Recommendations on climate risks to the Swiss National Bank

The SNB could already invest sustainably today. Climate Alliance Switzerland shows how the SNB can simultaneously protect the stability of the Swiss financial system and the climate.

climate alliance switzerland

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Abstract

The SNB's investments are responsible for a similar amount of greenhouse gas emissions as Switzerland's total direct emissions and the bank's investments contribute to a catastrophic temperature increase of 4–6°C. This contradicts the SNB's own investment guidelines, which exclude investments in companies that systematically cause serious environmental damage.

While the President of the European Central Bank (ECB), Mario Draghi, says that the ECB is committed to the Paris Agreement, the SNB has so far ignored this, even though Switzerland has ratified the Paris Climate Agreement. In addition to reducing greenhouse gas emissions and strengthening the ability to adapt to climate change, the third pillar of the Paris Agreement redirects financial flows so that the goal of a warming of well below 2°C can be met. The country's financial institutions must therefore contribute to this reorientation to achieve the Paris objectives of decarbonisation. Eight central banks and supervisory authorities in England, France, Germany, the Netherlands, Sweden, China, Singapore and Mexico have also declared their intention to play a leading role in this climate protection effort. The reasons for this are that climate change threatens both the stability of the financial markets and the long-term value of their investments.

The G20 experts responsible for financial stability warn of climate risks to the global financial system and eight central banks want to start developing climate stress tests and scenario analyses for the financial systems. The SNB has so far paid little attention to climate risks on its investments and the Swiss financial system, despite the global importance of Switzerland as a financial centre and the growing recognition that the catastrophic effects of climate change will force political and economic actors to take drastic measures. The transition to a fossil free economy will have to take place very quickly and these shocks will cause major shifts in asset values. Unprepared industries and companies will be exposed to severe risks from all angles, including reputational damage. They are also increasingly becoming the target of liability litigation by communities, institutions or individuals harmed because of climate change. These factors can result in financial collapses with a widespread impact. Potentially, disastrous chain reactions due to the interdependence between financial institutions could be triggered, for example with a succession of bankruptcies. The later effective measures are taken, the more sudden a crisis can occur.

The SNB's legal duty is to conduct monetary policy in the overall interest of the country and to contribute to the stability of the financial system. **The SNB's optimal currency and investment policy must not ignore climate change. It must inevitably include short, medium and long-term risks. After all, it is in the interests of both the state and the SNB to analyse the impact of climate change on the security, return and liquidity of the SNB's investments in an integrated manner and to implement the necessary measures**. Considering the size of its currency reserves, the bank should take the lead in decarbonising these assets.

With the following recommendations, Climate Alliance shows how the SNB can invest in its current mandate in a climate-friendly manner and fulfil its task of preserving financial stability by taking climate risks into account:

- In a public statement, the SNB acknowledges the **Paris climate agreement** and the **UN Sustainable Development Goals** and announces the first steps.
- As a precautionary measure, the SNB develops principles that enable climate risks to be controlled while maintaining the **stability of the financial system**.
- SNB begins by conducting **climate stress tests and scenario analyses** for the Swiss financial sector – insurance companies, banks, pension funds – and publishes measures to contain macro risks.

- SNB evaluates the **exposure of its own investments to climate risks**.
- SNB **extends the investment guidelines** to exclude investments in companies that systematically cause serious climate damage.
- SNB determines and publishes the **2°C compatibility** and **CO_2 emissions** of its securities portfolios.
- SNB reveals the measures it intends to take to achieve the **2°C compatibility path** in good time and **reduce CO_2 emissions**, and how it will measure their success.
- SNB starts by divesting from the coal companies and all the **companies with the largest fossil fuel reserves** of the Carbon Underground 200 list.
- For the **other sectors exposed to climate risks** (e.g. electricity producers, suppliers to fossil fuel companies or car manufacturers), SNB also takes a "**best in class**" approach. SNB supports those companies that are determined to implement the energy transition (e.g. by switching to renewable energies).

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Preliminary remarks

With the "Climate Protection Memorandum" of 20 April 2017, Climate Alliance and 135 members of Swiss society called on the Swiss National Bank to submit an exit plan from fossil fuels. The SNB's investments correspond to the direct CO_2 emissions of the whole of Switzerland.

