundesinternen Arbeitsgruppe zu Sustainable Finance?» or Motion 20.3798 «Obligations vertes en faveur du climat et de la biodiversité»

30 The Responsible Business Initiative would have required that Swiss-based firms prove they had taken due care to prevent abusive labour conditions and environmental damage in their own operations and supply chains abroad. The initiative was however rejected by popular vote.

31 For the counter proposal to come into force, an implementing ordinance of the Federal Council based on consultation is still needed to regulate the open detailed questions on the due diligence obligations. This will likely happen in 2022.

32 ECOFACT (30.11.2020). *The Swiss Responsible Business Initiative was rejected. What now?*. Available at: www.ecofact.com/blog/the-responsible-business-initiative-was-rejected-by-swiss-voters-what-now/

33 SFAMA & SSF (16.06.2020). *Sustainable Asset Management: Key Messages and Recommendations of SFAMA and SSF.* Available at: www.sustainablefinance.ch/upload/cms/user/EN_2020_06_16_SFAMA_SSF_key_messages_and_recommendations_final.pdf

Civil society

Besides government and politicians, other actors in Switzerland have turned a critical eye on the finance sector. At the beginning of 2021, the Climate Strike movement presented a 377-page action plan outlining how Switzerland could achieve a net-zero goal by 2030, with a dedicated chapter and requirements for the financial sector.[34] Pressure has also grown from NGOs such as the Swiss Climate Alliance. Their assessment of 110 Swiss pension funds showed that around 10% of all pension funds have aligned their investment behaviour with the Paris climate targets.[35] Finally, WWF Switzerland and PwC published a report mapping out over 40 concrete measures for a sustainable Swiss financial sector. A common denominator of this NGO-driven activity is the ambitious call to reduce the negative impact of financial flows on the environment as fast as possible, and make sure all such flows contribute to the transition to a sustainable economy within a decade.

Developments in the European Union

The rollout of the interconnected set of sustainable finance policy measures in the European Union (EU) as shown in Figure 43 is impressive, and proof of the determination of the European Commission (EC) to leverage private finance for the achievement of its sustainable policy objectives. The finalisation and implementation of new regulation and standards over the past year has required fast adjustments on the part of financial service providers and also affects Swiss financial market participants with activities in the EU or with European clients.

Most notably, the Sustainable Finance Disclosure Regulation (SFDR), which introduces various disclosure-related requirements at entity and product level, entered into force in December 2019.[36] Since March 10th 2021, the SFDR requires investors (including advisers) to report on the integration of sustainability risks and provide additional information, depending on the degree to which sustainability elements are promoted by products. Furthermore, the Regulatory Technical Standards (RTS), which supplement the SFDR, will become applicable in January 2022 and require disclosures on the adverse sustainability impacts of investments starting 2023, based on a catalogue of 18 indicators.[37]

In 2020, the EC also adopted delegated acts supplementing the EU Benchmark Regulation. These set out the requirements for the Climate Transition and Paris Aligned Benchmarks and specify how traditional benchmarks must provide a statement on ESG factors. Also in the pipeline are amendments to MIFID and the IDD, which have been adopted by the European institutions and will require investment firms to integrate sustainability when providing investment advice to clients.

Underpinning the EU's policy-related activities is the EU Taxonomy Regulation, which sets out a classification system for economic activities that can be considered "green". The taxonomy currently interlinks six environmental objectives together through a "do no significant harm"[38] requirement and includes a minimal social safeguard clause. Proposed technical screening criteria have been published for climate change mitigation and climate change adaptation activities[39], and the taxonomy provides key guidance for products seeking to pursue environmental objectives as per SFDR Art. 9. The taxonomy will also feed into several forthcoming regulatory initiatives such as the EU Green Bond Standard or the EU Ecolabel for retail investment funds. While the taxonomy thus far clearly speaks to the financial industry, it is also expected to be relevant for other policy areas. In June 2020, the EC announced that spending under its Covid-19 economic recovery instrument, which aims to raise an additional EUR 750 bn on capital markets, is to be guided by the sustainable taxonomy.[40 | 41]

34 Climatestrike Switzerland (08.01.2021). *Klimaaktionsplan. Financial Sector.* Available at: https://climatestrike.ch/de/posts/cap-8-financial-sector

35 Klima-Allianz Schweiz (02.11.2020). *Erst ein Bruchteil der Pensionskassen investiert klimaverträglich.* Available at: www.klima-allianz.ch/beitrag/erst-ein-bruchteil-der-pensionskassen-investiert-klimavertraeglich/EMAIL_CAMPAIGN_2018_08_30_08_31_COPY_01&utm_medium=email&utm_term=0_f4ff8b12b2-b6ab87ae03-587536380

36 Regulation (EU) 2019/2088 on sustainability-related disclosures in the financial services sectors. Available at: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32019R2088

37 As stipulated in the proposed Regulatory Technical Standards released by the European Supervisory Authorities, the 18 indicators consist of: 9 environmental indicators, 5 social indicators and 2 indicators for investments in sovereigns and supranationals, as well as 2 indicators for real estate.

38 Activities making a substantial contribution to one objective cannot be considered taxonomy compliant if they significantly harm other environmental objectives.

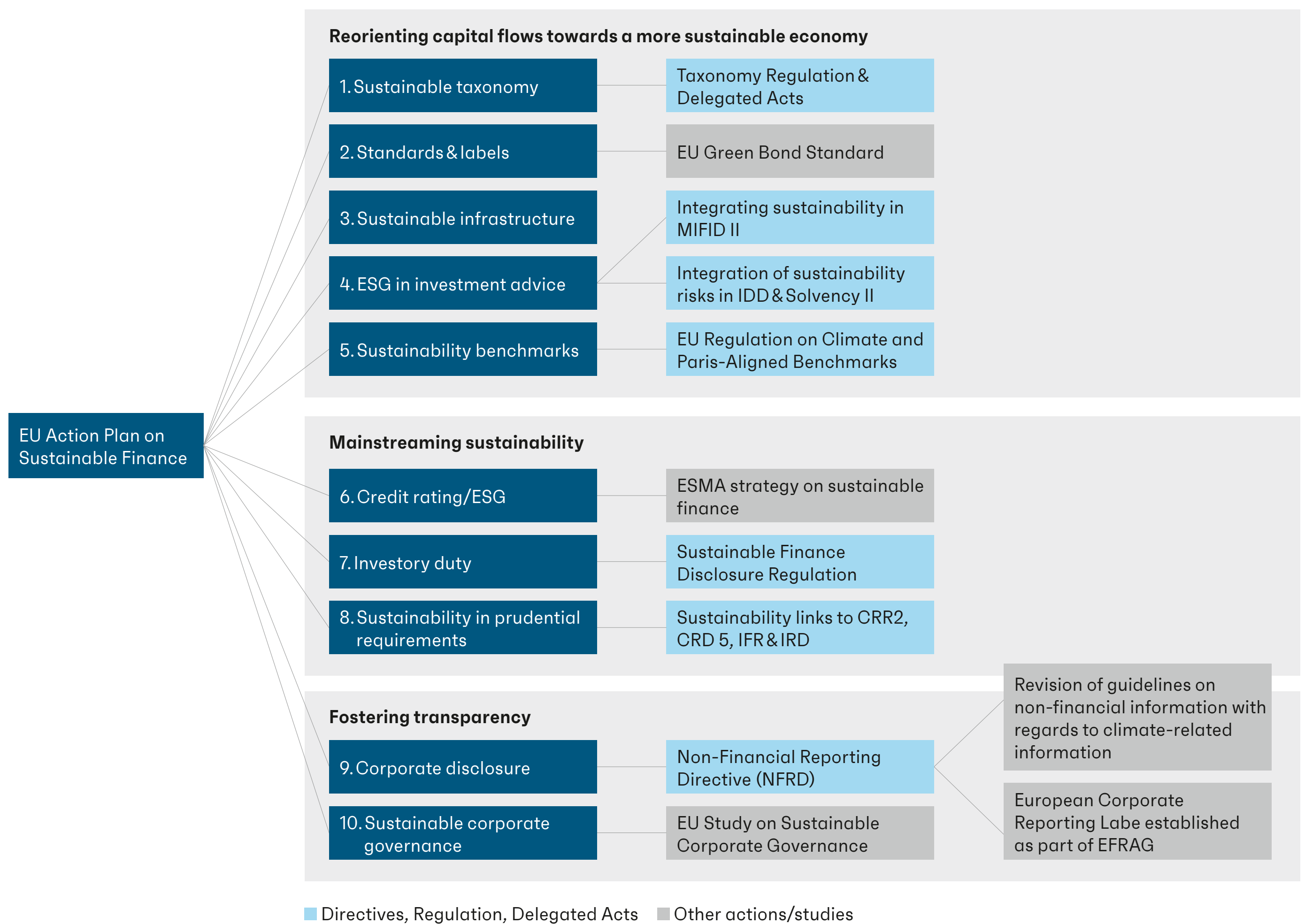
39 Further technical screening criteria are being developed by the EU platform on sustainable finance

40 EU Technical Expert Group on Sustainable Finance (27.04.2020). *Sustainable recovery from the Covid-19 pandemic requires the right tools.* Available at: https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/200426-sustainable-finance-teg-statement-recovery_en.pdf

41 If Member States wish to tap the Commission's Covid-recovery funds, they must demonstrate that at least 37% of their investment plans support decarbonisation; and none of the cash can be used to finance projects that significantly harm the six environmental objectives laid out in the taxonomy. (For more information see: www.consilium.europa.eu/en/press/press-releases/2021/02/11/eu-recovery-package-council-adopts-recovery-and-resilience-facility/)

Figure 43: **Overview of EU Action Plan**

Source: EU Action Plan & Econsense Infographic on Sustainable Finance



Not surprisingly, the implementation of the Taxonomy still faces many challenges, in particular when it comes to data issues. In this context, the European Commission is currently assessing the creation of a single access point for companies' financial and sustainable investment-related information.[42] To further improve disclosure of climate and other environmental data by companies and thus support application of the Taxonomy, a review of the Non-Financial Reporting Directive (NFRD), to be re-named Corporate Sustainability Reporting Directive (CSRD), is currently underway. Following advice from the European Supervisory Authorities (ESAs), large companies falling under the directive will have to provide information related to climate change adaptation and mitigation in their non-financial statements as of 2022, while disclosures related to the other four environmental objectives of the Taxonomy will need to be included, starting 2023.[43]

Looking forward, the EU is expected to present a Renewed Sustainable Finance Strategy over the course of summer 2021, which builds on the measures developed under the Action Plan. The Renewed Strategy is expected to make a substantial contribution to the objectives of the European Green Deal, Europe's new economic growth strategy. The effects of these encompassing policy developments in the EU will likely stretch far into the future and beyond the EU's borders.

Global developments

On a global level, a range of actors are in the process of developing and deepening sustainable finance strategies. While there are few initiatives as encompassing and legally binding as the EU's, many national authorities have moved forward on the issue, creating advisory committees on sustainable finance, assessing taxonomies, or launching their own sovereign green or sustainability bonds.[44] Intergovernmental and non-state actors also continue to put down markers and have set important standards in many areas.

National initiatives

When looking at the national level, many jurisdictions emphasise the necessity of a sustainable recovery from the Covid-19 crisis, focusing in particular on transparency around climate risks and improving investor disclosure. Canada, for example, announced in early summer 2020 that it would make climate risk reporting based on TCFD mandatory for firms seeking to receive Covid-19 bailout funding. Even more notably, New Zealand became the first government to introduce mandatory TCFD disclosure in September 2020, to take effect as of 2023 if passed by Parliament.[45] Similarly, the UK government released draft TCFD reporting guidance for pension schemes and has introduced mandatory TCFD reporting for large pension schemes.[46] The guidelines foresee, amongst others, scenario analysis and absolute emission metrics. Despite *Brexit,* the UK is still a frontrunner in the field, with the Bank of England utilising a stress-testing framework for the UK financial system[47] and the UK government currently assessing the social risks and opportunities for occupational pension schemes.[48]

Other jurisdictions are working on enhancing non-financial disclosure of corporates, such as the Securities and Exchange Board of India (SEBI), which introduced ESG disclosure requirements for the country's 1000 largest companies. With regards to disclosure, a lawsuit filed in Australia against the government, alleging that it failed to disclose climate change related risks to investors for its sovereign bond, also illustrates the growing importance of transparency and disclosures.[49] Beyond climate, some countries are starting to become active in the field of biodiversity and natural capital. In the Netherlands, the central bank conducted an assessment of the Dutch financial sector's exposure to biodiversity loss.[50]

