SwissBanking

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Guideline for the integration of ESG considerations into the advisory process for private clients

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Summary

- Financial service providers play a key intermediary role in the allocation of capital to sustainable economic activities, in particular vis-à-vis private clients.
- Clients are becoming increasingly aware and demand transparency about ESG[1] conscious investments.
- The advisory process[2] is comprehensively regulated by existing regulation (FinSA[3] in Switzerland, MiFID in the EU, etc.). ESG considerations can be fitted into the existing regulatory framework.
- These guidelines are not meant to create additional regulatory requirements. They provide a framework on how financial service providers can successively integrate ESG considerations into the advisory process for private clients. The guidelines are essentially principles that can be applied in the context of the specific advisory processes of financial service providers. They are not legally binding and promote ESG considerations in the market, recognizing that individual institutions are on varying paths in fulfilling these recommendations.

Private clients are increasingly aware that investments leave a "footprint" – either negative, neutral or positive – from an ESG perspective. They want to understand, influence or even control the consequences of their investments more effectively. It is therefore becoming more important for financial service providers to determine whether (or not) clients have ESG preferences[4]. In accordance with the preferences (if any) expressed by the clients suitable investment solutions and services should be provided.

1 Environmental, Social and Governance (ESG) considerations means the deliberate inclusion of ESG criteria into investment decisions.
2 The advisory process is defined as the interaction at the point of sale encompassing all financial services provided to clients under FinSA (including advisory and discretionary mandates but excluding execution only).
3 The Financial Services Act (FinSA) – rules for the provision of financial services and offering of financial instruments.
4 ESG preferences mean a client's (or potential client's) preferences for environmentally sustainable investments, social investments or good governance investments.

In practice, clients' increased awareness manifests itself through five different, but complementary motivations for sustainable investments:[5]

- Compliance with individual or institutional standards;
- Expression of values;
- Improvement of investments' risk/return profile;
- Promotion of sustainable development and sustainable business practices;
- Generation of a genuine social and environmental impact.

Sustainable finance is not a new field for financial service providers in Switzerland. Over the past decades, an internationally recognised ecosystem of sustainable finance has developed across the country. The penetration of financial instruments managed in accordance with ESG considerations is around 21% (as of 2019), which is about twice as high as the global average.[6]

Internationally, there are many indicators and initiatives that help private and public actors determine how financial flows contribute to a more sustainable world. The UN Sustainable Development Goals (SDGs)[7] have created a globally accepted framework.[8] The Paris Climate Change Convention (Art. 2 para.1 letter c)[9] is another important reference point in the area of sustainability. Each bank intending to implement these guidelines remains free to select the relevant indicators and how to implement these principles into the advisory process.

Going forward, one of the challenges but also an opportunity for the financial services industry may be the transition to a more sustainable financial system. In a market economy, this transition can only succeed if financial service providers take informed decisions. It is thus important that:

5 Based on SSF Handbook on Sustainable Investments with additions. Available at: https://www.sustainablefinance.ch/upload/cms/user/201712_Handbook_on_Sustainable_Investments_CFA.pdf.
6 Swiss Sustainable Investment Market Study 2019; SBA Banking Barometer 2019; McKinsey Performance Lens – Global Growth Cube 2018.
7 https://www.un.org/sustainabledevelopment/sustainable-development-goals.
8 The SDGs are not a concrete investment framework and they are not the sole valid reference to describe what sustainability is about. GRI (Global Reporting Initiative) or SASB (Sustainability Accounting Standards Board) are other examples of well-established frameworks.
9 https://unfccc.int/process-and-meetings/the-paris-agreement/the-paris-agreement.

1. ESG considerations are integrated into investment processes, which will take expertise and time to implement;
2. Client advisors are given appropriate training regarding ESG considerations and investment solutions, and on how to advise clients in this respect;
3. Financial service providers are encouraged to further enhance expertise and provide ESG instruments and services;
4. Digitisation is used in a supportive manner so that decisions are based on solid and comparable data.