The points below address the main elements of the response to the Climate Protection Memorandum issued by the General Secretariat of the SNB on 30 May 2017:

- The criteria of the SNB's investment policy in terms of security, return and liquidity as well as the instruments used (diversification, passive management, neutrality) are discussed.
- The SNB's interpretation of exclusion criteria for companies
- Determination of the 2°C compatibility and CO_2 emissions of the SNB's entire global portfolio

The SNB's opinion is stated at the beginning of each chapter and subchapter.

The final chapter sets out the recommendations made by Climate Alliance for a sustainable and climate-friendly policy of the SNB, followed by a list of the first steps.

What are the shortcomings in the implementation of the legal mandate?

The argument that the SNB must be "neutral", "passive" and generally "non-political" in investment policy conceals **non-compliance with international objectives** for tackling climate change (Paris Agreement). This also applies to sustainable investments, such as the UN Sustainable Development Goals (Agenda 2030), the UN Principles of Responsible Investment and the ESG aspects (environmental, social, governance).
A neutral, passive and generally non-political approach to investment and monetary policy inevitably also requires the inclusion of climate risks.

The SNB's **failure to take climate factors into account** has the following effects:

- The SNB fails to fulfil its legal mandate to align monetary policy with the overall interest of the country, its economy and its inhabitants,
- The SNB fails to fulfil its mandate to support monetary and currency stability through an investment policy based on security, return and liquidity factors whose interpretation is in the overall interest of the country,
- The damage caused by the SNB's non-compliance with international and national objectives in climate policy and sustainable development,
- The **violation of the bank's own investment guidelines**, which exclude companies that "systematically cause serious environmental damage or massively violate fundamental human rights" by treating climate damage neither as environmental damage nor as a violation of the right to life (e.g. heat-related deaths),
- The SNB's non-compliance with the findings of its international peers (e.g. the World Bank as well as the central banks and supervisory authorities of England, France, Germany, the Netherlands, Sweden, China, Singapore

and Mexico) on **future climate risks to the financial system** and the need to **redirect financial flows** to achieve the objectives of the Paris Agreement on climate change.

- The backing, with the weight of its approximately 790 billion CHF foreign exchange reserves and as the eighth largest global public investor, of a **global warming pathway that is far above the target of the Paris Agreement**, which aims to remain below 2°C, but better still 1.5°C, as a tolerable threshold.

From the SNB's point of view, the management of investments is **based on its interpretation of the criteria of security, return and liquidity**. The SNB's interpretation is against any forward-looking policy, and is neither sustainable in the economic sense nor in the overall interest of the country:

- **Security** in investment policy is only good in the complete sense if it takes into account the climate effect of its investments. Investments that are not climate-friendly tend to be riskier than those that are. The investment policy should guarantee the stability of the Swiss financial sector (security interest of the country), which in itself requires the holistic inclusion of climate risks.
- The **returns** could be increased with a climate-friendly investment strategy. The risk/return ratio of climate-friendly investments is better than that of conventional investments, and sustainable investments in general perform at least as well as non-sustainable investments. The SNB has a wide range of climate-friendly and sustainable investments available to it.
- **Liquidity** is not at risk. The markets for climate-friendly shares are just as liquid as for conventional CO_2-intensive stocks.

Reflections on the SNB's legal mandate

Investment policy of the SNB

This chapter examines the investment criteria of the SNB: Security, return and liquidity as well as the resulting instruments of diversification, neutrality and passive investment is the approach used by the bank. The SNB cites these elements as justification for the fact that it currently sees no need to divest from fossil fuel companies.

Investment policy criteria

Security

Climate Alliance questions the view that the minimum loss on investments is achieved by diversification using a world average. It proposes a plan of investment security while maintaining the stability of the financial system.

The position of Climate Alliance:

The SNB should apply the term "security" to Switzerland's overall interest and to the long-term value of its investments.

By not having an overall view of security, the SNB ignores the threat to the stability of the financial system posed by the effects of climate change. The approach of international peers (e.g. the central banks of China, Singapore, Mexico, England, France, Germany, the Netherlands and Sweden) requires the SNB to also begin to assess fossil fuels and the economic sectors dependent on them as medium-term risk factors to the country's financial stability. It is in Switzerland's interest that climate damage is prevented. According to the ProClim report "Spotlight on climate in Switzerland", climate hazards will have a particularly severe impact on Switzerland.

Security is also important for the SNB's investments. Non-climate friendly investments entail higher financial risks. High carbon exposure is a danger for financial institutions (banks, insurance companies, pension funds). In addition to observing these 'micro-risks', there are 'macro-risks' to also consider. The interdependence of the players and the domino effect pose risks for entire financial systems. Maintaining financial stability in the overall interest of the country is a legal duty of the SNB.