42 European Commission (n.d.). *Targeted consultation on the establishment of a European single access point (ESAP) for financial and non-financial information publicly disclosed by companies.* Available at: https://ec.europa.eu/info/consultations/finance-2021-european-single-access-point_en
43 ECOFACT (07.05.2020). *EU Sustainability Taxonomy Regulation: What's in it for the real economy?.* Available at: www.ecofact.com/blog/eu-sustainability-taxonomy-regulation-whats-in-it-for-the-real-economy/
44 For example Germany, the United Kingdom or Luxembourg
45 Burton, M. (15.09.2020). *New Zealand to require financial firms report climate change risks. Reuters.* Available at: www.reuters.com/article/us-climate-change-newzealand/new-zealand-to-require-financial-firms-report-climate-change-risks-idUSKBN2653EG
46 Department for Work and Pensions (27.01.2021). *Closed Consultation. Taking action on climate risk: improving governance and reporting by occupational pension schemes – response and consultation on regulations.* Available at: www.gov.uk/government/consultations/taking-action-on-climate-risk-improving-governance-and-reporting-by-occupational-pension-schemes-response-and-consultation-on-regulations
47 Bank of England (n.d.) *Climate Change.* Available at: www.bankofengland.co.uk/climate-change
48 Department for Work & Pensions (March 2021). *Consideration of social risks and opportunities by occupational pension schemes.* Available at: www.gov.uk/government/consultations/consideration-of-social-risks-and-opportunities-by-occupational-pension-schemes/consideration-of-social-risks-and-opportunities-by-occupational-pension-schemes
49 Pandey, S. (22.06.2020). *Student files first climate change lawsuit against Australian government.* Reuters. Available at: www.reuters.com/article/us-climate-change-lawsuits-australia/student-files-first-climate-change-lawsuit-against-australian-government-idUSKCN24N0CT?utm_medium=Social&utm_source=twitter
50 De Nederlandsche Bank & Planbureau voor de Leefomgevin (June 2020). *Indebted to nature. Exploring biodiversity risks for the Dutch financial sector.* Available at: https://www.dnb.nl/media/4c3fqawd/indebted-to-nature.pdf

There is also a clear momentum around sustainable finance taxonomies, with a number of countries working on definitions or comprehensive classification systems. The UK announced in November 2020 that it plans to implement a green taxonomy, based to a large extent on the thresholds and criteria in the EU taxonomy. In January 2021, one of the measures proposed by the Green Finance Industry Taskforce of Singapore included a taxonomy for Singapore-based financial institutions. The proposal has similarities to EU taxonomy, with overarching concepts such as "do no harm" and sector-specific guidance, but lists only four environmental objectives.[51] Also on the taxonomy front, Canada is planning a taxonomy that focuses on incentivising key sectors to reduce their carbon footprint. Looking even further, there are taxonomy frameworks in discussion in Malaysia[52] and South Africa[53]. Already in place in China since 2015 is a project catalogue for green bonds, often referred to as the Chinese taxonomy, as well as a green industry guidance catalogue updated in 2019.

On the level of broader policy developments, some major steps have been made in the world's largest economies. The tide has clearly turned in the United States, which re-joined the Paris Agreement. Moreover, the US Federal Reserve is now part of the NGFS, and in a further effort to address climate change across its operations, it has created two committees on sustainable finance, alongside other financial bodies that have set up dedicated teams on the topic.[54] China announced in September 2020 that it aims to bring carbon emissions to peak by 2030 and reach carbon neutrality by 2060, and to this end it has published new guidance to promote climate investment and finance.[55]

Intergovernmental and industry-led initiatives

Both intergovernmental and industry-led initiatives remain major drivers for sustainable finance policy around the globe. As mentioned above, the NGFS, the global network of central banks and supervisors, has gained valuable support with the US Federal Reserve becoming an official member in late 2020. Additional momentum is expected from the re-establishment of the G20 sustainable finance working group, which is due to be led by the US and China and intends to promote transparency around climate-related financial risks, sustainable finance, and a strong, green post-pandemic recovery. Also on the intergovernmental level, the International Platform on Sustainable Finance (IPSF), which aims to foster policy dialogue and convergence and is currently working on a 'common ground' taxonomy, now counts 17 active members, including Switzerland.

Multilateral bodies with a broader focus on business and human rights norms also pertain to the financial industry, and the Covid-19 health crisis has raised awareness of social and human rights-related issues. The UN Guiding Principles on Business and Human Rights celebrated their 10th anniversary and has dedicated a focus area to the role and leverage of financial sector actors.[56] In the case of the OECD Guidelines for Multinational Enterprises, the complaint and conciliation mechanisms provided by the National Contact Points (NCP) continue to be used for resolving cases of alleged misconduct. In Switzerland, three new complaints were filed in 2020[57], including a case that involves a financial institution's asset management business and offering of passive products, which led the Swiss NCP to provide clarifying statements on the scope and boundaries of the concept of business relationship.[58]

51 Green Finance Industry Taskforce (n.d.). *Identifying a Green Taxonomy and Relevant Standards for Singapore and ASEAN.* Available at: https://abs.org.sg/docs/library/gfit-taxonomy-consultation-paper

52 Central Bank of Malaysia (27.12.2019). *Climate Change and Principle-based Taxonomy. Discussion Paper.* Available at: www.bnm.gov.my/documents/20124/761679/Climate+Change+and+Principle-based+Taxonomy_Discussion+Paper.pdf/459228e8-d4ac-e8f4-e8da-33cda15bb76f?t=1578628525516

53 South African National Treasury, IFC, National Business Initiative, Carbon Trust (09.10.2020). *Developing a National Green Finance Taxonomy.* Available at: http://sustainablefinanceinitiative.org.za/wp-content/downloads/Stakeholder_Briefing_Document_9_October_2020.pdf

54 NGFS (15.12.2020). *US Federal Reserve joins NGFS and two new publications released.* Available at: www.ngfs.net/en/communique-de-presse/us-federal-reserve-joins-ngfs-and-two-new-publications-released

55 Luo, N. (08.01.2021). *Delivering carbon neutrality in China.* The PRI. Available at: www.unpri.org/pri-blog/delivering-carbon-neutrality-in-china/7000.article

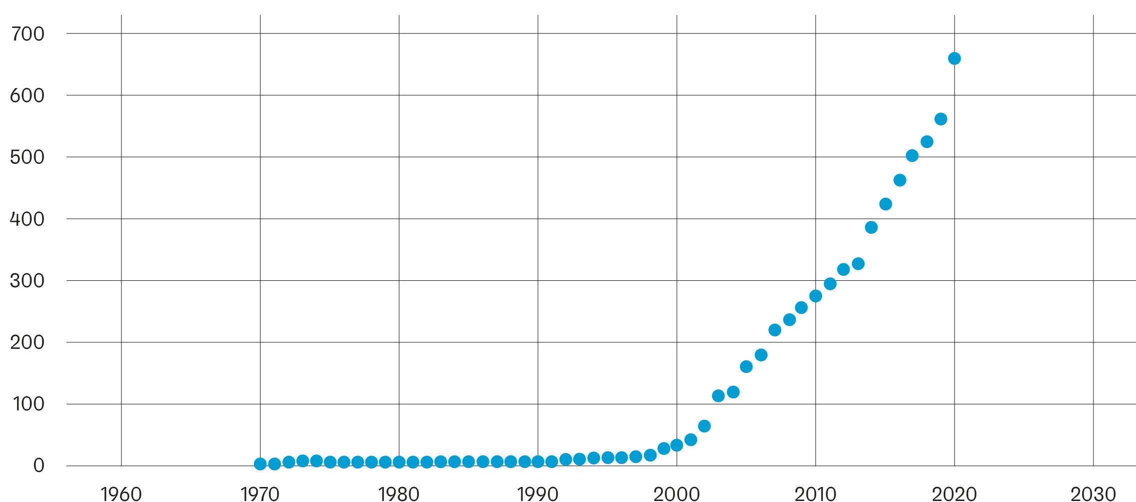
56 OHCHR (n.d.). *The UNGPS 10+ Project: Financial sector tracks.* Available at: www.ohchr.org/EN/Issues/Business/Pages/UNGPsBizHRsnext10.aspx

57 Nationaler Kontaktpunkt der Schweiz für die OECD-Leitsätze für multinationale Unternehmen (2020). *Jahresbericht 2020.* Bern

58 National Contact Point of Switzerland (20.01.2021). *Initial Assessment. Specific Instance regarding UBS Group AG submitted by the Society for Threatened Peoples Switzerland.* Bern

Figure 44: **Cumulative number of sustainable finance policy interventions**

Source: PRI responsible investment regulation database



As mentioned, the topic of biodiversity entered the spotlight more prominently, with governments expected to agree on a new 10-year biodiversity framework in May 2021. Regarding biodiversity and the financial sector, the launch of a working group to develop the Task Force on Nature-related Disclosures (TNFD) set a clear a milestone for the industry. The preparatory work on the TNFD aims to develop an international reporting standard for biodiversity and natural capital with the involvement of several governments and private stakeholders, including the Swiss government and Swiss financial institutions.[59]

Self-regulatory and trade associations also further developed guidelines for sustainable finance. The existing Green & Social Bond Principles, which provide guidelines for the use of proceeds of sustainable bonds and are compiled by the International Capital Markets Association, expanded their reach with the launch of the Sustainability-Linked Bond Principles in 2020.[60] Other well-established industry initiatives such as the Principles for Responsible Investment (PRI) continue to witness a strong inflow of supporters. In October 2020, the PRI presented a new framework to increase accountability among signatories by introducing human rights questions into its reporting framework – initially on a voluntary basis. Moreover, the PRI delisted signatories for the first time since inception, and its younger sister organisation the Principles for Responsible Banking (PRB), also set up a mechanism to delist signatories that do not meet the initiative's key steps. The Net Zero Asset Owner Alliance, which unites some of the world's largest insurance companies and pension funds, sets out intermediary emission reduction target proposals, publishing rules on how investors should calculate and set targets, and allocate capital to support decarbonisation.[61] Additionally, in December 2020 the equivalent to the asset owner alliance was created for the asset management industry: the Net Zero Asset Manager Alliance already unites assets worth more than USD 32 tn and requires members to set clear decarbonisation goals. Finally, the collaborative engagement initiative Climate Action 100+ released an assessment of the world's largest corporate greenhouse gas emitters and their progress in the transition to the net zero future, providing investors with a mechanism for tracking progress.[62]

59 TNFD (n.d.). *Homepage.* Available at: https://tnfd.info/
60 ICMA (June 2020). *Sustainability-Linked Bond Principles. Voluntary Process Guidelines.* Available at: www.icmagroup.org/sustainable-finance/the-principles-guidelines-and-handbooks/sustainability-linked-bond-principles-slbp/
61 U.N.-Convened Net-Zero Asset Owner Alliance (January 2021). *Inaugural 2025 Target Setting Protocol.* Available at: www.unepfi.org/wordpress/wp-content/uploads/2021/01/Alliance-Target-Setting-Protocol-2021.pdf
62 Climate Action 100+ (n.d.). *Net-Zero Company Benchmark.* Available at: www.climateaction100.org/progress/net-zero-company-benchmark/

Conclusion

It is clear from the above that sustainable finance remains a dynamic area of policy development. Given that at its core, it is still a relatively new area of regulation, we can expect more extensive policy interventions in the years to come (see Figure 44). To design sustainable finance regulation, policy makers have diverse options and – depending on their objectives – can choose to focus on ensuring the adequate integration of ESG risks, enhancing transparency and disclosure, and/or channelling investment into sustainable solutions. With some concrete legislation now in force, it will be interesting to see how these different measures interact and to what extent they can effectively contribute to making the financial system more sustainable, for the ultimate benefit of both the people and the planet.

As sustainable finance policies multiply, actors all over the world will need to keep up efforts to create comparable frameworks that facilitate international investment in our interconnected systems. Furthermore, the strong focus on the real-world impact of sustainable finance means that developments in the field of measurement and data will be decisive for the uptake of activities. For this to be possible, additional efforts will be needed to embed sustainability in broader economic and environmental policies.

05

Conclusion and Outlook

Sustainable investments: growth without limits?

The SI market in Switzerland once again enjoyed impressive growth in 2020. We have outlined the main drivers of this growth: wider adoption of SI approaches in combination with inflows and the positive market performance in 2020. At the same time, one needs to ask: is there a limit to this growth story?

First of all, it is important to acknowledge that we use sustainable investments as an umbrella term covering any investment approach integrating environmental, social and governance (ESG) factors into the selection and management of investments. This definition is in line with other major market reports such as the Global Sustainable Investment Review.[63] Furthermore, in a recent review article, several international sustainable finance academics also expressed a similar understanding.[64] Such a broad umbrella term covers all ESG-related investments – be it minor exclusions or a very sophisticated SI investment strategy. As such, it does not come as a surprise that volumes are steadily increasing and SI funds now exceed conventional investment funds in Switzerland for the first time. We deliberately chose such a broad scope for our study to demonstrate precisely this SI mainstreaming effect over time. Building on such a definition, it is not unrealistic to expect that close to 100% of all assets will count towards SI within a few years.

At the same time, this growth trend manifests the need for a more granular classification scheme for different ESG and impact investment styles. Without this, investors (especially private investors) lose orientation. A new classification scheme might increase transparency, but would only work on condition that it is widely accepted and applied. A range of separate schemes – launched by individual governments or even financial institutions, for example – would create more confusion than anything. Thus, the development of one uniform scheme will be of overriding importance. Several proposals are on the table. Most prominently, the European Commission has proposed a classification system under the Sustainable Finance Disclosure Regulation (SFDR). Articles 6, 8 and 9 of this SFDR provide a clear description of different sophistication levels of SI. It remains to be seen how such efforts will develop and what the role of the European SFDR – including the green taxonomy – will be for the definition of different SI approaches.

