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Corporate ESG reporting: Latest developments

The last quarter of 2022 saw two notable advances in relation to ESG reporting in Switzerland and in the European Union. In Switzerland, the Federal Council adopted an Ordinance on Climate Disclosures to complement the non-financial reporting rules that apply for the first time with respect to the financial year 2023. In the EU, the co-legislator adopted the new Corporate Sustainability Reporting Directive, representing a significant overhaul of the already existing non-financial reporting rules. Both of these developments are significant for large Swiss public interest companies as they gear up preparations for their first reportable financial year.

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Background

The recently enacted Articles 964a to 964c of the Swiss Code of Obligations ("CO") require large Swiss public interest companies to prepare on an annual basis a report on non-financial matters (i.e., environmental, social and employment-related matters, respect for human rights, and anti-corruption), covering, for the first time, the financial year starting in 2023, to be issued in 2024.

These new Swiss non-financial disclosure rules capture large Swiss public interest companies, namely Swiss publicly traded companies and entities supervised by the Swiss Financial Market Supervisory Authority FINMA (e.g., banks, insurance companies or securities firms) qualifying as "large" by virtue of having a balance sheet total of CHF 20 million or a turnover of CHF 40 million and at least 500 FTEs on an annual average basis, over the course of two consecutive years (including controlled entities worldwide).

In 2022, large Swiss public interest companies started gearing up their processes and data collection efforts in preparation for their first mandatory report. As these efforts will undoubtedly intensify in 2023, it is useful to look at two important recent regulatory developments that will guide future ESG disclosures:

- in Switzerland: the adoption of the implementation Ordinance on Climate Disclosures by the Swiss Federal Council (the "Climate Ordinance"), on 23 November 2022; and
- in the EU: the adoption of the Corporate Sustainability Reporting Directive ("CSRD") by the Council and the European Parliament, in November 2022.

1. The Swiss Climate Ordinance

The Climate Ordinance details the climate-related reporting required as part of the environmental disclosures to be included in the report on non-financial matters (Article 964b (1) CO). The report on non-financial matters, including the climate-related disclosure, will have to be adopted by the board of directors and approved by the shareholders.

Pursuant to the Climate Ordinance, large Swiss public interest companies are required to disclose both the effects of climate change on them and the effects of their activities on climate change, in line with the general "double materiality" requirement of Article 964b (1) CO.

In order to comply with the requirements of the Climate Ordinance, the climate disclosures must meet the following three cumulative conditions:

- Follow the Recommendations of the Task Force on Climate-related Financial Disclosures (TCFD) (version of June 2017) and its annex Implementing the Recommendations of the TCFD (version of October 2021), taking due account of the TCFD's cross-sectoral and sector-specific guidance, as well as, where possible and appropriate, its Guidance on Metrics, Targets, and Transition Plans (version of October 2021). In a nutshell, this should lead to covering eleven climate topics, structured around the following four themes: governance, strategy, risk management, and metrics and targets;
- Include:

  a climate transition plan comparable with the Swiss climate goals (where possible and appropriate, accompanied by quantitative information, as well as the main baseline assumptions for comparison purposes and the methods and standards used),

  quantitative CO2 targets and, where relevant, targets for other greenhouse gases,

  and, where possible, information on all greenhouse gas emissions, including scope 3 emissions, for the entire value chain; and

- Allow for a qualitative and quantitative overall assessment of the effectiveness of the measures taken in connection with climate issues.

Financial institutions are required, in addition, to include forward-looking, scenario-based climate compatibility analyses when implementing their TCFD sector-specific guidance.

If the above are met, the reporting entity will be presumed to comply with its climate reporting obligations under Art. 964b (1) CO. That said, a reporting entity remains free to follow other standards and guidance than the TCFD recommendations prescribed by the Climate Ordinance. In this case, however, the reporting entity will have to demonstrate that its climate reporting nevertheless complies with the requirements of Art. 964b (1) CO.

Where no climate reporting concept or information on climate issues is included or is only partly included in the non-financial report, the company needs to provide a clear and motivated explanation as to the reasons for this gap in its report. This so-called "comply or explain" approach has the effect of making the TCFD recommendations the mandatory basis for climate reporting.

For the time being, neither the Climate Ordinance nor the broader Swiss rules on non-financial matters require an independent third-party verification or audit of climate disclosures, contrary to what will apply in the EU under the CSRD.

The Climate Ordinance will enter into force on 1 January 2024. The first report on non-financial matters to be issued in 2024 (for the reporting period covering the financial year starting in 2023) will, therefore, have to include the mandated climate disclosures under the Climate Ordinance and be made available electronically. Starting from January 2025, electronic publication will require the use of widespread electronic formats making the relevant climate reporting readable both by humans (e.g., PDF) and by machines (e.g., BBRL).