Climate risks = financial risks

Climate change has indirect and direct effects on financial risks. This link has been in the mainstream since the establishment of the G20 Green Finance Study Group during China's presidency. The SNB should therefore determine which economic sectors will be particularly affected by climate change and what the current unchanged consequences will be for the security of its investments compared with a recognised sustainable and climate-friendly benchmark. According to the system of the Financial Stability Board of the G20 in the Recommendations of the Task Force on climate-related financial disclosures (TCFD), the following climate risks must be taken into account:

The risks when moving to a carbon-reduced economy:

- regulatory risks (e.g. if the increase in climate disasters makes regulatory intervention for decarbonisation absolutely necessary)
- legal risks (e.g. liability claims by climate-affected communities, insurers, shareholders, owners)
- technology risks (e.g. disruptive processes in the conversion to electricity generated from renewable sources in conjunction with storage technologies or the breakthrough of electric cars)
- Market risks (e.g. collapse in demand for fossil fuels, collapse in the valuation of fossil fuel reserves)
- Reputation risks (e.g. reduced earnings due to stigmatisation of diesel vehicles, higher hurdles in approval procedures)

Physical risks:

- acute risks (e.g. damage caused by an increase in storms and floods, interruption of transport and supply chains)
- chronic risks (e.g. reduced productivity due to hot spells, increase in water supply costs, permanent supply chain disruptions, including the elimination of port infrastructures and production sites due to rising sea levels, increase in infrastructure costs to protect coastal sites)

Climate deterioration is a threat to the country's financial security

With its monetary policy and with the effect of its investments, the SNB must contribute to the country's economic and financial stability. This includes the identification of future risks to financial stability. Mark Carney, Governor of the Bank of England and Chairman of the Financial Stability Board, the G20's advisory body, assigns an important role to central banks and comparable financial institutions as financial policymakers in his speech "Breaking the Tragedy of the Horizon – climate change and financial stability" of 29 September 2015. The increasingly catastrophic effects of climate change would force political and economic actors to take drastic measures. More frequent climate damage would trigger decisions that could lead to financial shocks. It is the responsibility of fiscal policy makers to ensure that the financial system remains stable enough to cope with this transition. Similar points have been stressed at the European Central Bank (Report of the European Systemic Risk Board – "Too late, too sudden: Transition to a low-carbon economy and systemic risk").

For the Euro zone, a climate stress test (Stefano Battiston, Institute of Banking and Finance of the University of Zurich, and co-authors) quantifies the combined exposure of financial actors in climate-sensitive sectors at up to 54% and points to risks of interdependencies between financial institutions that could trigger chain reactions (e.g. with a sequence of bankruptcies).

The first actors are already working on the implementation of these findings. The Bank of England has begun to draw up a climate strategy, and other national banks are preparing the ground, including the Dutch central bank with a climate stress test of the financial system. One of the commitments made at the One Planet Summit in Paris in December 2017 is the declaration of intent by eight central banks and supervisory authorities (China, Singapore, Mexico, England, France, Germany, the Netherlands and Sweden), coordinated by the Banque de France, to develop the basis for climate stress tests of the financial system. These nine institutions have joined together in the Network for Greening the Financial System. Finally, the EU Commission has also included the requirement of prudential regulation by the supervisory authorities in its "Financing sustainable growth" action plan.

The SNB should also live up to its stability mandate with regard to climate-related risks by developing the basis of climate stress tests for the Swiss financial centre and publishing recommendations for macro security measures.

Climate intensity of a financial asset is a proxy for security

The SNB's basic assumption that investments in fossil fuel companies, in particular in the largest fossil fuel production companies ("Carbon Underground 200" list) are not financially affected must be questioned. Climate risks have a negative impact on the security of the SNB's portfolio.

Important institutions warn of the financial risks of the particularly carbon-intensive industries. The OECD report "Divestment and Stranded Assets in the Low-carbon Transition" (2015) shows that due to unavoidable global climate protection measures "a substantial share of today's reserves of coal, oil and natural gas cannot be brought to market". Thus, there is a risk of stranded assets. The study "Carbon risks for the Swiss financial centre" (2015) by the Swiss Federal Office for the Environment (FOEN) also shows that the global pricing of climate damage caused by CO_2 emissions, such as emissions trading and greenhouse gas levies, would lead to stranded assets. Depending on the scenario, the top five oil companies (Shell, Total, Exxon Mobil, BP, Chevron), for example, would suffer losses in corporate values between 40 and 100%. In fact, the negative development has already begun. The stocks of the worst polluters of CO_2 emissions, coal producers, have already fallen massively in value over the last few years. Major Swiss investors such as the two largest pension funds PUBLICA and BVK have already drawn the consequences and removed coal producers from the portfolio.