The new challenge: demonstrating real-world impact

With the SI mainstreaming effect, a clear differentiation of approaches and their main objectives – be it value alignment, risk/return improvement or real-world positive impact – becomes more important. It is imperative to better understand client needs and profiles and match them with the diverse offering of SI solutions in order to avoid confusion and disappointments.

Generally we see growing demand from clients to consider impact, in response to the general trend towards greater public awareness of key environmental and social issues.

As the results of this year's report demonstrate, the market is catching up accordingly. While all of the SI approaches grew in volume in 2020, the ESG engagement approach is now ranked second in terms of volumes, up from third place last year. The category of impact investments shows the highest growth rate of all SI approaches and for the first time has moved up from its bottom rank. Furthermore, the most common action applied by both asset managers and asset owners is to start an engagement effort whenever they detect norms violations by a specific firm. Such an active approach gives investors the opportunity to influence a change in behaviour.

The good news is: there is a clear trend towards more impact-oriented investments. Many investors focus on enhancing their ESG engagement efforts. At the same time, we need to acknowledge that generating impact goes beyond pure ESG integration or management. On the one hand, we can observe that the notion of impact is catching on. On the other hand, we need to make sure that impact is not just another buzzword for established ESG products. As such, a better understanding is needed of how investments can achieve impact in the sense of additional "real world" effect (for more insights see interview with Julian Kölbel on page 58. The fact that the SI approaches applied are becoming more sophisticated clearly shows investors are on the right track. Furthermore, SSF has started an academic discussion to address and develop a better understanding of how impact can be assessed and measured.

63 http://www.gsi-alliance.org

64 See Busch, T., Bruce-Clark, P. Derwall, J., Eccles, R., Hebb, T., Hoepner, A., Klein, C., Krueger, P. Paetzold, F., Scholtens, B., Weber, O. (2021). *Impact Investments – a call for (re)orientation.* SN Business & Economics 1 (2): 33. https://link.springer.com/article/10.1007/s43546-020-00033-6

Next steps and the way ahead

Last year we concluded that further alignment of the definition and understanding of SI approaches is an ongoing task. Still too often, expectations of product sustainability performance risk being misaligned with product intentions. Although much work has gone into this topic over the last year, we are not there yet. There is a need to improve the understanding of practitioners and clients around the common classification schemes and we believe this should be a top priority for the industry. The EU Action Plan and the SFDR have kicked off the necessary discussions. As such, there will be a new and, most significantly widely accepted understanding at some point in time. Swiss players should play an active role in the ongoing discussions towards building this understanding. This is the only way to ensure that the products offered to clients are a true match to their expectations. For now, it seems important that Switzerland continues its current SI path. Building on the industry's high level of expertise will help to further sustain the development of the Swiss SI market. These efforts, notably with increasing activity in the impact domain, will help advance sustainable development in Switzerland and on a global scale. We experienced a turbulent 2020, and the beginning of 2021 has not been much different. It is therefore even more important that SI can serve as counterbalance, by contributing to more reliability and stability in financial markets.

06

Additional market insights

6.1 Insights into the Swiss Government's Work on Sustainable Finance

David Gerber,
Head Insurance & Risks

Christoph Baumann, Deputy Head Insurance & Risks, State Secretariat for International Finance (SIF)

Last June, the Federal Council published a report and guidelines on sustainability in the Swiss financial sector, in which it stated that the Swiss financial centre should become a leading centre in sustainable finance. Why is this a key objective of the Federal Council?
Well, there are two main reasons why promoting sustainable finance is important for the Swiss Federal Council. On the one hand, the Swiss government sees sustainable finance as a valuable opportunity for the Swiss financial centre to continuously improve its competitiveness. On the other hand, we also want to enable the financial centre to contribute effectively to the 2030 sustainability agenda and Switzerland's climate goals. The Federal Council intends to shape framework conditions in such a way that both these objectives can be attained.

For the report, the SIF also analysed sustainable finance activities in other countries. Based on this comparison, in which areas is Switzerland leading, and where do you see room to catch up?
Switzerland has without doubt been a pioneer in the field of impact investing and other areas of sustainable finance. Nowadays, many of the large Swiss financial institutions are frontrunners in the field. However, other financial centres are not sleeping, and we are currently witnessing a real race to top. With its Action Plan, and in particular the taxonomy project, the EU is of course a leading actor in the sphere. Other countries, such as the UK, are also well advanced when it comes to integrating climate risk scenarios in the financial industry. Going forward, we see a great opportunity for Switzerland to utilise its expertise in green digital finance, thereby also supporting further development of cross-border wealth management, an area where Switzerland can build on clear strengths.

The Federal Council and the SIF also stress the importance of the private sector for addressing sustainable finance challenges. Is this an approach that has been successful in other areas of financial market regulation?
Close cooperation with the private sector is a key element of financial market policy in all areas and we are convinced that this is a key reason for the global attractiveness of the Swiss financial sector. Through the involvement of private sector stakeholders and cost-benefit analysis, we have been able to strike a good balance of regulation and introduce efficient measures in many fields. An actual example of this policy is the revision of the Insurance Oversight Act (IOA).

What are your expectations vis à vis Swiss financial market players and industry associations when it comes to sustainable finance?
The success of a market-based approach depends to a large degree on the ambitions and efforts made by financial market players and industry associations. However, we are confident that this is an effective approach, since it is in their interest to find optimal solutions and create suitable products for their clients. As an example, when it comes to providing transparency, we currently see that is not just the authorities pushing the issue. Financial market players also have an incentive to improve transparency and create trust among clients, with the support of industry associations such as SSF.

Speaking about transparency, last December the Federal Council suggested making the TCFD recommendations mandatory for companies of all sectors. Do you believe this will automatically lead to better alignment of the Swiss economy with climate goals?
We are indeed convinced that disclosure under TCFD will help investors align their portfolio with climate goals and reduce risks stemming from climate change. While many companies already offer a certain degree of transparency, the information published is often not comparable. Here, mandatory TCFD disclosure can bring considerable improvements, even though the TCFD does not cover all environmental issues, let alone all types of sustainability challenges. Nevertheless, we consider introducing mandatory reporting on climate issues an important first step, since the discussion on how sustainability issues translate into financial risks is furthest advanced in the field of climate change. In addition, metrics and tools to assess climate risks are already largely available and include forward-looking indicators. Similar efforts on the topic of biodiversity are underway, with the Swiss government and strong private sector involvement supporting the creation of a Taskforce on Nature-related Financial Disclosure (TNFD).

Furthermore, it will become mandatory for large companies to report on other key sustainability issues, based on the counterproposal to the Responsible Business Initiative that will now come into force.

The Federal Council has also emphasised the prevention of greenwashing in its communication. Do you think greenwashing is prevalent in the Swiss financial market nowadays?

It is difficult to assess how prevalent greenwashing is, but the problem is that it undermines the confidence of the consumers or investors – and this is an issue for the market as a whole. At SIF, we consider it is important that financial market players offer a certain comparability for their sustainable investments, and clarity about what a product can actually deliver. At the moment, we sometimes observe a lack of clarity about whether an ESG product aims to minimise risk or contribute to real-world sustainability goals. This can lead to accusations of greenwashing. Of course, all types of ESG approaches have their purpose and should not be played out against each other, but regardless of the approach taken, we think there is definitely work to be done in providing more transparency on what a sustainable financial product aims to achieve.

Switzerland is a now a member of the International Platform on Sustainable Finance (IPSF). What are Switzerland's key objectives and priorities within this engagement?

The IPSF was established in 2019 by the European Commission and a number of countries, with the goal of taking stock of the different approaches in sustainable finance policy. The two main areas of work of the IPSF are taxonomy and disclosure, and for Switzerland, the discussions around disclosure are particularly important. Switzerland is co-chair (together with EU and Japan) of the disclosure working group which is currently preparing a report examining how ESG disclosure regulations and recommendations are set up across different jurisdictions.

SIF has established the "Green Fintech Network". How can fintech help the Swiss financial centre become more sustainable?

Digital finance has a huge transformative potential, and in Switzerland the expertise already available in the thriving fintech scene should be further leveraged to help solve multiple sustainable finance challenges. For example, one reason why financial flows are not yet better aligned with sustainable development goals is that there is not enough low-cost, readily available data. Here, fintech in general and concrete technologies such as blockchain can help provide standardised, low-cost and reliable data.

With the Green Fintech Network, we intend to further broaden the areas of application, since we see vast potential for technology and solutions developed by Swiss green fintechs to cater to global needs. The aim is to build on the already well-positioned and diverse green fintech scene, by strengthening not only small start-ups, but also well-established companies with a global profile.

The Green Fintech Network has prepared an action plan to foster green fintech.[65] What are the main recommendations you make?

To summarise, the network essentially identified various measures for improvement: *First,* reduce barriers for access to sustainability data and more transparency on pricing of such data; *Second,* cultivate new start-ups through innovation challenges and accelerator tracks; *Third,* promote access to clients for green fintech, for example through collaboration with existing financial institutions and open finance; *Fourth,* ease access to risk capital; and *Fifth,* boost the green fintech ecosystem, including universities.

It is important to keep in mind that the action plan is the product of the entire network, composed of public- and private-sector players, and does not necessarily reflect the opinion of the Swiss government. With these recommendations, the network aims to assess how the framework conditions of the entire ecosystem of green fintechs can be improved.

SIF has launched the new website "finance.swiss" and sustainable finance is a key element promoted on the platform. What is the role of sustainable finance within Switzerland's overarching finance strategy?

Well, sustainable finance is one of the three pillars of the new financial sector strategy and, as mentioned previously, we think it is crucial for ensuring the competitiveness of the Swiss financial sector. The SIF is constantly working on improving framework conditions for sustainable finance. Looking into the future, we consider that further work in the field of adequate carbon pricing, transparency on sustainability risks and green digital finance will contribute to strengthening sustainability in the Swiss financial sector. Switzerland offers different formats to discuss these topics and we look forward to an in-depth exchange with all stakeholders, be it through SSF events or the Building Bridges Week.

65 See: Green Fintech Network Switzerland (April 2021). *Harnessing the Power of Digital Finance for Sustainable Financial Markets.* Available at: https://www.sif.admin.ch/sif/en/home/dokumentation/fokus/green-fintech-action-plan.html

6.2 How Investors Can Generate Impact

Julian Kölbel, Head of Research at the Center for Sustainable Finance and Private Wealth (CSP)

In your "Investor's Guide to Impact"[66] you give a clear definition of investor impact. Can you briefly explain it to us?
To start, impact requires that something changes because of something you do, implying a causal link between the outcome and your action. In the context of sustainability, this real-world outcome can be mitigating climate change, improving labour conditions, alleviating poverty, or many other things.

As an investor however, you do not directly cause these real-world changes. Rather, investors cause impact by the change they induce in companies, which then generate real-world impact through their products and services. We define this mechanism as investor impact.

What are the main motivations for investors to aim for and focus on impact?
In general, there are three main motivations for sustainable investing: aligning investment decisions with values, enhancing the risk-return profile of investments and generating impact. The focus on impact often arises out of an intrinsic motivation: investors who care about real-world outcomes – be they social or environmental – also seek to support these outcomes with their investment behaviour.

An increasing focus on impact also comes from a regulatory and political perspective, however. Financial markets, and sustainable investing more specifically, are perceived by policymakers more and more as a tool or lever to achieve real-world social and environmental objectives. Furthermore, public awareness of the potential real-world impact generated through investment decisions has increased too.

What are the two main types of investor impact that you identified?
First, investor impact can be generated by enabling firms with a sustainable product, service or business model to grow. Through the provision of capital to impactful firms, investors can help them penetrate markets, crowd out existing, less sustainable technologies and thus have a positive impact on people and the planet.

A second type of investor impact focuses on transforming firms that are not yet sustainable, but exhibit substantial potential for improvement. This mainly pertains to large firms, where investors can play an active role in accelerating improvements, such as replacing a harmful substance in a product with a biodegradable one.

There is also a third, more indirect type of investor impact. Large financial market players can use their voice to advance sustainability in the public discourse and support broader political and economic change. While this channel is not exclusive to the financial sector, it can be very useful for catalysing change.

In which asset classes and through which mechanisms can investors best contribute to the growth of impactful companies?
Growth capital is mainly required by small and young companies. Hence primary markets, such as venture capital or private equity, play a particularly important role for the growth mechanism. In addition, facilitating access to lending can also support companies in scaling sustainable solutions.

To generate the biggest impact possible, investors should aim for additionality, i.e. provide capital to those companies that would not have raised the capital without them. However, this can be difficult to achieve and measure.

And with which actions (and in which asset classes) can investors encourage company improvement?
The most well-established strategy to encourage companies to improve is through shareholder engagement, i.e. voting, engagement and other stewardship activities. Less clear from an academic point is whether other approaches such as ESG integration or best-in-class can also shift company behaviour. Here, there is still need for further research, but I believe that investors who define and communicate transparent, detailed and actionable criteria, can give companies an additional incentive to improve.

