CENTRE DE DROIT
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Sustainable finance

FINMA nudges banks and insurance companies towards sustainable investment

Par Jeremy Bacharach le 20 July 2021

The theory of *nudges*, developed by American academics Richard Thaler (Nobel Prize in Economics 2017) and Cass Sunstein, postulates that it is possible to regulate certain behaviours without implementing restrictive rules. Instead, Thaler and Sunstein suggest influencing human choices using various methods of elementary psychology, with the aim of encouraging certain socially beneficial behaviours, without, however, making them compulsory. A typical example is that of a cafeteria : it is possible to encourage people to eat better, but without reducing their freedom of choice, by placing healthy dishes at eye level and making it more difficult to access less healthy dishes. Presenting the dishes in this way is an example of a *nudge*.

So far, it seems that the reception of this theory in Swiss law has been limited. However, when examining the measures adopted by FINMA to promote transparency with regard to climate risks, one wonders whether *nudges* have not made their way into Swiss financial regulations.

On 31 May 2021, FINMA published a number of amendments to Circular 2016/1 'Publication – banks' and Circular 2016/2 'Publication – insurers *(public disclosure)*', which came into force on 1 July 2021. These amendments now require the largest Swiss banks and insurance companies to publish certain information on 'climate-related risk management' in their annual reports. This obligation applies to category 1 and 2 banks, i.e. the five largest banks, as well as the four largest insurance companies.

The principles governing these new publication obligations are short and concise, so that it is possible to quote them here in their entirety. We reproduce below the new Annex 5 to Circular 2016/1, it being specified that the amendments to Circular 2016/2 (cm. 13.1 ff) are almost identical, *mutatis mutandis* :

> *"Banks in supervisory categories 1 and 2 shall publish information on the management of climate-related financial risks as part of their annual report each year.*
>
> *The publication shall include at least the following information :*

- *central characteristics of the governance structure available to the bank to identify,* *assess, manage, monitor and report on climate-related financial risks,*

- *description of short-, medium- and long-term climate-related financial risks, their influence on the commercial strategy and the risk strategy, as well as their repercussions on existing risk categories,*
- *risk management structures and processes to identify, assess and manage climate-related financial risks,*
- *quantitative information (key figures and objectives) on climate-related financial risks as well as on the methodology used.*

Banks shall publish the assessment criteria and methods on which their analysis of the materiality of climate-related financial risks is based."

FINMA's commentary provides some useful clarifications for the implementation of these rules in practice. FINMA emphasises in particular that it is *financial risks* that must be published. More specifically, banks and insurance companies are expected to make public the way in which they manage the ordinary financial risks inherent in their activities – credit risk, market risk, operational risk and, where applicable, insurance risk – in the light of the consequences of climate change. It should also be emphasised that this is only a *pure obligation to publish* : technically, the amendments to circulars 2016/1 and 2016/2 do not affect the substantive rules applicable to the actual activities of banks and insurance companies. For FINMA, the costs incurred by the companies subject to the regulations should therefore be limited to IT, personnel and *consulting* costs.

As is now the case for most developments in financial regulation, this decision is not an initiative of FINMA, but stems from a *soft law* text adopted by a transnational organisation. This is the *Recommendations on Climate-related Financial Disclosures*, a document published in 2017 by the *Task Force on Climate-Related Disclosures* (TCFD), a working group made up of 32 members, most of whom hold senior positions in multinationals. The *Recommendations of* the TCFD are already being implemented by a large number of multinational companies, including six banks and insurance companies affected by the amendments of 31 May 2021.

Legally, this new obligation for banks is based on the rules for the publication of own funds, namely Art. 3*g of* the Banking Act and 16 of the Financial Institutions Ordinance, relating to Pillar 3 of the Basel standards. With regard to insurance, these are the transparency obligations enshrined in art. 25 LSA and 111*a of* OS, derived from the *Core Principles* of the*International Association of Insurance Supervisors*. These legal bases were not designed to regulate climate risks : they are therefore used as 'vehicles' to integrate the TCFD recommendations into Swiss law.

In our view, the amendments to circulars 2016/1 and 2016/2, however, go further than a 'simple' publication obligation. By designating climate change as a financial risk, and by requiring banks and insurance companies to disclose how they manage this risk, FINMA is actually encouraging these institutions to distance themselves from activities with a high environmental impact and to move towards green and sustainable projects. This objective is also implicit in the TCFD *Recommendations on* Climate-related Financial Disclosures. The effect – if not the aim – of FINMA's intervention is therefore to indirectly influence the behaviour of the institutions subject to its supervision, without however imposing corresponding obligations on them in a direct and explicit manner. This measure therefore has all the appearances of a *nudge*, encouraging banks to participate more actively in the transition to a more sustainable economy. It is not surprising that the '*disclosure*' obligations are explicitly cited in the work of Thaler and Sunstein as an example of a *nudge*.

The adoption of this regulatory method is commendable, as it makes it possible to limit the length and complexity of the regulations. However, there is one regret : Sunstein and Thaler recommend that the authorities be fully transparent about the aims and effects of their *nudges*. It would have been desirable here for FINMA to play along, explicitly recognising the concrete consequences of this new regulation for its regulated entities.