Finally, unlike private banks, insurance companies or pension funds, the SNB is not obliged to perform with the same returns. The bank must determine Switzerland's monetary policy and interpret its investments accordingly. As a result, SNB must invest in foreign currencies and should take the least possible financial risk. This requires the inclusion of climate risks and thus the effective implementation of the Paris Climate Agreement and other relevant international guidelines such as the UN Sustainable Development Goals and the UN Principles of Responsible Investment. In their statement at the One Planet Summit, eight central banks and supervisory authorities committed themselves to promoting "green", climate-friendly financing. They recognise the objective of the Paris Agreement to align financial flows with a "well below 2°C" path and see opportunities in its implementation. They want to determine the benefits of a climate-friendly investment policy. It is time for the SNB to set an example, at least in its very own area of investing foreign exchange in equities and non-government bonds.

Return

The SNB notes that security, return and liquidity in combination are the key factors. Accordingly, the SNB also aims to make a profit if this is feasible within the scope of the stability objective.

The position of Climate Alliance:

The sole criterion of return cannot make legitimate any investments that are against a climate-friendly investment policy. The SNB could achieve better returns through climate-friendly investment. The risk/return ratio of climate-friendly investments is better than for conventional investments.

Increased performance through climate-friendly investment

In its report "Climate-friendly investment strategies and performance" (2016), the Federal Office for the Environment (FOEN) states that "eight out of eleven of the climate-friendly indices examined had a better risk/return ratio than the respective benchmark index", and the return was better in ten out of eleven cases. This finding is based on the analysis of indices of two leading providers compared to the respective conventionally formed standards:

- STOXX Low Carbon Global vs. STOXX Global 1800,
- STOXX Low Carbon Europe vs. STOXX Europe 600;
- STOXX Industry Leaders Low Carbon Global vs. STOXX Global 100;
- STOXX Industry Leaders Low Carbon Europe vs. STOXX Europe 100;
- STOXX Low Carbon Footprint Global vs. STOXX Global 1800;

- STOXX Low Carbon Footprint Europe vs. STOXX Europe 600;
- STOXX Climate Change Leaders vs. STOXX Global 1800;
- MSCI ACWI ex fossil fuels, MSCI ACWI Low Carbon Target, MSCI ACWI Low Carbon Leaders and MSCI Global Clean Technology vs. MSCI ACWI.

As the energy transition progresses, the balance will develop even more to the advantage of the low-carbon economy. The globally leading fund provider and asset manager BlackRock states that investors can no longer ignore climate change and that climate factors are underestimated and hardly reflected in the prices. BlackRock, in turn, calls on investors to seize the opportunities offered by an increasingly better range of climate-friendly investment strategies and vehicles.

The scientific studies agree: sustainable investments in general are at least as good as conventional forms of investment. This is confirmed by the FOEN's roadmap towards a sustainable financial system in Switzerland. The FOEN relies on a comprehensive overview study, which evaluates over 2000 individual studies and concludes that not only did the performance not deteriorate but that yields were significantly better in at least half of the studies. The umbrella association Swiss Sustainable Finance and the pension fund association ASIP also confirm that sustainable investments neither limit investment opportunities nor reduce performance, but that, especially for equities, significant ESG factors even lead to superior returns.

Liquidity

The Governing Board of the SNB writes that, should a change in monetary policy become necessary, the SNB must be in a position to sell off the (very high) foreign exchange holdings in a short-term period and without any loss in value.

The position of Climate Alliance:

The markets for climate-friendly stocks are just as liquid or illiquid as for conventional CO_2-intensive securities and therefore do not jeopardise the SNB's liquidity target.

Furthermore, it can be assumed that a reorientation of the SNB's investments would only affect a small portion. By shifting some CHF 15 billion invested in stocks of the 200 companies with the largest fossil energy reserves to low-carbon assets, the current CO_2 impact of the SNB could be significantly reduced.