Is there academic evidence that companies really change their behaviour based on engagement?
Yes. A number of studies have analysed whether companies complied with the engagement requests and in many cases, the engagement had a real effect. One study, for example, was able to show improvements in air quality within a one-mile radius of plants targeted by environmental engagement, ruling out alternative explanations and establishing a clear link between environmental activist investing and corporate environmental behaviour.

Moving on to another concept introduced in your "Investor's Guide to Impact": could you explain to us how exactly investor "signalling" works?
"Signalling" is a concept that comes from the Impact Management Project (IMP). In our guide, we further differentiate between market signals and non-market signals. Market signals are price signals generated by selling or buying a stock. I think it is still up for debate whether ESG-related decisions really drive market prices.

The other option is non-market signalling, where investors take a clear stance for or against a specific company or industry. This type of signalling can influence the public discourse on pressing challenges and pave the way for a political process to follow suit. However, there is a caveat here: non-market signalling works well for divestment, which can be prominently broadcast, but less for more complex approaches such as ESG integration or best-in-class.

Why would price signals actually encourage "laggard" companies to improve?
It really depends on how big the price signal is and how much money it takes a company to improve. Given strong market signals, an oil company or a mining company in a developing country may consider implementing best practices and improve its labour standards. However, it is fairly unlikely to fundamentally change its business model. Taking the example of the tobacco industry, a study showed that tobacco companies experienced depressed share prices due to widespread divestment. However, it seems that tobacco companies are living with that fact, rather than trying to change their business model.

Coal divestment has become extremely prominent in the past years. Has this already led to a measurable change in the stock price of coal companies (or led to other financial disadvantages)?
Coal company stock prices have indeed come under pressure in recent years, and it is possible that coal divestments have played a role in this. Yet, it is very difficult to prove the causality and I am not aware of an academic study that has isolated the effect. There is an interesting piece of research from the US showing that it was in fact mainly political pressure campaigns at the local level, alongside federal pollution regulation, that persuaded coal plants to shut down early – investor divestment is not mentioned in the paper as a contributing factor. But apart from divestment's effect on the market price, which is uncertain, divesting from coal still sends a pretty strong signal to society at large.

How can an investor with a broad portfolio aim for the greatest impact?
I would recommend three things. First, to the extent that you are invested in primary markets (private equity, venture, infrastructure, real estate), try to identify green companies and support them in their growth path. Second, for the larger part of your portfolio (equity and bonds), implement an engagement approach and combine it with clear, practice-based ESG criteria, pushing for measures that companies can implement at a reasonable cost. Finally, it should not be forgotten that being publicly vocal about what industries you do and do not invest in is also a valuable channel for impact.

In Germany, a consumer organisation sued a large bank for misleadingly overselling the impact of one of its funds. The main allegation was that the approximations used by the bank for its "impact calculator" are misleading to potential retail investors. To what extent do you think we can realistically expect precise impact measurement and calculations of investments?
Yes, this is a really interesting case. These types of issues arise when a provider markets the impact of the companies in the portfolio as direct investor impact. It depends on the context, of course, and certain approximations when attempting to measure impact are both necessary and reasonable, but unfortunately, investor impact and company impact are often conflated, when actually they are not the same.

There are many reasons why investors integrate ESG factors into an investment process. Is it no longer justified to invest sustainably for the sake of value alignment or improvement of the risk-return profile?
No, not at all, both value alignment and the improvement of the risk-return profile remain very valid motivations for sustainable investing. Nowadays, impact is a key consideration for the overall field of sustainable investing since it can support the advancement of social and environmental goals, but I believe products should cater to values or other motivations too. For all types of sustainable investments, it is important to be clear about the underlying objectives, since problems emerge when a product caters to one objective, but is expected to comply with other objectives.

Finally, I would like to advocate for thinking of impact not as a category of investment, but a property that all type of investment products can potentially generate. The challenge that currently confronts us is figuring out how substantial the impact is.

66 Heeb, F. & Kölbel, J. (2020). *The Investor's Guide to Impact. Evidence-based advice for investors who want to change the world.* Available at: https://www.csp.uzh.ch/dam/jcr:ab4d648c-92cd-4b6d-8fc8-5bc527b0c4d9/CSP_Investors%20Guide%20to%20Impact_21_10_2020_spreads.pdf

6.3 Switzerland's Leading Role in Private Asset Impact Funds

Over the years, sustainable investments have grown and evolved to include products from most asset classes, markets and strategies with vastly different sustainability goals. SSF is therefore grateful to the many actors and specialists who are committed to exploring the various approaches and segments forming the sustainable investment landscape, where their expertise is a welcome addition and helps provide a more complete understanding.

Switzerland, for instance, has a long history in the area of development finance and has spearheaded the impact investment industry with innovative and effective microfinance products. The initial goal of the pioneers in this field was to attract private capital to what was originally considered mainly public-sector funded development activities. The products, mostly falling under private debt in the early years, proved successful with investors. Many responded to the need to ensure comprehensive impact reporting for their funds, measuring how they financed the growth needs of underserved microenterprises and low-income households in developing countries.

The fast growth of this sector in the 2000s went hand in hand with growing demand from impact investors to tackle development needs beyond the scope of microfinance. As a result, these historical microfinance products have today been complemented by a variety of fund offerings in themes such as Climate & Energy, Food & Agriculture or Health & Education, to name a few, all with specific impact narratives forming their core business proposition.

It is this segment that the Private Asset Impact Fund (PAIF) survey[67] examines more closely, offering valuable information on the sector of the sustainable investment industry that serves the bottom of the pyramid. These offerings aimed at underserved economies are intended to alleviate poverty and create better socio-economic conditions on an environmental, social and governance (ESG) level.

Study characteristics

The investment universe definition of PAIFs applied in the survey includes all investment vehicles with more than 50% of their non-cash assets allocated to private debt and/or private equity instruments and to emerging and frontier markets, with a development impact bias.[68]

- PAIF survey coverage: This survey compiles data on 157 funds affiliated to 78 managers that are located in 26 countries. The survey team identified and contacted 435 PAIFs and 210 managers. In terms of assets under management, the survey covers about two-thirds of the market for private asset impact funds.
- Market size: The survey aggregates USD 22.2 billion of fund assets. The total private asset impact fund market was estimated at USD 33 billion overall at the end of 2019.

These numbers reveal an important difference from the GIIN's market size estimate of USD 715 billion in impact investments. However, this difference is explained by the narrower scope of the PAIF study that looks to target impact funds (from a legal status of collective investment schemes perspective, not the broader set of impact investors overall) operating in private markets and investing primarily in emerging and frontier markets, whose impact can be very concisely identified, measured and managed. This segment of the investment industry allows one to gain the best understanding of direct impacts of investments and hopefully extrapolate these to other types of investments.

67 The "PAIF Survey" is run by Tameo, a spin-off from Symbiotics focusing on independent market research, impact reporting and investment solutions targeted at private asset impact funds.

68 See table 1 from the full report to gain an understanding of the methodology used. The full report can be downloaded from the website: https://tameo.solutions/research

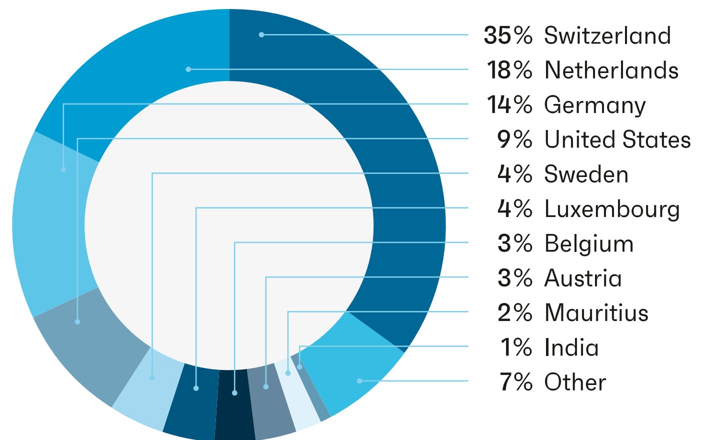
Significant market share for Switzerland

Within this segment of sustainable finance, Switzerland is positioned as the leading country for investment management activities. Building on their pioneer roles in facilitating development finance activities, Swiss-based investment management companies account for 35% of all fund assets captured in the PAIF survey, equating to about USD 8 billion (Figure 45).

Positive returns driving the growth of the sector

The PAIF study also showcased how impact investing strategies through funds brought positive financial returns for impact investors during the 2019 calendar year, in addition to fulfilling their development finance goals. Private debt funds returned a net 4.3% in USD for their shareholders, while private equity funds delivered a 6.3% IRR. Returns of mixed funds fell in between, at 4.6%. Multiple factors drive the net returns for investors, including the asset strategy of the fund (private debt vs. private equity), its positioining within the impact ecosystem (investment sectors) and its overall business model (investee types, cost structures, currency strategy, etc.). With the global pandemic sending shockwaves through financial markets in 2020 and beyond, the effect on the ability of PAIFs to deliver attractive returns in 2020 will be tested.

Figure 45: **Top 10 fund investment management countries**



Impact performance as a key differentiator for investors

Development finance funds have a comprehensive set of tools and methodologies to meet their long-term impact aspirations built around which sustainable development goals (SDGs) they address, how they filter the investment universe, and how far and how deep they reach out with their investments.

As a result, PAIFs increasingly map their social and/or environmental goals against the SDGs. Some do it at the fund level (52 funds), others map it at the investee level (42 funds), while others take a more granular approach at the transaction level (37 funds). The survey also showed that most PAIFs (80 funds) have dedicated SDG reporting for their investors, and among those which do not have it, 32 are planning to do so soon.

While most PAIF portfolios are still channelled into microfinance today, investors nonetheless have a much broader choice of business propositions to address specific SDGs compared to 20 years ago (see Figure 46).

Volumes for SME development have increased as a natural next step to microfinance in contributing to financial inclusion goals. Portfolios in Climate & Energy, as well as Food & Agriculture, either through specific products or as part of a multi-sectoral strategy, are mushrooming as well, and being offered not only by Swiss impact investment companies, but also other specialised non-Swiss actors (see Figure 47).

We are keen to see the diversification start to take effect when it comes to the accessibility of impact products for investors. Overall, PAIFs are set to develop even further and hopes are that this segment will be able to gain further traction in order to deploy impactful capital to help meet all 17 SDGs by 2030.