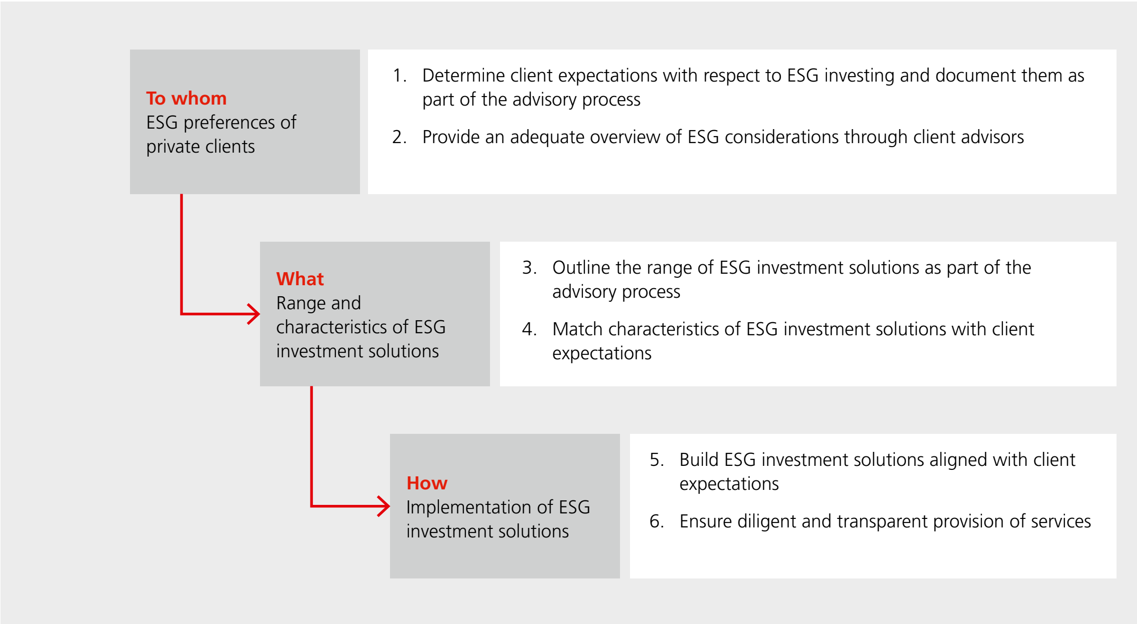
These are important levers for accelerating the "mainstreaming" of sustainable finance. In this context, the advisory process plays a central role. The integration of clients' ESG preferences into the advisory process should therefore be emphasised. Consequently, if the client has indicated an interest, financial service providers should integrate ESG considerations into this process, thereby creating added value for clients and enabling informed decision-making. To the extent possible, these considerations are to be integrated into the existing advisory processes. The additional administrative work created by this obligation for client advisors should be kept to a minimum.

Each financial institution will continue to follow its own investment processes, but ESG preferences are ideally explicitly integrated into these processes so that adequate information is provided to the client. The starting point are the framework conditions and the provisions of FinSA. Its chapter on rules of conduct covers aspects such as suitability and investment advice. As a principles based regulation, these articles cover a wide field of application.

> The following six principles provide guidance for the integration of ESG considerations into the advisory process for private clients. The advisory process covers both discretionary and advisory mandates. Execution only is not in scope as there is no related service provided in the advisory process.

Fig. 1

Six principles provide guidance for the integration of ESG considerations



Source: SBA

1. ESG preferences of private clients

Principle 1
Determine client expectations with respect to ESG investing and document them as part of the advisory process

The set of rules for fulfilling the documentation obligations under FinSA covers all essential steps of the entire suitability process. This includes, for example, the introductory clarifications within the framework of the suitability process such as the client's investment objectives, financial circumstances and knowledge and experience of financial instruments.

Furthermore the bank has to assess the client's potential investment restrictions, if there are any. A structured interaction with the client is necessary to determine their investment profile, which not only takes into account traditional preferences, but also ESG preferences in a standardised approach as defined individually by each financial service provider.

ESG preferences refer to a client's preferences for environmentally sustainable, social or good governance (ESG) investments. Consequently, such ESG preferences also form part of the documentation framework under FinSA requirements.

Should a client express no interest in applying ESG criteria to their investments, this should also be adequately documented and, in such event, these guidelines are not applicable to this client relationship. However, in line with FinSA requirements regarding financial risk disclosure, ESG criteria should still be taken into account as far as they have an effect on the financial risks of an investment.

Principle 2
Provide an adequate overview of ESG considerations through client advisors

The financial service provider should ensure that their client advisors are adequately trained in ESG considerations. In addition to general expertise about the financial instruments and services offered to clients, the client advisor should be able to address the risks and opportunities related to ESG considerations and the intended effect of an investment (for example: "How does investing in this financial instrument address issues related to climate change?").

2. Range and characteristics of ESG investment solutions

Principle 3
Outline the range of ESG investment solutions as part of the advisory process

The sustainable investment industry has been in constant development since the 1990s, when the first ESG financial instruments were rolled out in Switzerland. According to the Swiss Sustainable Investment Market Study 2019, there are a total of eight different sustainable investment approaches[10] currently applied to various financial instruments and available to clients to different degrees.

With the current mainstreaming of sustainable investing, along with constant developments and innovations in this area, it is likely that the industry will develop further and that new approaches will be introduced. Current approaches can be applied separately or in various combinations, depending on a client's motivation as outlined in the introduction.

10 See Appendix.

The financial service provider, where appropriate with the support of ESG experts, should ensure that the client understands the range of available investment solutions, and should discuss potential options based on the identified client preference(s), if any, for sustainable investing.

Principle 4
Match characteristics of ESG investment solutions with client expectations

FinSA addresses aspects such as suitability and appropriateness, which also apply for ESG investment solutions. In line with those regulatory requirements, the guidelines suggest that financial advisors should ensure that similar considerations are made with regard to the ESG preferences of the client.

When assessing suitability of financial instruments with the client profile in the advisory process, the ESG preferences and ESG characteristics of financial instruments also need to be considered for the corresponding investment service.