Liquidity is not at risk from climate-friendly restructuring, on the contrary

The markets for climate-friendly stocks are just as liquid or illiquid as for conventional CO_2-intensive securities. Liquidity necessarily refers to the asset class and not to climate friendliness. Although the market for climate-friendly investments is not yet as mature as the conventional market, it offers enough investment vehicles for every asset class, particularly in relation to shares and corporate bonds. Shifting to climate-friendly investment solutions therefore poses no threat to monetary policy in terms of liquidity either. In addition, the trend in fixed-interest and project financing is towards climate-friendly green bonds, which means that liquidity is also developing favourably in this asset class. Finally, it can be assumed that the liquidity of climate-friendly investments will increase in the future, as demand can be expected to increase. The opposite trend applies to "high carbon" assets, which may be less in demand in the future. Therefore they will be less liquid.

Divestment from fossil fuels only affects a few percent

Equities and non-government bonds account for about a third of the CHF 790 billion in foreign exchange reserves. The demand for a phase-out scenario from investments in fossil fuel companies concerns only this category. The rest, mainly government bonds and bonds in supranational organizations, is not in focus. The climate protection memorandum calls for the exclusion of equity investments in the 100 companies with the largest coal reserves and the 100 companies with the largest oil and gas reserves ("Carbon Underground 200" list).

A rough estimate based on the figures from the Artisans de la Transition study shows that the corresponding investments in equities in the USA represent around 6% of the US equity portfolio. Extrapolated to the whole world and taking into account non-government bonds, the percentage of money invested in the Carbon Underground 200 is unlikely to increase. In a conservative estimate this results in no more than about CHF 15 billion, which would have to be divested (6% of CHF 250 billion, i.e. of a third of the total CHF 790 billion in foreign exchange reserves). This is a comparatively small amount, far from seriously threatening the "flexibility" of the CHF 790 billion foreign exchange reserves that the SNB considers necessary. These considerations also apply if the application of broader ESG criteria and full climate compatibility (reduction of greenhouse gas intensity in conformity with the objectives of the Paris Agreement) would also require the exclusion of further companies and sectors (e.g. weapons producers, car manufacturers continuing to rely on fossil fuels, generally CO_2-intensive companies).

Is it necessary for all of the CHF 790 billion to be liquid in the short term?

In general, it is difficult to explain why the SNB must have full "flexibility", which includes the entire portfolio of CHF 790 billion. Prior to the major financial crisis, when the currency stock was only around 50 billion, there was no criticism of an allegedly insufficient currency stock.

Investment policy instruments

The following reflections consider the aspects of diversification, neutrality and passive management of the investment policy currently applied by the SNB.

Diversification

The SNB notes that, given the large portfolio, it is necessary to spread financial risks and thus diversify as widely as possible across all asset classes and within the asset classes.

The position of Climate Alliance:

The current application of the principle of diversification by the SNB is the reason for increased investment in non climate-friendly sectors.

In view of the risks of climate change, the stability and security objectives call for intelligent diversification on the part of the SNB, giving greater weight to the low-carbon economy.

Diversification stands for the promise of representing the broadest possible spectrum of the market. The SNB may limit diversification as long as this serves the stability and security objective. The instrument of maximum diversification under financial security considerations is therefore not mandatory but only instrumental in order to increase risk capacity. Intelligent diversification, which gives the low-carbon economy a high weighting, would therefore be suitable to counter the risks of loss that the carbon-intensive economy entails. The exclusion of individual sectors, as demanded by the climate protection memento and a comprehensive sustainability policy, thus appears to be quite in line with the overriding goals of monetary policy.

Neutrality and passive management

The SNB considers that passive and neutral management is necessary to ensure that the stock markets are not influenced – this is to exert as little influence as possible on the pricing of individual sectors and companies. Investments that are over- and underweighted in individual sectors or companies should be avoided to follow the limits of neutrality set by a central bank. It can also be assumed that the SNB prefers passive management for reasons of cost efficiency.

The position of Climate Alliance:

The SNB's investments flow mainly into the dominant companies and thus also into societies that do not operate in a climate-friendly and sustainable manner. This is not a priori neutral, not least because the other sectors of the real economy are disadvantaged. As the eighth largest public investor in the world, the SNB is therefore shoring up structures that are detrimental to the global economy by artificially keeping alive sectors that are opposed to achieving the objectives of the Paris climate agreement.

The current fixation concealed by the concept of "neutrality" should be abandoned in favour of a sustainable and climate-friendly, broader investment policy.

There is a wide range of passive sustainable investment solutions on offer that meet both cost efficiency and the requirements of sustainability and climate compatibility.