Figure 46: **Available impact sectors and corresponding link to specific SDGs**

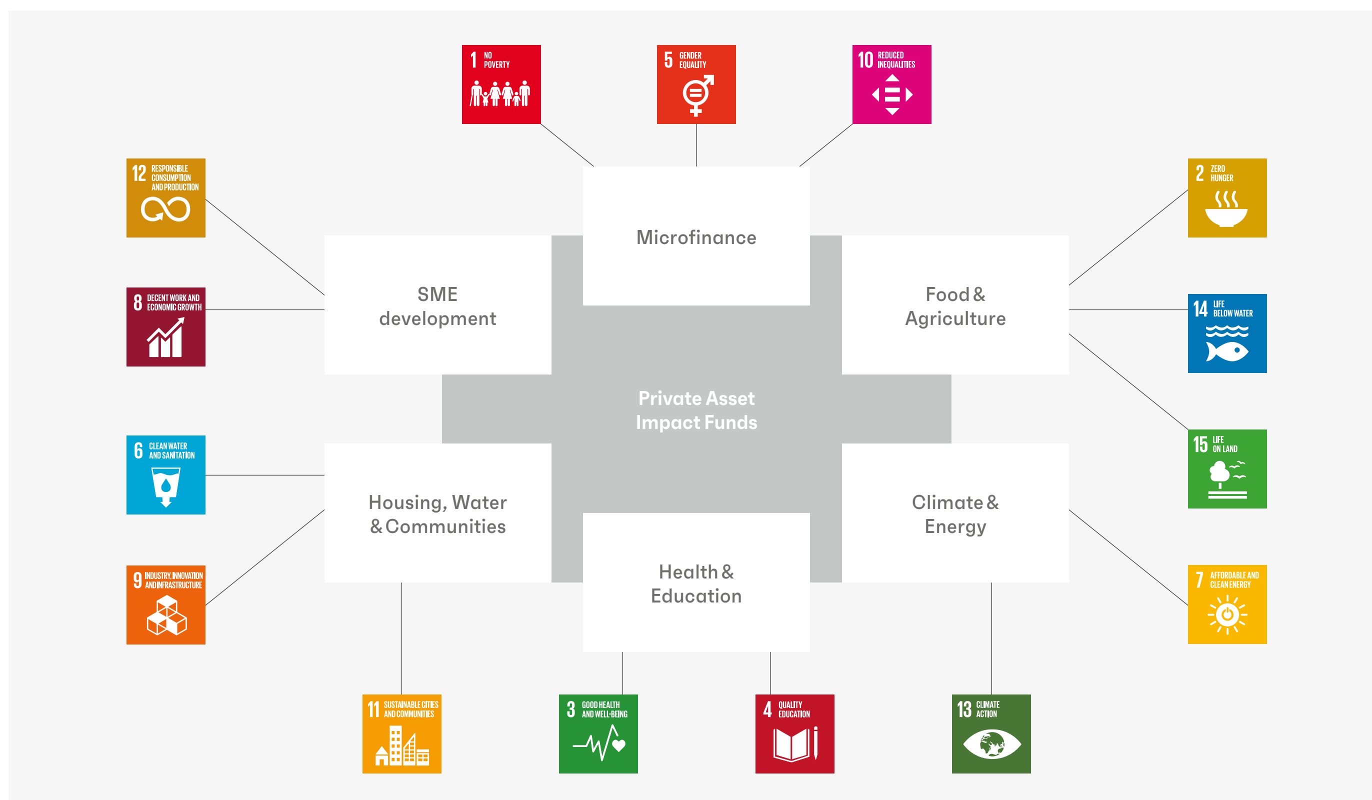
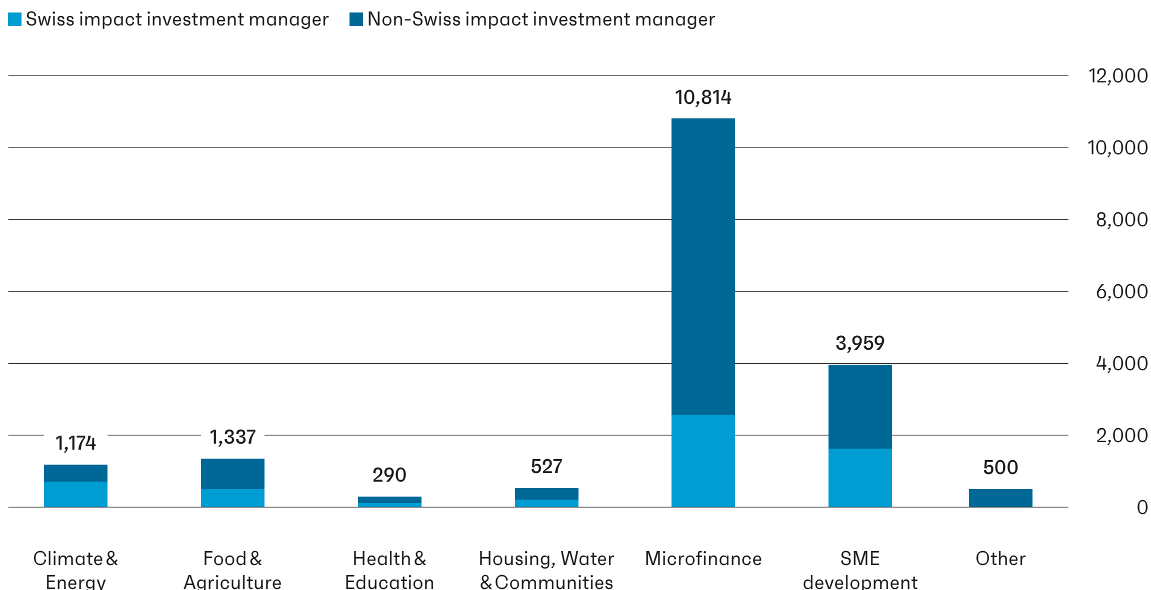


Figure 47: **Outstanding volume by impact sector**



About Tameo Tameo Impact Fund Solutions SA is a Swiss startup company specializing in the provision of independent and expert services aiming to mainstream the impact investing industry. Tameo provides specialized fund managers and investors with market intelligence, fund research, impact reporting and analysis, and deal valuation as well as other consulting services. Incorporated in December 2020, Tameo currently employs eight people. https://tameo.solutions

07

Sponsor Contributions

Transition bonds – a pioneering concept to finance low-carbon transition efforts

Daniel Gussmann, Chief Investment Officer, AXA Schweiz

Green or climate bonds are a relatively new type of financial instrument intended to fund projects with climate or environmental added value. Interest in such bonds has soared recently, with the market now worth more than USD 1 trillion, as companies and investors become increasingly engaged in building diverse portfolios with positive environmental impacts. The issuers of green bonds, however, are often sovereigns, utilities or financial companies with high investment grades. Hence, there is a need for new instruments to support carbon intensive players that are actively decarbonizing but have not yet reached the grading or "greenness" that makes their efforts eligible for green bonds. Even if the world adopts a steep low-carbon trajectory, it will not be enough to meet the global energy demand in the short to medium term. It is therefore essential, that the generation and use of carbon intensive energy is replaced with low-carbon business activities, and financing for these activities is made available. To help tackle these issues, AXA developed a new concept and launched, in November 2019, the first of its kind "transition bond" in partnership with Crédit Agricole CIB.

Whereas green bonds have strict eligibility criteria to determine what can be classified as a "green project", transition bonds fill the gap between "already green" projects that are eligible for green bond funding, and those that are not, but would nevertheless make huge strides towards lowering their carbon footprint. The main difference with green bonds is that the use of proceeds will be directed to industrial companies from "brown industries" with the aim to decarbonize their business activities. This includes the transition from e.g. carbon intensive coal- or oil-based power to gas for companies that cannot yet change their business model to solely rely on renewable energy.

Use of proceeds

In these transactions, the use of proceeds from the transition bond can for example be used in the following ways:

- electricity production: loans made to an electric utility company in an emerging economy currently dependent on coal and oil for power generation. These loans finance the development of gas fired power stations. Current Combined Cycle Gas Turbine technologies have an average carbon intensity of 353 tCO_2/kWh, which is 60% lower than the average coal production unit;
- marine transport: loans made to shipping companies to switch from heavy marine diesel oil to liquid natural gas propulsion (25% emissions reductions), which is the most efficient improvement currently available at scale to reduce emissions for large scale commercial shipping. Shipping is currently one of the few activities where transition technologies can be implemented on a large-scale;
- industrial resource efficiency: loans made to a South American industrial company implementing energy efficiency and waste-water treatment with expected reduction in energy intensity by 44% between now and 2040.

Transparency

Just as for green bonds, we believe that issuers of transition bonds must provide a means of mapping the invested funds to be able to clearly demonstrate that they are used for green projects (use of proceeds). Transparency is critical in this regard: investors must be regularly informed about how money is being used and what environmental outcomes are being achieved. AXA encourages transition bond issuers to use indicators, like those developed in the Green Bond Principles, to demonstrate the environmental impact of the transition bond funded projects or the strategic shift to a low carbon business model. In addition, transition bond issuers should clearly communicate what climate transition means in the context of their current business model and their future strategic direction, including a commitment to align their business with meeting the Paris Agreement goal of limiting the global temperature increase to below 2°C by the end of this century. It is important to have transparent and accepted "Transition Bonds Principles", which is why AXA worked through AXA IM together with peers and policymakers within the International Capital Markets Association (ICMA) to launch the Climate Transition Finance Handbook.

At AXA, we believe that transition bonds have the potential to provide carbon-intensive companies with a much-needed new source of financing to "green" their business activities. We view transition bonds as a new and attractive asset class for investors – and ultimately as an important instrument to accelerate the fight against climate change.

KIEGER
dare to care

Covid-19: a trigger for impact investors in global healthcare

Urban Fritsche, Portfolio Manager, Kieger AG
Dr. Maria Specogna, Portfolio Manager, Kieger AG

The Covid-19 pandemic has highlighted weaknesses in global healthcare and opened up long-term opportunities for investors striving for a positive impact, especially on underserved populations.

Given ageing demographics in the OECD and the growing needs of prosperous emerging countries, reforms were inevitable. The pandemic simply served to accelerate the process. Crises are typically a trigger for change: the 1918 Spanish Flu for instance led to the rise of broad-based public healthcare. Revamped healthcare systems will provide long-term opportunities for private stakeholders. Rather than passively investing in healthcare ETFs, we believe that investors should consider allocating capital to listed equity impact funds, helping shape a sustainable and fairer future and achieving competitive financial returns. The full growth potential of many healthcare companies has yet to be recognised by the broader market.

A period of change

The colossal economic cost of inadequate healthcare systems has been clearly exposed by this crisis. On a daily basis, we were confronted with images of glaring shortcomings. A lack of hospital beds and protective equipment, exhausted personnel and limited testing capacities forced lockdown measures. Still, both the state systems and private actors responded with innovative solutions.

Tests, vaccines and therapies were developed at an unprecedented speed, alongside an acceleration in digitalisation (telemedicine, online education, digitalised clinical trials). More alternative care sites were also established (home treatment and outpatient centres). What began as a strategy to free up bed capacities and protect patients is set to continue, helping control costs and improve the quality of care. Finally, healthcare funding commitments stand to increase, boosting demand for innovative solutions.

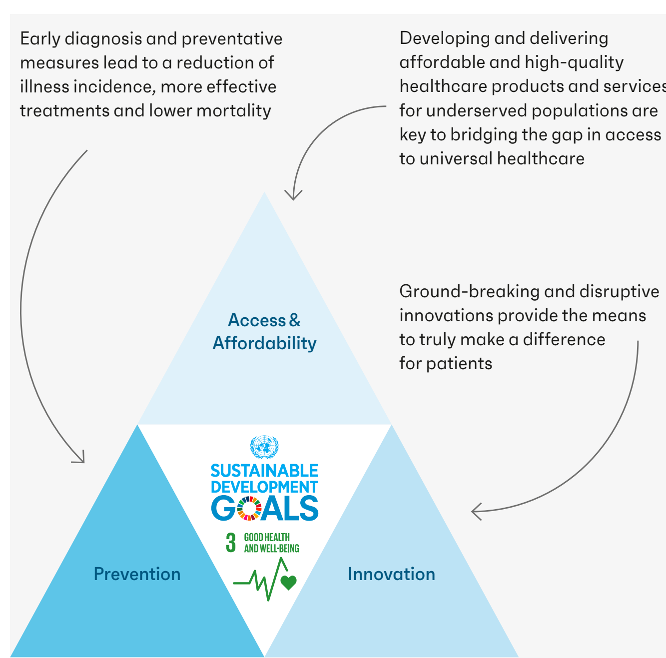
Enhanced access, improved quality and cost deflation are key requisites for better healthcare services. Private investors will play a crucial role in keeping up the momentum for change and directing funds to where there is most potential for sustainable transformation.

Three target areas for investment

- Access & Affordability: enable low-income consumers – those most affected by the pandemic to access basic healthcare at affordable prices. New business models developing around telemedicine provide big opportunities for underserved populations. Better distribution of biosimilars and generics will also be crucial.
- Prevention: focus on comprehensive screening, accurate diagnosis, vaccination and healthy lifestyles. Advanced data science yields opportunities for data interpretation and forecasts.
- Innovation: target disruptive technologies. Ground-breaking innovations (mRNA, cell and gene therapies, artificial intelligence, data sciences, etc.) established their proof of concept during the pandemic and now have a chance to realise their full potential.

We believe that investors should focus on companies that are leaders in one of these three areas – thus contributing to improving healthcare across the globe and helping address one of the most pressing sustainability challenges.

Kieger's three target areas for impact investing in healthcare



Climate Progress Dashboard: will 2021 be the year of decisive change?

Andy Howard, Global Head of Sustainable Investment, Schroders plc

Schroders' latest update on climate change indicators offers a disappointing result. But our Global Head of Sustainable Investment expects more policymakers and companies to release detailed climate action plans than ever before this year.

A long-run temperature rise of around 3.7 degrees over pre-industrial levels is the latest estimate our Climate Progress Dashboard[69] suggests. This result, based on analysis of projections from four key categories in the fourth quarter of 2020, is marginally down from the 3.8° degree rise implied in the autumn of 2020.

But it is still a long way from the "below 2°" target enshrined in the Paris Accord in 2015. These headlines may be disappointing, but pressure is building and 2021 could prove to be the year of decisive change, as our analysis shows. In the run up to the 26th Conference of the Parties (COP26) in November, the stream of announcements from policymakers and companies is set to gain momentum.

With the global summit – postponed from last year due to the COVID-19 pandemic – now set to go ahead, we should start to see the much-needed details and actions for meeting the Paris Agreement ambition.

How our Climate Progress Dashboard reflects incremental improvements

To date, policymaker announcements have tended to focus more on long-term targets than on shorter-term policy action. But there are signs of tangible steps being taken in many countries. The scale of change since Q3 2020 may be modest, but the indications are reflected in the dashboard. Every indicator is either unchanged or has improved since the last reading, with sharply higher carbon prices the biggest driver of change.

