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Sustainable finance – FINMA introduces new anti-greenwashing rules for Swiss funds

FINMA has published anti-greenwashing rules for Swiss funds, as well as organizational requirements for investment managers of Swiss and foreign funds. FINMA has not yet introduced binding rules for sustainability preferences at the point of sale, pending the Swiss Federal Council's report expected to be published later this year.

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1. Background

In the context of increasing success of sustainability-related financial products, and against the backdrop of recent national and international developments regarding sustain-ability-related transparency, FINMA has taken certain measures against greenwashing, issuing a new guidance on prevention and combating of greenwashing (the **FINMA Guidance 05/2021**). "Greenwashing" is defined by the Swiss regulator as the fact of misleading clients and investors about characteristics of financial products and services.

Given the absence of a specific legal basis, FINMA's measures are limited. The Swiss regulator focuses in this context on investor/client protection, rather than the protection of the markets, unfair competition between participants, or the general goal of channeling private investments towards sustainable finance. FINMA also notes that greenwashing represents legal and reputational risks, not only for market participants but also for the market as a whole.

Preventing and combatting greenwashing is now one of FINMA's priorities. Importantly, the regulator indicated in a recent presentation, that around one-third of its on-site inspections will be related to greenwashing.

2. Fund-level regulation

For Swiss collective investment schemes, the regulator introduces two sets of requirements. The first set – related to transparency – is not new. FINMA had already set out specific re-quirements on this point in a letter addressed to all fund management companies in February 2021. These rules are now anchored in FINMA's Guidance 05/2021. The second set of rules – on sustainability-related reporting – are new and summarized below.

Scope

The fund-level requirements set out in FINMA Guidance 05/2021 concern **Swiss collective investment schemes**. They are therefore primarily addressed to Swiss fund management companies and SICAVs. In our view, such requirements will likely apply to the forthcoming Limited Qualified Investor Funds (L-QIF), expected to become available as of January 1, 2023.

The scope of FINMA Guidance 05/2021 is limited to sustainability-related financial products, meaning products, which refer or link to sustainability or sustainability-related (e.g., by using terms such as "sustainable", "green", "ESG", "environment friendly"), typically in their name, product documentation, marketing materials or otherwise in the way they are marketed ("**Sustainability-Related Funds**").

In this context, a link to sustainability can be created through the fund documents (contract, prospectus, investment regulations, or Articles of association: "**Fund Documents**"), but also simply via advertisement. If such link exists (for example, because a fund is marketed as "green" on a distributor's website), FINMA may impose requirements at the fund level. This fund-level regulation could therefore have indirect effects on entities marketing the funds. Fund management companies and SICAVs may be well advised to tighten control over advertisers to avoid potential references to sustainability for non-sustainable products, both in Switzerland and abroad.

Non-Swiss investment funds advertised or offered in Switzerland are not directly impacted by the fund-level requirements introduced by the FINMA Guidance 05/2021. However, FINMA is taking the view that the "name rule" is also applicable to UCITS funds approved in Switzerland so that the regulator may step in if a non-Swiss fund uses a deceptive name.

Transparency

In line with the requirements mentioned by FINMA in its February 2021 letter, the information provided in the Fund Documents of a Sustainability-Related Fund must comply with specific requirements aimed at preventing greenwashing and, where applicable, achieving transparency on the fund's sustainability characteristics or links. Fund Documents must notably (i) avoid references to sustainability where no sustainable investment strategy/policy is pursued, (ii) include details about the sustainability approach and its implementation, (iii) ensure consistency between the approaches chosen and the investments allowed, (iv) provide for approaches other than widespread exclusion

criteria (which would not be sufficient as such), (v) include reference to "impact investments" or zero-carbon" only where such impacts or carbon reductions can be actually measured and verified, and (vi) provide details about the investment strategy/policy, the selection of permitted investments, and details on how sustainability considerations are integrated into the investment decision process; in such context, general information is not sufficient.