Market influence

The current practice of passive investment followed by the SNB is a selection based on the criterion of market capitalisation, using the indices of the respective countries. However, this in no way reflects the economy of a country. Most companies, such as SMEs, are not listed on the stock exchange and are therefore not included in these indices.

In this way, with its current “neutral” investment strategy the SNB excludes the real economy outside the stock markets. The national economies in which the SNB invests are thus influenced in favour of large companies. This is not neutral. On the contrary, the SNB acts in favour of the largest companies in the world economy present on the financial markets. By making its funds available to these large companies in a "neutral" and undifferentiated way on the financial markets, SNB promotes sectors and companies that are not compatible with the objectives of the Paris climate agreement and supports actors whose practices are not in line with international guidelines and standards in the ESG area (environmental, social, governance). In doing so, the SNB ignores international sustainability objectives, such as the UN Sustainable Development Goals, which include climate protection, and the UN Principles of Responsible Investment.

This is nothing more than the preservation of structures in climate-unfriendly sectors and influencing the market and economy in a way that contradicts the overall interest of the country and its need to secure global stability. The legitimacy of using the concept of "neutrality" for the SNB's current investment policy must therefore be questioned.

Cost effectiveness

A change to a sustainable and climate-friendly investment policy can be made just as cost-effectively while maintaining the "passive" approach. The SNB has a wide range of climate-friendly and sustainable indices at its disposal as a guideline. This is evidenced by the two FOEN studies mentioned above, "Carbon risks for the Swiss financial centre" (2015) and "Climate-friendly investment strategies and performance" (2016). As can be seen from the Swiss Sustainable Finance Handbook, sustainable share indices have existed for 25 years, offered by MSCI, Solactive, S&P, STOXX, FTSE and others. The range of sustainability indices and benchmarks has grown strongly in recent years and increasingly includes bond indices.

Definition and implementation of the exclusion criteria

According to its investment guidelines, the SNB does not invest in companies that systematically cause serious environmental damage. Nevertheless, the SNB invests in the largest climate-damaging companies of the Carbon Underground 200.

In this chapter, Climate Alliance examines the current lack of transparency when making exclusion decisions. And Climate Alliance questions the legitimacy of the SNB's extremely narrow interpretation of its exclusion criteria, which in addition to environmental damage also include the violation of human rights, as well as the legitimacy of the classification of the largest climate-damaging companies in the Carbon Underground 200, considered as environmentally acceptable by the SNB.

Intransparency in the implementation of the exclusion criteria applied

The SNB informs us that it bases its implementation of the exclusion criteria on the recommendations of specialised companies but does not disclose the criteria applied.

The position of Climate Alliance:

As an important public institution, the SNB should live more fully by the principle of public access to information. This means that SNB publishes in detail the global standards and international agreements that are used when applying exclusion criteria.

It can be assumed that in excluding companies that produce internationally outlawed weapons, massively violate fundamental human rights or systematically cause serious environmental damage, the SNB and the specialised companies mentioned are relying on certain international standards and conventions. As a bank of the people, the SNB should create greater transparency in this respect. The weight of the SNB's foreign exchange investments is very important globally. International guidelines and standards in ESG (environmental, social, governance) and responsible investment are also supported by Swiss actors and are echoed in Swiss civil society. Transparency is therefore the democratic basis for continuing discussions on the role of the SNB.

Social Consensus and "Politicization"

The SNB notes that the definition of the exclusion criteria must correspond to a broad social consensus and believes that the SNB's investment policy must not become a pawn in individual political concerns which, for example, concern entire sectors such as in fossil fuels, which are important for the economy and whose products are also widely used by the population. SNB also aims to prevent numerous other stakeholders in civil society from approaching the bank with the concern for environmentally friendly and socially desirable criteria for investment policy.

The position of Climate Alliance:

The SNB uses the catchword "politicization" to ward off civil society's demands for conformity with overriding national and international objectives. The bank is behaving politically, and in a one-sided manner.

In the minimalist interpretation of the exclusion criteria there is a serious risk to the SNB's reputation. This reputation is further damaged the more the national and international public becomes aware of the consequences of investments in inhuman, environmentally damaging and climate-wrecking sectors and companies.

Why are the Paris Climate Agreement and the UN's Sustainable Development Goals with Chapter 13 Climate Action not regarded as a framework for the SNB's investments? The Paris Agreement insists in Art. 2 letter c that financial flows be consistent with a pathway towards low greenhouse gas emissions and climate-resilient development. With its ratification by both Councils in Switzerland, which was also supported by the economy, the SNB is not complying with Switzerland's popular will.