The client advisor, where appropriate with the support of ESG experts, strives to match the client's ESG preferences with regard to ESG investment solutions through the ESG characteristics of specific financial instruments and services offered by the financial service provider. Deviations from the ESG preferences should be clearly identified, for instance if an ESG-related alternative is not available for the desired asset class. Clients should understand the ESG characteristics and should be willing to bear the related risks and consent if a particular investment deviates from their originally defined ESG preferences.

3. Implementation of ESG investment solutions

Principle 5
Build ESG investment solutions aligned with client expectations

Consistency should be sought between clients' ESG preferences and the proposed financial instruments or services. Clients should be informed to what extent a financial instrument or service takes into account their ESG preferences.

In particular, the client advisor should inform the client, in line with FinSA requirements, whether the advisory service provided is purely transaction-based or portfolio-based, or whether it is portfolio management as a service. As the breadth of financial services offered and the trust between the financial service provider and the client increases, so do the information obligations. Consequently, the FinSA creates different levels of care and corresponding obligations for client advisors.

In accordance with FinSA, the client advisor should provide information on the characteristics and functioning of the financial instrument, as well as on the risk of losses and other relevant information for the client. Typically, this information is available in the form of a product document (such as a prospectus, KID, etc.).

Principle 6
Ensure diligent and transparent provision of services

The principles of diligent and transparent provision of services are set out in FinSA, in FinSO as the corresponding ordinance as well as in the SwissBanking self-regulation guidelines. Misleading or false product information is not permitted under FinSA and other relevant legislation.

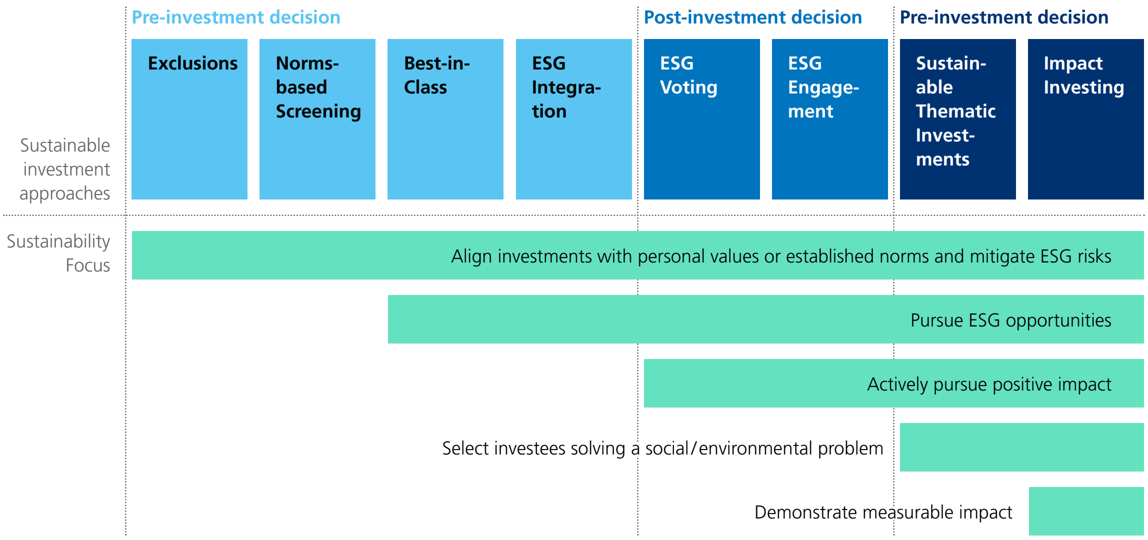
Best execution is a fundamental requirement under FinSA and also applies to ESG preferences, as far as the client has provided specific preferences on ESG financial instruments within the bank's assessment of the client's potential investment restrictions.

Appendix

The following chart summarises the common approaches and briefly outlines their main objectives and effects.

Fig. 2

Categorisation of sustainable investment approaches



Source: adapted from Swiss Sustainable Finance, Swiss Sustainable Investment Market Study 2019

The non-exhaustive table below explains the currently common 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 (or representatives of shareholders) with the goal of convincing the management of investee companies to take account of ESG criteria so as to improve ESG performance and reduce risks.
ESG Integration	The explicit inclusion 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 financial instrument categories (e.g. weapons, tobacco), activities (e.g. animal testing), or business practices (e.g. severe violation of human rights, corruption).
Impact Investing	Impact investments are those made in companies, organisations and funds with the intention of generating 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 market rate, depending upon the circumstances. Generally, impact investments have three main characteristics: intention to create impact, management of impacts and measurability of impacts.

Norms-based Screening	Screening of investments against minimum standards of business practice based on national or international standards and norms.[11]
Sustainable Thematic Investments	Investment in businesses contributing to sustainable solutions, both in environmental and social topics.

Source: adapted from Swiss Sustainable Finance, Swiss Sustainable Investment Market Study 2019

11 https://unfccc.int/process-and-meetings/the-paris-agreement/the-paris-agreement (Global Compact, ILO, UNICEF, UNHRC). This includes for example the UN Guiding Principles on Business and Human Rights, the ILO Tripartite Guidelines on MNE and Social Policy, or the OECD Guidelines for Multinational Enterprises.

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