Reporting

The main novelty of FINMA's Guidance 05/2021 consists in introducing retrospective reporting requirements on the extent to which a Sustain-ability-Related Fund has achieved its sustain-ability goals. Although the regulator does not mention which standards the reporting should follow, it recommends a "high degree of transparency".

Based on FINMA's developing practice, this ex-post ESG reporting should be (i) publicly available, (ii) consistent (in terms of form and content), (iii) highly transparent, and (iv) avoid extensive disclaimers (e.g., regarding ESG ratings).

Entities performing their reporting based on EU standards could generally assume compliance with Swiss rules in this respect.

More detailed regulation may follow in the future on this topic, but none is expected in the short term.

3. Organizational requirements

FINMA further clarified the organizational requirements applicable to entities based in Switzerland managing Sustainability-Related Funds (both Swiss and foreign) based on Article 9 of the Financial Institutions Act ("**FinIA**") and Articles 14 (1) (c) and 20 (1) of the Collective Investment Schemes Act ("**CISA**"):

- The investment decision process must consider sustainability factors, which shall then be reviewed as part of the investment controlling and risk management monitoring.
- Sustainability-related knowledge and expertise must be available within the governance, supervision and control function, as well as at the operational level.
- The body for governance, supervision, and control (ie, the board of director in a corporation) is responsible for setting out the sustainability strategy.
- Information provided by external data providers (analysis, data, tools, and rating) must be carefully assessed, monitored, and validated.

These requirements include an obligation to comply with the sustainability strategy of each product, and to appropriately capture sustainability risks within the risk management processes, in addition to more traditional investment risks.

The organizational requirements detailed in Guidance 05/2021 are applicable to **Swiss banks, securities firms, insurance companies, investment managers of collective assets, fund management companies, and SICAVs** managing Swiss and non-Swiss collective investments.

Against this backdrop, due attention should in particular be paid to the following potential shortcomings:

- changes introduced based on customer pressure;
- unclear exclusion criteria;
- insufficient awareness of greenwashing risks;
- insufficient control framework for data delivery from external rating and benchmark providers;
- inadequate performance targets for ESG team members; and
- incomplete integration of ESG risks in the risk reporting/control framework.

4. Point of sale

FINMA did not introduce binding rules at the point-of-sale level, pointing to a lack of legal basis to do so. However, it takes the view that greenwashing risks exist at the point-of-sale level and that financial service providers are expected to manage them accordingly. Managers or advisers may be exposed to investors' claims for not having complied with sustainability-related instructions.

Point of sale recommendations apply in respect of **both Swiss and non-Swiss financial products (not limited to funds)**.

FINMA refers to the Guideline for the integra-tion of ESG considerations into the advisory process for private clients published by the Swiss Bankers' Association (SBA) in June 2020, which can help reduce the greenwashing risk.

5. Timeline

Fund-level requirements **for Swiss funds** have entered into force on September 1, 2021. FINMA will not approve updates of Fund Documents on other topics if sustainability requirements are not met. FINMA requires in any event that all Sustainability-Related Funds update their Fund Documents by **June 30, 2022**.

Regarding reporting and organizational requirements, FINMA did not indicate the date on which these would enter into force. Entities that are not yet organized to perform such sustainability reporting would, however, be well advised to start preparing for this as soon as practicable.

Of note, for point-of-sale questions, a Federal Council's report is currently expected by the end of November or early December 2021, which could include proposals to amend the Financial Services Act ("**FinSA**") on sustainability preferences.

6. Climate-related financial risks

FINMA, in a separate press release issued on the same day as FINMA Guidance 05/2021, indicated that it is currently developing climate-risk management concepts for banks and insurance companies, which shall be implement-ed starting in 2022. FINMA and the Swiss National Bank are finalizing a pilot project to identify and measure risk concentration with systematically important banks. The largest banks and insurance companies are subject to disclosure requirements based on the Task Force of Climate-related Financial Disclosures since the amendment of FINMA Circulars 2016/1 and 2016/2, which entered into force on July 1, 2021.

Please do not hesitate to contact us in case of any questions.

Legal Note: The information contained in this Smart Insight newsletter is of general nature and does not constitute legal advice.

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