2. The EU CSRD

An important development on ESG reporting rules also took place in the EU with the entry into force of the CSRD on 5 January 2023. The EU Member States now have to transpose the CSRD into their domestic law until 6 July 2024. The new CSRD aims to strengthen the current EU non-financial reporting requirements introduced by the Non-Financial Reporting Directive 2014/95/EU ("NFRD").

In a nutshell, the CSRD will bring about four key changes:

- mandatory harmonized European Sustainability Reporting Standards ("ESRS"). The European Commission is expected to adopt a first set of ESRS as delegated acts in June 2023, based on the recommendations submitted by the European Financial Reporting Advisory Group in November 2022;
- the abolition of the comply-or-explain approach relied upon under the NFRD, after a three years transition period;
- a mandatory external assurance obligation for the reported sustainability information (as opposed to this verification being optional under NFRD); and
- most notably, a significant expansion of the scope of application of non-financial reporting obligations to:
  - public and private large EU companies (i.e., exceeding at least two of the following: balance sheet total of EUR 20 million; net turnover of EUR 40 million; 250 employees on an annual average basis);
  - EU parent undertakings of large groups (exceeding, on a consolidated basis, two of the three above-mentioned balance sheet, net turnover or number of employees criteria);
  - listed EU companies (except micro undertakings);
  - non-EU companies (labelled third-country undertakings) generating a net annual turnover of more than EUR 150 million in the EU (at individual or group level) and having (i) a branch with a net turnover of at least EUR 40 million in the EU or (ii) a large or listed subsidiary in the EU (micro subsidiaries excepted). In this case, the EU subsidiary or branch will be responsible for

preparing a non-financial report at a group level, for its non-EU parent.

The requirements of the CSRD will apply gradually in four stages:

1. reporting in 2025 on the financial year 2024 for companies already subject to the NFRD;
2. reporting in 2026 on the financial year 2025 for large companies that are currently not subject to the NFRD;
3. reporting in 2027 on the financial year 2026 for listed small and medium-sized undertakings;
4. reporting in 2029 on the financial year 2028 for non-EU companies.

These changes are material and may have a significant impact on non-EU companies, including Swiss companies with subsidiaries or branches in the EU. A Swiss parent may see its EU presence captured by the reporting requirements of the CSRD in two cases: (i) as a large or listed small or medium-sized EU subsidiary (on an individual, non-consolidated reporting basis) and/or (ii) under the third-country undertakings requirement (on a consolidated reporting basis), provided certain thresholds are met.

The EU rules do leave room for exemptions in the event the in-scope company is already covered by a sustainability report based on "equivalent" standards. Currently, under the NFRD, EU Member States retain discretion in granting such exemptions. In the future, the CSRD will designate the EU Commission a competent authority for this "equivalence test". To date, there is no visibility as to which non-EU regulations or standards might be deemed equivalent. As things stand, it seems unlikely that the Swiss non-financial reporting rules would pass the test. The Swiss government is, however, working on a further alignment of the Swiss non-financial reporting regime to the CSRD and is expected to issue amendment proposals by July 2024.

3. The challenges ahead

The year 2023 will undoubtedly be eventful for Swiss companies looking to stay ahead of relevant ESG reporting rules.

The preparation of the first mandatory comprehensive report on non-financial matters, including climate disclosures in accordance with the Swiss Climate Ordinance, will be time and resource consuming.

Swiss companies with an EU presence that triggers reporting duties under the CSRD will need to devote additional resources to understand the new rules that may apply to them beyond 2023. This may require navigating an increasingly complex web of reporting regimes, often on a subsidiary-by-subsidiary basis, and getting ahead of developments on potential "equivalence" protocols.

In parallel, it will remain paramount to keep a close eye on new international standard developments, such as the new framework to be launched in September 2023 by the Taskforce on Nature-Related Financial Disclosures (TNFD), which, once finalized, will likely receive the same recognition for nature-related (incl. biodiversity) disclosures as the TCFD standards enjoy in the field of climate reporting.

Developments in ESG reporting aimed at achieving increasingly comprehensive and comparable sustainability disclosures will be instrumental in improving the assessment of companies by investors. This should also considerably facilitate the integration of ESG preferences and risks by financial services providers. By way of reminder, under the new guidelines of the Swiss Bankers

Association (SBA) of June 2022, Swiss banks will be subject to a number of requirements aiming at the inclusion of ESG criteria when providing investment advice and portfolio management services (as from 1 January 2024 for new clients and 1 January 2025 for existing clients).

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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