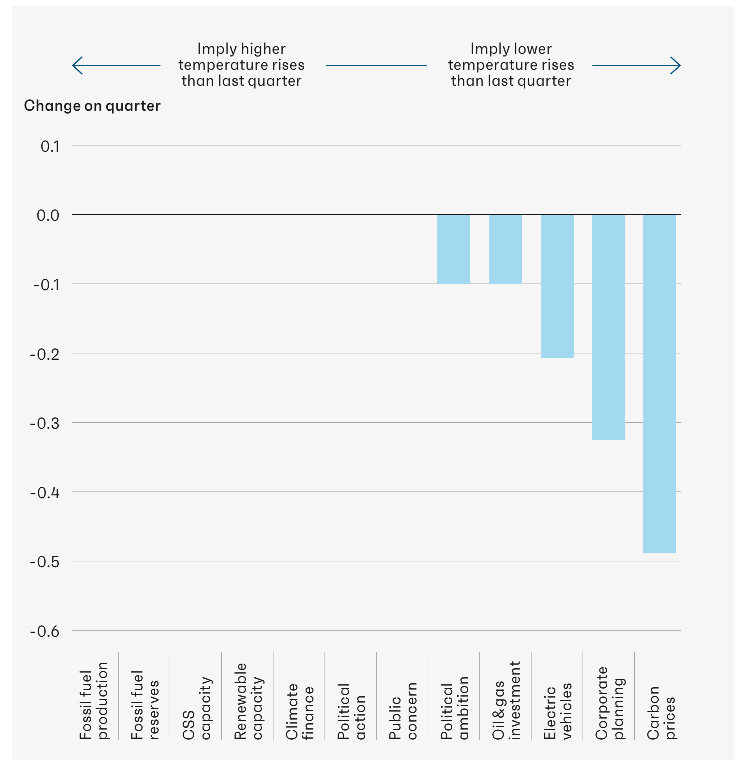
EU Emissions Trading System (ETS) prices have reached close to EUR40/t at the time of writing, new highs for that market. In the US, prices in the Regional Greenhouse Gas Initiative (RGGI) carbon price auction have been similarly strong. With the Biden administration likely to take a new direction in climate policy, pressure on the US could well accelerate.

Coordinated response needed

As an active asset manager that invests across the public and private markets globally, we have a fundamental responsibility and imperative to encourage companies to re-orientate their business models towards decarbonisation, and to lead by example with our own business practices.

Now is not the time to be complacent. We are in a pivotal moment, and whilst some progress is being made, we need an aggressive and coordinated approach across policy markets, corporates and investors.

Summary of changes
The chart below plots the changes in each indicator relative to the last update (Q3 2020).



69 The Climate Progress Dashboard compares projections made by international organisations to estimate the temperature change implied by the current progress seen in four categories: political action, business and investment, technology development and fossil fuel use. Overall, we monitor 12 individual indicators (3 in each category).

https://www.schroders.com/de/ch/asset-management/themes/climate-change-dashboard/

Building an ESG competency network to foster ESG integration across all business activities

Nelufer Ansari, Head ESG, Swiss Life Asset Managers
Dominik Pfoster, Head Responsible Investment, Swiss Life Asset Managers

Responsible Investing and ESG mark a profound change in the financial industry. Accompanied by regulatory pressure in Europe and increasingly in Switzerland, asset managers are facing challenges to adapt the traditional business model to one fit for the future. A key aspect to manage sustainability risks and seize business opportunities is the integration of ESG into an asset manager's core processes and existing value chain.

A strong need for ESG expertise across the entire company
Swiss Life Asset Managers is fully committed to sustainability and therefore strives for a comprehensive and permanent integration of ESG aspects into all core activities. This dynamic and profound change comes with challenges. Most important is to build in-depth ESG expertise that is not concentrated in a separate team of specialists but is built into existing job descriptions as a natural part for all employees and thus is distributed across the entire organisation. Besides hiring ESG experts as a reasonable starting point to acquire specialist know-how, every employee shall build-up an in-depth knowledge of sustainability and ESG.

Swiss Life Asset Managers decided to launch the ESG Ambassadors Programme to build up the ESG expertise internally and to empower its own employees to make the change: Around 50 employees from various business areas and locations were appointed as ESG ambassadors in 2020. This number will increase continuously in the coming years. The ambassadors receive special training and regular updates on sustainability topics. As part of their annual personal targets, they take responsibility for applying and further developing our approach to responsible investment in their area of business. They are supported by the top management's clear commitment to ESG, setting a positive and encouraging tone from the top.

Close collaboration on training and projects
The programme started with a general introduction to responsible investment provided by the PRI Academy for all ESG Ambassadors, as participants started from quite different levels. This overview was followed by tailor-made trainings and workshops for specific functions or locations. These helped the ambassadors gain a thorough understanding of the data and models used. Specialists completed appropriate off-the-shelf certificate courses, e.g. those offered by the CFA institute. As part of this train the trainer concept, ESG ambassadors are required to pass on the knowledge and skills to their colleagues. At all-staff "virtual coffee" meetings, employees are educated on general ESG topics and on Swiss Life Asset Managers' specific ESG concept. With this information cascade, we aim to continuously build-up knowledge throughout the entire organisation. With the help of ESG experts, the ambassadors assumed their role in projects and drove the ESG implementation in their day-to-day business. They contributed to the development of new products or enhanced existing products to make them fit for ESG labels. They established a sustainable building guideline, set up systematic carbon monitoring of portfolios and developed proprietary ESG scoring models. Through these projects, our ambassadors establish collaboration across the organisation and geographical regions, thus enhancing flexibility and agility.

Encouraging experiences solidify the ESG Ambassadors community
Since they are directly involved in the core business processes, the ESG ambassadors effectively bridge the gap between business knowledge and specialised ESG know-how. They use their in-depth knowledge of the company's products and processes to comprehensively integrate ESG aspects. The ESG ambassadors closely collaborate with ESG Committees, divisional ESG team and with the ESG Board, which consists of representatives from each business unit and relevant functions. Together, they form a strong ESG competency network. The programme's impact is largely driven by ESG ambassadors' high intrinsic motivation and strong conviction to act on and be part of socially relevant topics. This passion contributes further to boost speed and innovation. With encouraging experiences, we aim to increase dedicated resources and grow the community with additional ambassadors. We want to further develop the training offering to fit various needs and keep it updated. Furthermore, encouraging interaction and sharing of insights within the community enables ambassadors to be at the forefront of market developments.

Investing in a future proof business model
With these measures, we proactively shape and expand our internal ESG knowledge throughout the organisation with the aim to make our ESG strategy persistent and pervasive. Ultimately, knowing ESG and acting sustainably in everyday business will become an obvious and natural skill for each employee. A strong company-wide ESG competency network helps Swiss Life Asset Managers to have the expertise and the agility to assert its position in a constantly and rapidly changing market environment. Integration of ESG aspects is not limited to portfolios and products, it is foremost about evolving the business and making it future proof.

UBS

Feasible passive investment solutions to address climate change challenges

Michael Baldinger, Chief Sustainability Officer, UBS Group AG

A lot of action is needed to fight the negative consequences of climate change, and both the financial industry and investors can help combat this crisis. To create a climate-smart economy, a vast amount of capital is required: Policy is calling for annual investment of USD 3.8 trillion by 2050[70], which would potentially generate USD 26 trillion in business opportunities[71].

While the global transition to a low-carbon future is a must, investors are looking for solutions that can both meet their financial objectives and contribute to a low-carbon economy. Passive investments tracking an index play a big role here, as they are widespread among institutional investors with substantial amounts of assets. A common solution is investing in funds tracking indices that exclude fossil fuels. While this might initially look like an easy and obvious choice, there are consequences. For instance, by excluding "oil majors", investors will miss opportunities, as some of these companies are among the largest investors in renewable energies or likely to provide technological solutions, such as carbon sequestration.

Engagement instead of exclusion

While considering the needs of passive investors, such as staying close to a benchmark and keeping costs low, UBS Asset Management's rules-based strategy for climate-aware investments is different. It maintains allocations to carbon-emitting companies with the two goals of supporting positive change through proactive engagement with companies that appear to be the least well positioned, while also supporting companies that are developing new, lower carbon technologies.

Depending on their business models, companies are subject to different risks related to climate change. In our investment process, we assess five major risk categories:

— **Regulation risks:** for example the effect on costs of carbon pricing on large GHG emitting companies
— **Market risks:** such as the move away from products with high carb on- and energy-intensity
— **Technology risks:** such as the large scale substitution of products and services
— **Physical risks:** such as the risk to fixed assets and/ or supply chains
— **Reputational risks:** such as the stigmatization of an industry

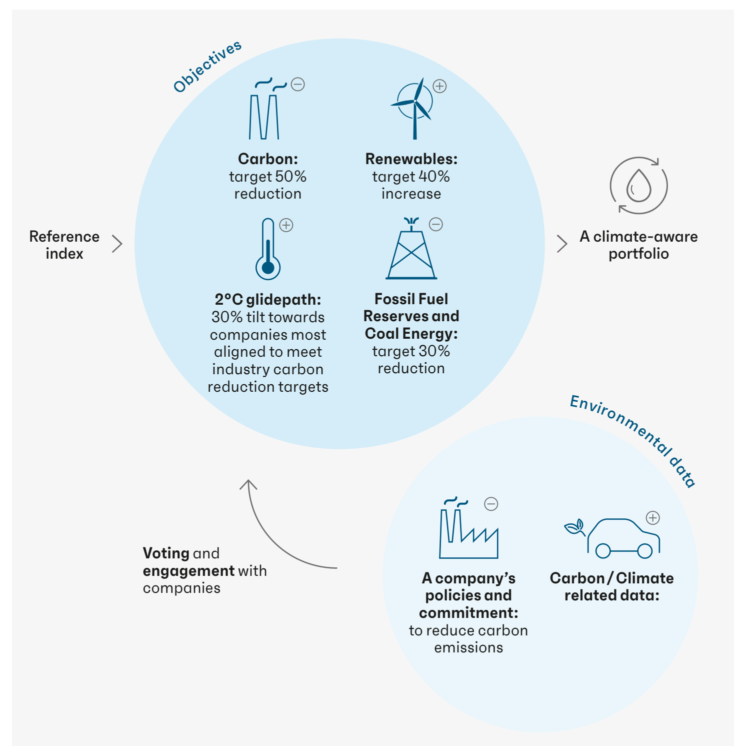
In the equity space, our climate approach applies tilts to an equity benchmark away from companies we believe are less likely to be in line with the low-carbon economy – and towards companies we expect to meet industry carbon reduction targets (see exhibit). By analyzing how companies are positioned for the transition to a low-carbon economy, the strategy seeks to reap the benefits of that shift. Recently, we have also implemented the strategy to a global corporate bond benchmark.

The portfolio targets:

— At least 40% higher exposure to companies that generate renewable energy and supporting technology compared to the parent index
— A 30% tilt towards companies most aligned to meet industry carbon reduction targets in line with the beyond 2˚C scenario
— 50% reduction in carbon intensity scope 1. We also aim for reductions at scope 2 and 3.

At UBS AM we see a clear investor appetite for directing capital in climate solutions. We believe that continuous development of offerings and active client engagement is crucial to investor success in an increasingly carbon-constrained world.

Portfolio construction process
Source: For illustrative purposes only. UBS Asset Management, June 2021.



70 Source: https://www.climatepolicyinitiative.org/publication/global-landscape-of-renewable-energy-finance-2020/
71 Source: https://www.wri.org/blog-series/the-26-trillion-opportunity

The evolution of Impact Investing in listed markets – and what happens next?

Victoria Leggett, Head of Impact Investing, Union Bancaire Privée (UBP)

A lot has changed in the last few years. Impact investing in listed equity is relatively new and, in recent years, there has been much debate about whether impact can even be achieved in secondary markets. However, two factors go a long way to settling that argument: engagement and accessibility. Investors in listed markets can and should engage deeply with companies, behaving like true stakeholders with associated expectations and time horizons. Furthermore, as impact investing grows in listed markets, individual investors have access to more products that allow them, sometimes for the first time, to make choices that both respect their values and meet their financial objectives.

The measurement challenge

However, even as the industry has begun to understand and embrace impact investing in listed markets, challenges remain. Measuring impact has been one of the biggest issues: it remains complex, particularly in the social impact space, although there has been noticeable progress on the environmental side.

Measuring impact in listed equity is inherently difficult for several reasons: an investor is one of many shareholders and cannot specify its desired outcomes at the outset with certainty that these will not conflict with other investor priorities. Also, the non-financial information disclosed by listed businesses, even those generating a positive impact, is still limited. Of the data that is disclosed, very little of it is audited and it can be calculated in different ways, making it hard to compare companies. Progress has been made here, with several cornerstone organisations such as the Cambridge Institute for Sustainability Leadership and the GIIN establishing working groups and in some cases producing a set of standard metrics, however imperfect they might be. The Impact Alliance classification system is also a useful development in enabling investors to compare products.

Regarding carbon, measurement has progressed significantly, although it has been a long journey! Initially, the main challenge was simply to get key stakeholders – governments, companies and consumers – to recognise that carbon emissions are something to worry about in the first place. This battle has only really been won in the last five years despite the overwhelming evidence.

After reaching consensus on that, we faced the more complex matter of measuring emissions to allow reduction targets. Typically, the process is as follows: a large company starts out by measuring emissions in Scope 1 (from sources owned or controlled by the company) and Scope 2 (associated with purchased energy). However, these figures alone are very unlikely to present a true picture of the company's footprint. Scope 3 emissions cover 15 different categories, from emissions related to upstream elements of a company's supply chain (e.g. purchased goods and business travel) and downstream elements (use and end-of-life treatment of sold products). Scope 3 is highly complex and even the most advanced companies may only measure one or two of these 15 categories. We are a long way from having a full view of who is responsible for what. Double counting is also an important issue here. The headline, though, is that significant progress has been made, and initiatives such as TCFD and EU regulatory changes are all helping to keep up the positive momentum.

