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Sustainable finance in Switzerland – The greenwashing risk

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On 16 December 2022, the Swiss Federal Council published its position on the prevention of greenwashing in the financial sector, setting up a working group to come up with next-step proposals by the end of September 2023. In this article we consider recent developments in sustainable finance and how they may give rise to legal claims.

Sustainability is a significant challenge for financial markets – be it from the risk posed by climate change to market stability,[1] or from customer pressure on financial service providers for sustainable investment management strategies for their portfolios and/or more environmental, social and governance (ESG)-rated products.[2]

The Swiss Financial Market Supervisory Authority ("**FINMA**"), the Swiss Bankers Association ("**SBA**"), the Asset Management Association Switzerland ("**AMAS**") and Swiss Sustainable Finance ("**SSF**") have all attempted to address such risks by publishing rules and guidelines on sustainable investments.[3]

The resulting regulatory jungle of intricate non-binding recommendations, rules and guidance is complicated for clients and financial service providers alike – and conducive to greenwashing. Investigations by FINMA clearly show that greenwashing practices can be seen in the distribution of financial products and services, with providers often making vague or even misleading statements about their products.[4] Thus, the first major cases of greenwashing are beginning to emerge in Europe causing reputational damage to well-known actors.[5]

1.1 Potential risks that could lead to litigation for greenwashing

Switzerland currently has no legislative or regulatory requirements on transparency or compliance with specific sustainability criteria for financial services.[6]

As a result, financial service providers are at high risk from accusations of greenwashing at both fiduciary and product level. These risks can be notably the following:

i) Fiduciary level:

a) legal and reputational risks for financial institutions due to a lack of clarity about what constitutes a sustainable investment;[7]
b) clients being misled about the sustainability of the financial service and ESG risks;
c) mismanagement linked to investment advisory and portfolio management services;
d) for collective investment schemes, non-implementation of the information about the sustainability approach decided in the investment strategy/policy;
e) climate risks related to certain financial products.[8]

ii) Product level:

a) clients and investors being misled about the sustainability or contribution to sustainability of financial products;[9]
b) terms such as “impact” or “zero” carbon used without any means of measuring or verifying;
c) the collective investment scheme makes references to sustainability where:

- very general information in the fund documents;
- no sustainable investment strategy/policy is actually pursued;[10]
- the investment strategy/policy is only deemed sustainable because of widespread exclusionary criteria, without a specific sustainability component beyond this; 11
- there is no or only very general information about the corresponding investment strategy/policy and/or the selection of permitted investments, or how sustainability considerations are integrated into the investment decision process. Investors are not able to gain an impression of how sustainability is taken into account due to the lack of detail or transparency;[12]

d) The collective investment scheme investment policy is not in line with the sustainability approach pursued (best-in-class approach, approach integrating ESG considerations, stewardship);

Such risks may result in litigation by investors against their managers and advisors, or by investors against collective investment schemes managers and/or collective investment schemes managers against collective investment schemes issuer. The stakes are high for all parties and grounds for litigation will vary greatly, depending on the contractual relationship between investors, managers/advisors, and issuers.

Collective investment schemes

Here, the issuer, as well as representatives and managers, can be liable for greenwashing for breach of obligations under the Collective Investment Schemes Act (“**CISA**”).

- the issuer may be liable for using a confusing or misleading name for the collective investment scheme.[13]
- Managers and representatives may be liable for breach of their duties of loyalty, diligence, and information,[14] e.g., where fund managers manage below the sustainability and impact targets announced to FINMA.[15]
- Violation of CISA duties may trigger litigation by the investor and by the supervisory authority,[16] since CISA establishes a civil liability where an obligation is breached.[17]

Products, bonds, or shares

Under Swiss law, financial service providers are subject to rules of conduct, including duties of information, advice, and warning vis-à-vis their clients.[18]

With regard to climate risk information, Swiss doctrine considers that within the scope of these duties, financial service providers must also adequately take climate risks into account.[19] Indeed, climate risks can mean significant financial risks for investors which is why they must be included in the investment and advisory process in the same way as other risks, that may arise for the client as a result of an investment.[20] In this respect, explicit reference must be made to the financial risk of an investment that is exposed to climate-related physical, regulatory, liability or reputational risks.[21]

With respect to sustainable investment, part of the doctrine considers that there is no duty on financial service providers to take impact investing[22] into account, as such obligation does not automatically arise under either

supervisory or mandate law. In such a case, clients would only be able to sue their financial service provider for breach where their contractual agreement makes the impact investment part of the investment or management process. In this case, the relevant financial service provider would also have to take climate impacts into account as part of its duty to inform, advise and warn and, if applicable, its duty to monitor, in the case of asset management contracts.[23]

Read more here.