At the One Planet Summit, the World Bank announced that it no longer intends to make any funds available for oil and gas production, having already stopped financing coal projects in 2010. The President of the European Central Bank, Mario Draghi, has publicly declared in the European Parliament that the ECB is "committed to the Paris Agreement". The SNB lags far behind its peers.

In Switzerland, too, the discussion about a sustainable and climate-friendly financial centre has gained momentum. A broad-based involvement of key players from banks, insurance companies, institutional investors and finance produced the FOEN's proposals for a roadmap for a sustainable financial system in Switzerland. The recommendations are addressed not least to institutional and major investors. Measures to embed ESG criteria in investment policy and to improve transparency regarding the ESG effects of the portfolio are included.

According to media reports, the SNB stated as early as 2006 that its credibility was "not divisible between monetary and investment policy". The longer the SNB does not address the issue of sustainability and climate compatibility of its investments, the more the bank exposes its reputation to international and national risk. With its weight as the eighth largest investor worldwide, the SNB is particularly exposed to this risk. The SNB could damage the country's reputation and undermine the position of the Swiss Confederation's actors in the international climate negotiations.

Determination of 2°C compatibility and CO_2 emissions of the portfolio

The climate protection memento calls for the publication of CO_2 emissions. To date, the SNB has not complied with this requirement. Therefore, Climate Alliance in this chapter assesses the need to identify them as part of an investment policy that is committed to the goal of aligning investments to 2°C compatibility.

The position of Climate Alliance:

The SNB should use a G20-compliant scenario analysis to determine the compatibility of its portfolio of equities and non-government bonds with the 2°C target. In addition, SNB should disclose the carbon intensity related to shares and non-government bonds.

Given its mandate for the stability of the financial system and its globally important foreign assets, the SNB should play a pioneering role. In its role as a major investor, the bank could set an example by proactively disclosing the 2°C compatibility and greenhouse gas emissions of its foreign portfolio. In this way, the SNB could also motivate the players in the financial centre to be transparent. This is not least a prerequisite for the credible implementation of its task of controlling climate-related macro-prudential risks for the financial system.

Mark Carney, Governor of the Bank of England and Chairman of the Financial Stability Board, the G20's advisory body, is a strong supporter of disclosure of information on climate risks by all affected companies in sectors such as energy, natural resources and transport, as well as by the financial sector (banks, insurance companies, asset owners and asset managers). This should provide the basis for a process of controlled alignment of financial flows with the "well below 2°C" objective of the Paris Agreement. Transparency with regard to financial climate risks will also enable the financial market to adapt to future disruptions caused by climate change. In its Recommendations of the Task Force on climate-related financial disclosures (TCFD), the Financial Stability Board encourages market participants to develop a strategy for disclosing and embedding the effects of climate change on their business activities.

According to the TCFD, supported by the private sector and its President Michael R. Bloomberg, climate risk information of equal importance to companies and financial actors should cover the following areas:

- Governance (objectives set by top management; tasks set for management).
- Corporate strategy (identification of climate risks and opportunities; description of effects on business model, strategy and financial planning; disclosure of adaptability to the 2°C scenario, as well as to "well below 2°C")
- Risk management (description of the processes for identifying and managing climate risks and their integration into existing risk management processes)
- The measuring systems used and the targets set.

For investors and asset managers, the TCFD recommends in an annex the determination and publication of the greenhouse gas emissions of the investments as CO_2eq and derived from this the carbon intensity which is particularly relevant for the financial risk. All market participants are further advised to conduct forward-looking scenario analyses that provide information on how the company or, in the case of investors, the invested assets are positioned with respect to the 2°C target, as well as the "well below 2°C" target. These are primarily based on the assessment of transition risks, which are particularly relevant for the fossil energy, transport and energy-intensive industries and their value chains. Physical risks are also important for sectors such as insurance, agriculture and the food industry, but also for the value chains and production infrastructure of energy-intensive industries. For example, damage caused by increasing scarcity of resources and water, or by storms and floods as well as damage and protection costs caused by rising sea levels. With the recommendations of the TCFD, there is now an internationally uniform standard work for the identification and publication of greenhouse gas emissions as well as climate risks and opportunities. This work is designed to ensure its timely further development.