Tackling biodiversity

As the carbon measurement debate has progressed, the industry has begun to address the related and equally critical topic of biodiversity. Much of the global economy depends on natural systems working properly, on climate stability, ocean health and soil quality. When ecosystems are damaged, the natural services they provide are degraded. This is not only worrying for environmental reasons, but it presents clear and significant business risks, potentially hampering activities and value chains and causing raw material price volatility. System disruption also creates physical risks, transition risks for businesses left behind in the drive to reduce environmental harm (e.g. oil producers), and litigation risks associated with the finance industry's exposure to sectors or companies that may face legal challenges because of their role in biodiversity loss.

Assessing these risks is a key part of our work as impact investors, and indeed for all investors. The WEF ranks biodiversity loss as one of the top five threats that humanity will face in the coming decade, and so it is very important that progress on biodiversity is faster than it was for carbon, even though it is a more complex area.

Although we have come a long way, there is still a lot to be done in the impact investing space. We believe biodiversity will take centre stage in the coming years as the industry finds a way to measure losses and gains in this area, and ultimately to assess investments for their positive or negative biodiversity impact.

Amundi
ASSET MANAGEMENT

Social bonds – an innovative fixed income solution offering liquidity, diversification and social impact

Isabelle Vic-Philippe, Head of Euro Aggregate and lead PM Amundi Social Bonds

"Everyone can contribute to address increasing social inequalities"
Isabelle Vic-Philippe, lead PM Amundi Social Bonds

The pandemic has undoubtedly exacerbated existing social inequalities and highlighted the importance of integrating social risks into investment decisions.

A first possible strategy to integrate the social 'pillar' in financial strategies is to invest in social bonds. A social bond is a 'use-of-proceeds' fixed income instrument aimed at mitigating a specific social issue or at generating a positive social outcome. Social bonds can be an optimal fit for investors' fixed income portfolios to add diversification, serve as a solid platform for engagement with issuers on social themes and as a guarantee of measurable impact reporting to avoid 'social impact washing'.

The social bond market provides opportunities for investors to align their strategies with key global challenges. This market, largely driven by Sovereigns, Supranational and Agencies (SSAs) in its early years but now diversifying to also include issuers such as corporates and financial institutions, is expected to become an established aggregate fixed income market. New issuance of social bonds in 2020 totalled $160bn, accounting for 35% of total ESG bond issuances.

Social bonds also give an optimal opportunity to investors to put forward an effective engagement strategy. Issuers are strongly encouraged to annually provide a sufficient level of reporting on the use of proceeds. This enables investors to report with clarity on the measurable social impact of their investment.

In conclusion, long-term investors should consider social bonds to support the development of this innovative instrument at an early stage and reap the benefits of the expected market expansion.

Amundi has been a pioneer in the consideration of ESG issues and is committed to support the development of this new segment, having supported the expansion of green bonds in emerging markets and beyond pure investment grade instruments. With this objective in mind, Amundi actively supports the ICMA's effort to advance green and social bonds markets by contributing to different work streams.

BCV

Standardising ESG data for real-estate investment

Philippe Gabella, CIO, Swiss indirect real estate, Banque Cantonale Vaudoise
Fabio Simoncini, Senior Investment Manager, Swiss indirect real estate, Banque Cantonale Vaudoise

In real estate, just as in other asset classes, investors are increasingly on the lookout for certifications and ratings that quantify an investment vehicle's ESG performance. But how can an ESG score be assigned to a real-estate fund? BCV and the University of Lausanne (UNIL) have teamed up on a project to do just that – together they're developing a standardised ESG framework specifically for this asset class.

Quantifiable ESG data

Investments in real-estate funds can have a direct and verified impact on the CO_2 emissions of buildings – such data is readily available. Yet other ESG data for this asset class is unavailable or difficult to compile. Even environmental criteria, which are the easiest to measure, can be difficult to establish, and social and governance criteria are even less straightforward. In order to collect quantifiable data, the first step in the BCV –UNIL study is to create a survey that covers the three types of ESG criteria. BCV has been sharing its expertise in this type of data collection with UNIL, drawing on its extensive experience in indirect real-estate investment. Once finalised, the survey will be sent to all Swiss real-estate fund distributors, real-estate foundations and other real-estate companies.

ESG scores and reports

The researchers will collect, standardise and analyse the resulting ESG data – looking, for example, at how much energy a building consumes, whether a building complex has childcare facilities, and if a foundation's board is gender diverse. The goal is to provide an ESG score for each investment vehicle, but also to provide regular reports and even an ESG index. In this phase of the study, UNIL will work independently to develop a benchmark tool that can be used over the long term.

Sustainability: a key component in fund analysis

Filling out surveys like these requires additional resource commitments, but that outlay can quickly turn into an opportunity. Collecting and providing ESG information allows fund managers to measure what they manage and showcase the importance of sustainability in their strategy and operations. In a market where raising funds is not always easy, sustainability is more than just a third component of fund analysis alongside performance and risk – it is becoming a differentiating factor.

BLKB

ESG training and sales support as a key success factor

Andreas Holzer, Investment Specialist, Basellandschaftliche Kantonalbank (BLKB)

ESG training and support for employees is crucial for the implementation of a sound sustainability strategy. The banking industry should therefore put greater emphasis on the training of its employees in this field.

As an example, at BLKB efforts have been stepped up in the last years with a focus on sustainable investment. For banks that have systematically included ESG aspects in their range of investment products, it is important to ensure that all client relationship managers are comfortable explaining the role of ESG in the investment process and are able to handle related client questions. ESG considerations should therefore be integrated in all forms of investment related training; general product training, ESG focused certifications and in apprenticeships. At BLKB, training topics include ESG methodologies, ratings, market developments, peer comparison, marketing and BLKBs corporate sustainability. ESG training for the lending and mortgage business has also started.

The process of implementing an inclusive and comprehensive training is multifaceted. In our case, trainings are set up or accompanied by internal Investment Specialists. This team bundles the ESG knowhow and is the single point of contact for investment related questions and requests from Client Relationship Managers. In parallel, all marketing documents for our investment products were enhanced to provide relevant ESG information to clients, and company factsheets for the stocks covered by the BLKB investment research now include a description of ESG characteristics. Last but not least, the topic of sustainable investments is also regularly presented at client events. This also supports the objective to improve ESG literacy of clients, contributing to an overall better acceptance and uptake of sustainable investments.

In parallel, an additional program to anchor and develop sustainability knowhow in BLKB are the so-called Sustainability Champions and Topic Owners. They cover and promote, within their normal function, the most relevant sustainability topics in the bank. This also helps to further disseminate sustainability knowhow within the organization.

GAM Investments

Sustainability in Emerging Market Bond Strategies

Stephanie Maier, Global Head of Sustainable and Impact Investment, GAM Investments

Integrating ESG factors into sovereign strategies, in particular in emerging markets, requires a deeper look at ESG metrics and what they can tell us.

Sovereign ESG ratings are increasingly used in investment decisions, but as with corporate ESG ratings, it is important to understand what they are measuring. Typically, ESG assessments are an aggregation of data from recognised NGO country rankings (such as Transparency International's Corruption Perception Index) or ratings (such as the Freedom House score for civil and political freedoms, World Bank Governance Indicators or World Bank data on various subjects).

However, these aggregate scores mask deeper insights. For example, our research indicates that governance ratings, which capture issues such as levels of bribery and corruption, ease of doing business, quality of institutions and political stability, have the highest correlation with credit spreads, followed by social and environmental variables. But these issues are often inter-related – physical climate risks may materialise as water shortages; without adequate infrastructure to manage this shortage, social unrest may result, particularly in countries where governments and institutions are weaker and there are fewer resources to manage these risks. This trend is more pronounced in emerging markets compared to developed markets. While we believe governance issues are key, we also recognise much of the data commonly used in ESG ratings is infrequently updated and often significantly lagging, in particular for statistics that are submitted by countries which have little data collection infrastructure.

That is why we use a Crisis Cycle Filter to help us with our investments. The filter is designed to identify country-specific factors – including quantitative factors such as foreign exchange reserves or current account deficits, as well as an assessment of the vulnerability of the banking sector – considered to be the most reliable, early indicators of financial crises. These are frequently precipitated by poor governance. Using this tool alongside daily monitoring of relevant political, economic and ESG events and trends can be a valuable addition when making active investment decisions for emerging market bond strategies.

Graubündner Kantonalbank

swissQuant
Mastering Complexity

Key elements in a transformation into a sustainable bank

Adrian Schneider, Chief Investment Officer, Graubündner Kantonalbank

Integrating sustainability into the business strategy has become a key success factor for banks. More than 10 years ago, Graubündner Kantonalbank (GKB) has taken an active and systematic position on sustainability. In our operations, we have been CO_2-neutral since 2015 and we aim to achieve this goal in our investment and lending business by 2030, too.

By mid-2020, a comprehensive sustainability concept incorporating exclusion criteria, ESG integration, shareholder engagement and thematic investing was implemented in GKB's investment strategy, investment process and all investment solutions. The repositioning of the product range from traditional to sustainable brought many, albeit solvable, challenges.

The first objective was to define the "right" exclusion criteria. This definition is interesting because it requires subjective value judgements and, unlike rule-based screening, cannot be founded on objective criteria. Another challenge was to select a partner for ESG research that fits GKB's investment philosophy.

"Do the right thing and tell everyone about it," says an ancient proverb. Besides the technical implementation, communication and education are key elements of a functional sustainability concept: GKB is seeking an active dialogue with stakeholder groups. At the same time, it is pursuing the objective of transferring knowledge about the investment business to client advisors, and convincing clients and the public of the added-value created by more sustainable investment strategies.

After the implementation of a sustainable investment strategy last year, GKB has been steadily developing the sustainability approach further. The focus is on achieving the goal of making investment solutions climate-neutral. This entails two key elements: a clearly defined strategy setting out the path to CO_2 neutrality and dedicated sustainability reporting with clear details on both financial and climate performance indicators. Only such a transparent approach can strengthen the credibility of sustainable investments.

Outperformance through harvesting the full ESG potential

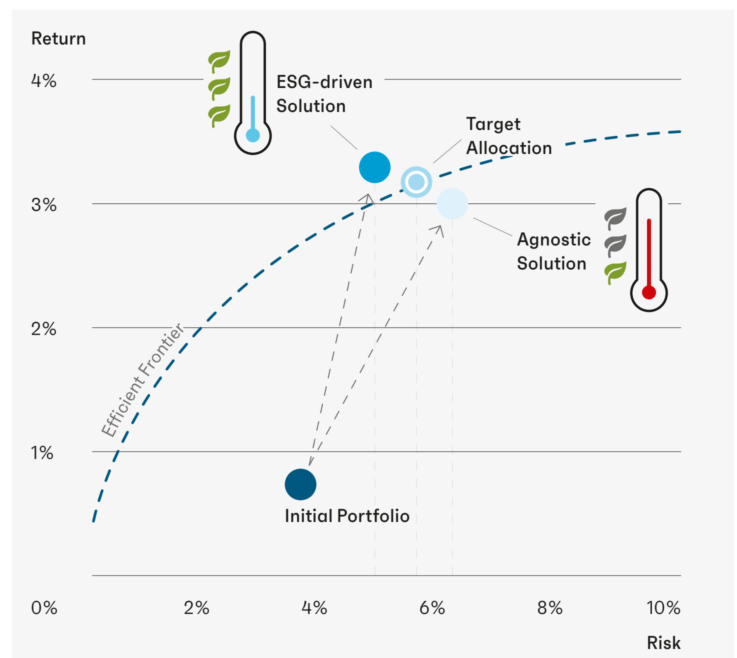
Michael Taschner, Head of Wealth Management and Sustainable Finance, swissQuant
Dr. Andrea Baggio, Head Optimization, swissQuant
Patrick Wirth, Manager ESG, swissQuant

Portfolio managers often apply overly restrictive rules or complex and resource-intensive investment approaches to find a compromise between attractive risk/return and ESG ambitions. By applying preference-driven portfolio optimization instead, better financial results can be achieved by maximizing the ESG impact.

When considering material sustainability risks and individual investors' ESG preferences in accordance with new regulations (e.g., EU Action Plan), both an optimal risk/return balance and a maximization of ESG preferences can be achieved simultaneously. This is possible by quantifying the sustainability risk and by considering it as an implicit risk in the optimization approach by applying climate scenarios. At the same time, by applying an ESG-driven optimization, better financial results can be achieved for both client and portfolio manager.

Using the investor's individual ESG preferences as well as the bank's internal view, swissQuant's Optimizer selects instruments which outperform, while at the same time making ESG tangible and transparent for both advisor and the client.

Boosting ESG Considerations into Optimal Portfolio Allocation



08

Appendix

Glossary

Best-in-Class
Approach in which a company's or issuer's ESG performance is compared with the ESG performance of its peers (i.e. of the same sector or category) based on a sustainability rating. All companies or issuers with a rating above a defined threshold are considered as investable.

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 (i.e. energy consumption, water consum ption), environmental governance (i.e. environmental management system based on ISO 14 001) and environmental product stewardship (i.e. vehicles with low fuel consumption).

ESG – Environment, Social and Governance
ESG stands for Environment (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 Engagement
Engagement is an activity performed by shareholders with the goal of convincing management to take account of ESG criteria. This dialogue includes communicating with senior management and/or boards of companies and filing or co-filing shareholder proposals. Successful engagement can lead to changes in a company's strategy and processes so as to improve ESG performance and reduce risks.

ESG Integration
The explicit inclusion by investors of ESG risks and opportunities into traditional financial analysis and investment decisions based on a systematic process and appropriate research sources.

ESG Voting
This refers to investors addressing concerns of ESG issues by actively exercising their voting rights based on ESG principles or an ESG policy.

European SRI Transparency Code
In May 2008, the European SRI Transparency Code was created to foster transparency of sustainable investment products. It builds on five pillars: (1) secure quality through transparency (2) investors know what they invest in (3) sustain the spectrum of sustainable investment (4) no prescription of ethical standards (5) no prescription for the portfolio composition.

Eurosif
Eurosif is the European association whose mission is to promote sustainability through European financial markets. It works as a partnership of several Europe-based national Sustainable Investment Forums (SIFs). Eurosif engages in a range of promotional activities such as public events or discussion forums, both with the industry and policy-makers. www.eurosif.org

Exclusions
An approach excluding companies, countries or other issuers based on activities considered not investable. Exclusion criteria (based on norms and values) can refer to product categories (e.g. weapons, tobacco), activities (e.g. animal testing) or business practices (e.g. severe violation of human rights, corruption).

Fiduciary Duty
In the institutional investment context, trustees of pension funds have a fiduciary duty 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. Given the 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 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.

ILO Conventions

ILO conventions encompass international labour standards which are integrated into legally binding international treaties, setting out basic principles and rights at work. Those legal instruments are ratified in all participating countries. The eight fundamental conventions cover the topics freedom of association and the effective recognition of the right to collective bargaining; the elimination of all forms of forced or compulsory labour; the effective abolition of child labour; and the elimination of discrimination in respect of employment and occupation. They are frequently used as the basis for exclusion and engagement approaches.

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. SSF considers impact investments as those having three main characteristics: intentionality, management and measurability.

IRIS

IRIS is a catalogue of generally accepted performance metrics that impact investors use to measure social, environmental and financial success, to evaluate deals as well as to improve the credibility of the impact investing industry. The catalogue is prepared by the Global Impact Investing Network (GIIN), a non-profit organisation dedicated to increasing the scale and effectiveness of impact investing. https://iris.thegiin.org/

Norms-Based Screening

Screening of investments against minimum standards of business practice based on national or international standards and norms such as the ILO declarations, the OECD Guidelines for Multinational Enterprises, the UN Global Compact or the UN Guiding Principles on Business and Human Rights.

OECD Guidelines for Multinational Enterprises

This is a comprehensive set of government-backed recommendations on responsible business. The governments who aim to adhere to the guidelines intend to encourage and maximise the positive impact multinational enterprises can make to sustainable development and enduring social progress. www.oecd.org/corporate/mne

Paris Agreement

Agreed at COP21 in Paris in 2015, the Paris Agreement's central aim is to strengthen the global response to the threat of climate change by keeping a global temperature rise this century well below 2 degrees Celsius above pre-industrial levels and to pursue efforts to limit the temperature increase even further to 1.5 degrees Celsius.

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.

Sustainable Investment (SI)

Sustainable investment (analogous to responsible investment) refers to any investment approach integrating ESG factors 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.

Sustainable Thematic Investments

Investment in businesses contributing to sustainable solutions, in the environmental or social domain. In the environmental segment, this includes investments in renewable energy, energy efficiency, clean technology, low-carbon transportation infrastructure, water treatment and resource efficiency. In the social segment, this includes investments in education, health systems, poverty reduction and solutions for an ageing society.

Sustainable Development Goals (SDG)

The SDGs are 17 goals set by the UN in 2017 aiming to catalyse sustainable development. They include goals such as no poverty, gender equality, decent work, sustainable consumption, climate action and reduced inequalities. The goals were created to replace the Millennium Development Goals (MDGs) which ended in 2015. Unlike the MDGs, the SDG framework does not distinguish between developed and developing nations.

Sustainable Finance
Sustainable finance refers to any form of financial service integrating 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.

Swiss Federal Act on War Material (WMA)
The WMA is a piece of Swiss legislation in force since 1998. This act focuses on the fulfilment of Switzerland's international obligations and the respect of its foreign policy principles by means of controlling the manufacture and transfer of war material and related technology. At the same time, it aims at maintaining Swiss industrial capacity adapted to the requirements of its national defence. The WMA was amended in 2013 to include the prohibition of the production, as well as the direct financing, of controversial weapons, encompassing cluster munition, anti-personnel mines, as well as biological, chemical and nuclear weapons. Switzerland is one of 13 countries regulating the financing of controversial weapons.

United Nations Global Compact (UNGC)
This UN initiative aims to encourage businesses worldwide to align their operations and strategies with ten universally accepted principles in the areas of human rights, labour, environment and anti-corruption. Companies signing the UNGC commit to regularly reporting on progress on the ten principles. www.unglobalcompact.org

UN Guiding Principles on Business and Human Rights
The Guiding Principles for Business and Human Rights are meant to support the implementation of the United Nations "Protect, Respect and Remedy" Framework. This set of guidelines seeks to provide a global standard for preventing and addressing the risk of adverse human rights impacts linked to business activity. They were proposed by the UN Special Representative for Business and Human Rights, John Ruggie, and endorsed by the UN Human Rights Council in June 2011. As they cover all areas of business, they are also applicable to the financial sector.

List of Abbreviations

Abbreviation	Meaning
AMAS	Asset Management Association Switzerland
AuM	Assets under management
BREEAM	Building Research Establishment Environmental Assessment Methodology
CHF	Swiss franc
CO_2	Carbon dioxide
CSP	Center for Sustainable Finance and Private Wealth
ESA	European Supervisory Authorities
ESG	Environmental, social and governance
EU	European Union
EUR	Euro
FINMA	Swiss Financial Market Supervisory Authority
FNG	Forum Nachhaltige Geldanlagen e.V.
FOEN	Swiss Federal Office for the Environment
G20	Group of Twenty (Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa, South Korea, Turkey, UK, US, EU
GHG	Greenhouse gas
GRESB	Global Real Estate Sustainability Benchmark
IDD	Insurance Distribution directive
IFC	International Finance Corporation
IMP	Impact Management Project
IPSF	International Platform on Sustainable Finance
IRIS	Impact Reporting and Investment Standards
LEED	Leadership in Energy and Environmental Design
MIFID	Markets in Financial Instruments Directive
NCP	National contact point
NFRD	Non-Financial Reporting Directive
NGFS	Network for Greening the Financial System
OECD	Organisation for Economic Co-operation and Development
PACTA	Paris Agreement Capital Transition Assessment
PAIF	Private Asset Impact Fund
PRB	Principles for Responsible Banking
PRI	Principles for Responsible Investment
SDG	Sustainable Development Goal
SFDR	European Sustainable Finance Disclosure Regulation
SI	Sustainable Investment
SIF	Swiss State Secretariat for International Finance
SIX	Swiss stock exchange
SNB	Swiss National Bank
SSF	Swiss Sustainable Finance
TCFD	Task Force on Climate-Related Financial Disclosures
TNFD	Taskforce on Nature-Related Financial Disclosures
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
UNFCCC	United Nations Framework Convention on Climate Change
USD	US Dollar
WMA	Swiss Federal Act on War Material

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Study Participants

Aargauische Pensionskasse
Allianz Suisse
AlphaMundi Group Ltd
Alternative Bank Schweiz AG
AXA Versicherungen AG
Baloise Versicherung
Bank J. Safra Sarasin Ltd
Bank Julius Baer & Co. AG
Banque Cantonale Neuchateloise (BCN)
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Basellandschaftliche Kantonalbank
BCGE Asset Management
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CAP Prévoyance
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Credit Suisse AG
de Pury Pictet Turrettini & Cie SA
die Mobiliar
EFG Asset Management
Ethos Services SA
Fundo SA
GAM Investments
Generali Versicherungen
Globalance Bank
Graubündner Kantonalbank
IAM Independent Asset Manaagement SA
INOKS Capital
Kieger AG
LGT Capital Partners AG
Lombard Odier Asset Management Switzerland
Loyal Finance AG
Luzerner Pensionskasse
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Suva
Swiss Investment Fund for Emerging Markets (SIFEM)
Swiss Life Asset Managers
Symbiotics
Thurgauer Kantonalbank
UBP SA
UBS Group AG
Unigestion
Vaudoise Assurances
Velux Stiftung
Vontobel Holding AG
zCapital
Zürcher Kantonalbank
Zurich Insurance Group Ltd

Overview Table: Swiss Sustainable Investment Market

CHF/EUR (Millions)	2020		2019	
Sustainable Investment Market	CHF	€	CHF	€
Funds	694,464	641,419	470,663	433,591
Mandates	269,790	249,183	208,869	192,417
Asset Owners	555,927	513,464	483,734	445,632
Total	**1,520,181**	**1,404,065**	**1,163,266**	**1,071,640**
Sustainable Investment Approaches	CHF	€	CHF	€
ESG Integration	1,075,433	993,288	808,157	744,502
ESG Engagement	1,045,946	966,053	633,020	583,160
Exclusions	971,970	897,728	754,709	695,263
Norms-Based Screening	723,340	668,089	488,557	450,076
ESG Voting	510,724	471,713	372,853	343,485
Best-in-Class	158,825	146,693	124,365	114,569
Impact Investing	85,585	79,048	50,369	46,402
Sustainable Thematic Investments	74,377	68,696	62,633	57,700
Asset Classes	CHF	€	CHF	€
Equity	437,851	404,407	311,905	287,338
Corporate Bonds	326,191	301,276	208,863	192,412
Real Estate/Property	189,210	174,758	149,318	137,556
Sovereign Bonds	180,179	166,416	168,598	155,318
Private Equity	58,795	54,304	47,045	43,340
Monetary/Deposit	38,697	35,741	33,022	30,421
Private Debt	38,085	35,176	33,657	31,006
Infrastructure	17,497	16,161	16,418	15,124
Hedge Funds	16,202	14,964	10,613	9,777
Supranational Bonds	13'408	12,384	28,508	26,262
Other	61,651	56,942	48,700	44,864
Not specified	142,415	131,537	106,620	98,222
Investor Types	CHF	€	CHF	€
Institutional	1,097,953	1,014,088	917,444	845,181
Private	422,228	389,977	245,821	226,459

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The mission of Swiss Sustainable Finance (SSF) is to strengthen Switzerland's position as a leading voice and actor in sustainable finance, thereby contributing to a sustainable and prosperous economy. The association, founded in 2014, has representative offices in Zurich, Geneva and Lugano. Currently, SSF unites over 175 members and network partners from financial service providers, investors, universities and business schools, public-sector entities and other interested organisations. Through research, capacity-building and the development of practical tools and supportive frameworks, SSF fosters the integration of sustainability factors into all financial services. An overview of SSF's current members and partners can be found on its website: sustainablefinance.ch

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CSP Center for Sustainable Finance & Private Wealth

Research Partner:
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The Center for Sustainable Finance and Private Wealth (CSP) is an academic research institution at the University of Zurich, Switzerland's largest university. The mission of CSP is to conduct research on the most pressing issues in sustainable finance and to train wealth owners and investment professionals in order to drive more capital towards sustainable development. See www.csp.uzh.ch.

Acknowledgements:

Swiss Sustainable Finance would like to thank first and foremost the SSF Market Study Workgroup. During the course of the project, the Workgroup provided valuable input to help shape the survey and motivate participation amongst Swiss actors, as well as contribute ideas for the report content and structure. A big thank you goes to all the organisations that participated in the survey and devoted their time to filling in the questionnaire. We also thank the external parties involved in providing interview material and special insights for chapter 6, to make sure the report contains up to date views from the Swiss government, academics and specialists. We would also like to thank all the sponsors to the report, without whose generous contribution this project would not have been possible.

Contributing authors:

Jannis Morgenthaler
Center for Sustainable Finance and Private Wealth, University of Zurich

Kelly Hess
Director Projects, Swiss Sustainable Finance

Anja Bodenmann
Project Manager, Swiss Sustainable Finance

Timo Busch
Center for Sustainable Finance and Private Wealth, University of Zurich

Sabine Döbeli
CEO, Swiss Sustainable Finance

Jean Laville
Deputy CEO, Swiss Sustainable Finance

Proofreading: Graeme High Language Consultants Ltd.
Design: frei – büro für gestaltung, Zurich | freigestaltung.ch
Cover: Saxer Lücke, Rüte, Switzerland. Photo by Eric Knoll on Unsplash

Zurich, June 2021

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sustainablefinance.ch

Swiss Sustainable Finance
Grossmünsterplatz 6
8001 Zürich
T 044 515 60 50

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Twitter: @SwissSustFin
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