In Switzerland, the FOEN and the majority of pension funds by investment volume have carried out a climate alignment pilot test (2017) to analyse future economic scenarios and their greenhouse gas emissions. The production plans of the companies in the portfolios were compared with a development necessary for the 2°C target. The analysis covered the four sectors of fossil energy, power generation, transport and industry (cement and steel), for which climate-damaging and alternative, climate-friendly technologies were investigated. The test showed that pension funds with their equity and bond portfolios promote on average a global temperature rise of 4-6°C. As the study by Artisans de la Transition shows, the SNB's portfolio is likely to be equally climate-damaging. As the FOEN model is compatible with TCFD standardisation and will be available without a licence in the near future, it seems sensible for the SNB to adopt this approach.

In view of its mandate for the stability of the financial system and its globally important international assets, the SNB should play a pioneering role. In its role as a major investor, with the proactive disclosure of the 2°C compatibility and the greenhouse gas emissions of its foreign portfolio, the bank could play the pioneering role in introducing the underlying measurement system and also motivate the players in the financial centre to disclose their climate risk exposure.

Recommendations by Climate Alliance

Taking climate risks seriously

In the overall interest of the country, the SNB must live up to its **stability mandate** by identifying risks to the financial system and contributing to their control.

- The SNB recognises that climate risks can jeopardise the country's financial stability.
- It is in the country's security interest to recognise the Paris climate agreement ratified by Switzerland as a global strategy for maintaining system stability and to implement it sustainably in the financial sector.

The SNB is responsible for the optimal management of foreign exchange reserves. **An optimal monetary policy must not ignore climate change. It must inevitably include short, medium and long-term risks**. Taking into account the criteria of security, return and liquidity as well as national and international objectives, the SNB is obliged to include climate indicators.

The legitimacy of its investment policy is based on the Paris climate agreement ratified by Switzerland:

- Dealing with climate deterioration is not a "political preference", but the avoidance of climate risks has become an international social norm with the Paris Climate Agreement.
- As the eighth largest public investor in the world, the SNB, which through its influence increases Switzerland's weight in the global context, is maintaining a structure that is very damaging to the global economy. The bank keeps alive the sectors that are harmful to the achievement of the objectives of the Paris climate agreement.
- The longer the SNB waits, the greater the risk to the bank's reputation; SNB could damage the country's international standing and undermine the position of the Swiss Confederation's players in international climate negotiations.
- The Paris climate agreement was ratified by the National Council and the Council of States, meets the will of the people and was also supported by the business community. It is therefore a basic consensus of the 8 million Swiss people and is a national social norm.

Risk factors that have a direct influence on security, return and liquidity are to be taken seriously:

- The SNB recognises that climate risks have an impact on the market capitalisation of companies.
- The deteriorating climate and the potentially disruptive effects of the energy transition to sustainable sources lead to sudden negative adjustments in the assessment of companies.
- The SNB integrates the monetary climate risks and the "well below 2°C" target of the Paris Agreement as criteria of high priority in its investment policy. The SNB consistently implements them in its investment decisions, starting with the most climate-sensitive positions in the portfolio.

Positive factors that have a direct impact on the return on the SNB's investments are recognised:

- The SNB recognises that the risk-adjusted financial performance of sustainable and climate-friendly indices is better and will improve in future as the energy transition progresses.
- By maintaining proven passive management, but applied to sustainable and climate-friendly investments, investment management remains cost-effective.

Suggestions for first steps

- In a public statement, the SNB acknowledges the **Paris climate agreement** and the **UN Sustainable Development Goals** and announces the first steps.
- As a precautionary measure, the SNB develops principles that enable climate risks to be controlled while maintaining the **stability of the financial system**.
- SNB begins by conducting **climate stress tests and scenario analyses** for the Swiss financial sector – insurance companies, banks, pension funds – and publishes measures to contain macro risks.
- SNB evaluates the **exposure of its own investments to climate risks**.
- SNB **extends the investment guidelines** to exclude investments in companies that systematically cause serious climate damage.
- SNB determines and publishes the **2°C compatibility** and **CO_2 emissions** of its securities portfolios.
- SNB reveals the measures it intends to take to achieve the **2°C compatibility path** in good time and **reduce CO_2 emissions**, and how it will measure their success.
- SNB starts by divesting from the coal companies and all the **companies with the largest fossil fuel reserves** of the Carbon Underground 200 list.
- For the **other sectors exposed to climate risks** (e.g. electricity producers, suppliers to fossil fuel companies or car manufacturers), SNB also takes a "**best in class**" approach. SNB supports those companies that are determined to implement the energy transition (e.g. by switching to renewable energies).

April 2018

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