December 2022

Newsletter

ESG Update

Climate reporting in Switzerland:

On 23 November 2022, the Federal Council adopted the ordinance on climate reporting for large companies which will enter into force on 1 January 2024. The scope of the new ordinance may be significantly expanded in the near future as the Federal Council announced on 25 November 2022 to assess an alignment of Swiss sustainability reporting obligations with recently adopted as well as upcoming EU regulation.

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General sustainability reporting specified for climate risks by the new Ordinance

Notably the Ordinance on Climate Reporting (Ordinance) is not based on a specific statutory delegation but on the general power of the Federal Council to ensure the implementation of legislation. The Ordinance essentially states that the recommendations of the Task Force on Climate-related Financial Disclosure (TCFD) are deemed suitable for fulfilling the reporting obligations of companies under art. 964a et seqq. of the Swiss Code of Obligations (CO). However, the implementation of the regulation may face considerable difficulties and will potentially have a significant impact on the affected companies. Not yet in force, the Ordinance may be significantly expanded in scope due to a planned alignment of Swiss sustainability regulation with EU regulation.

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Background of the Ordinance

1. Counterproposal to the "Corporate Responsibility Initiative"

The Ordinance is based on the indirect counterproposal to the "Popular Initiative for Responsible Business – for the Protection of People and the Environment" (Corporate Responsibility Initiative). Among other objectives, the initiative aimed at introducing civil liability for breaches of international environmental and human rights standards and was eventually rejected in November 2020 in a popular vote by the cantons. The counterproposal was adopted by the Swiss parliament as part of the revision of the company law in the CO, which provides for an annual reporting obligation of companies in the two areas of

(i) non-financial matters (art. 964a–964i CO), and

(ii) due diligence and reporting obligations in the areas of conflict minerals and child labour (art. 964j–964l CO),

both applicable as from the business year 2023. The EU Non-Financial Reporting Directive 2014/95/EU acted as the model for the current Swiss sustainability reporting obligations.

2. Specification of the Reporting Obligations

In August 2021, the Federal Council decided to specify the reporting obligation regarding climate matters in a separate executive Ordinance. The Ordinance regulates the reporting of companies according to art. 964a CO on climate issues as part of the non-financial reporting.

3. Objectives and benefits

The Federal Council expects that the Ordinance will create comparable data on climate issues and climate targets, which should improve transparency for investors and for the financial system as a whole. As a further advantage, the collection of such data is expected to reduce transaction costs for investors. In addition, the definition of reporting obligations in the CO increases legal certainty. Meaningful and comparable information about climate related risks and impacts enable stakeholders to make informed decisions. The aim is to influence the (financial) economy to achieve the climate targets under the Paris climate agreement and to reduce greenhouse gas emissions in the long term and ultimately avoid them altogether.

The TCFD and International Efforts to Implement the Recommendations

1. Task Force on Climate-related Financial Disclosure (TCFD)

The TCFD is an international expert commission of representatives from leading companies in the global economy. In 2017, the task force published internationally recognized recommendations for globally standardised climate reporting. To date, around 2,700 organisations and countries worldwide have committed to the recommendations. Switzerland officially declared its support on 12 January 2021. The TCFD sets minimum requirements for reporting standards so that the targets and emissions of the companies with regards to climate matters become more transparent and comparable.

2. International efforts to implement the recommendations

Various countries are currently intensively engaged in implementing the recommendations of the TCFD. The United Kingdom, for example, introduced binding requirements for the largest UK companies and financial institutions in April of this year, which are based on the recommendations of the TCFD. A worldwide introduction of the TCFD recommendations is supported namely by the G20, the Financial Stability Board (FSB) as well as the Organisation of Securities Commission (IOSCO).

Scope of the Ordinance and Implementation

1. Companies affected by the new Ordinance

The new Ordinance is limited to companies which are subject to the sustainability reporting obligation in accordance with art. 964a CO: publicly listed companies as well as companies that require a license, recognition, authorisation or registration with the Financial Market Supervisory Authority FINMA in accordance with the financial market laws (e.g. banks and insurance companies), provided they (including their subsidiaries)

(i) have an annual average of at least 500 full-time positions in two consecutive business years and

(ii) achieve a balance sheet total of at least CHF 20 million or sales revenue of at least CHF 40 million in two consecutive years.

2. Transition Period

Following the entering into force of the Ordinance on 1 January 2024, the relevant companies will have one year to publish their climate report as part of the general sustainability report.

3. Voluntary Implementation

Small and medium-sized enterprises are not subject to the reporting obligation. However, they can voluntarily implement the recommendations of the TCFD. As of today, there are over 50 internationally active companies in Switzerland that voluntarily implemented reporting in accordance with the TCFD recommendations.

Reporting Obligations

1. Main Reporting Areas

Reporting on climate issues shall specifically include the recommendations of the TCFD in the following four areas: (i) governance, (ii) strategy, (iii) risk management, and (iv) metrics and targets. The "Guidance on Metrics, Targets and Transition Plans" published by the TCFD in October 2021 can be used as an implementation aid. In addition, the obligation to report on significant environmental risks under the general sustainability reporting obligation also applies to climate risks (cf. art. 964a sec. 2 para. 4 CO).

Disclosure refers to the financial risks that companies take on through their climate-relevant activities, on the one hand, and to the effects that the business activities of the respective company have on the climate (double materiality standard). In addition, the companies must disclose the targets they have set for reducing their direct and indirect greenhouse gas emissions and how they intend to achieve them.

According to the Guidelines of the Federal Department of Finance on the Ordinance of 25 November 2022, this includes scope 3 emissions, i.e. indirect emissions in a company's value chain, "to the extent possible and appropriate". This will be a major challenge for companies.

The annual climate report of the company must be published as part of the general sustainability report in an electronic format that is machine-readable and recognised internationally. The report must be published on the website of the respective company and must remain publicly available for ten years.

2. Transition Plan and Applied Standard and Methods

In a transition plan, the companies must outline how they intend to implement the recommendations of the TCFD and, in particular, disclose their CO^2 targets as well as information on all greenhouse gas emissions they produce.

However, the Ordinance only establishes a presumption that the reporting obligations of the companies concerned under art. 964a CO are fulfilled if they comply with the recommendations of the TCFD. Companies are therefore free to base their reporting on other comparable standards or methods (such as the principles laid down by the Organisation for Economic Cooperation and Development (OECD)). Any such chosen standard and method must be disclosed in the report.

3. Comply-or-Explain Approach

If a company does not pursue any concept in one of the areas mentioned, the reason for this must be explained clearly and justifiably in the report.

This comply-or-explain approach is also followed in the EU and is intended to introduce a competitive element. However, non-compliance based on a week excuse may subject the company to legal prosecution and cause reputational damage. It may be mentioned that the comply-or-explain approach just introduced by the Swiss legislator will be given up in the upcoming European regulation (CSDR).

4. Consequences in case of Non-compliance

Failure to comply with the reporting obligation through either providing false information in the report or the omission of producing a report is a criminal offence and may be punished by a fine of up to CHF 100,000 in case of intent and up to CHF 50,000 in case of negligence. The same applies to companies which fail to comply with their obligation to retain the reports for 10 years.

The ultimate responsibility lies with the board of directors and the management board. In case of financial loss due to materializing climate risks or a drop in the stock price, derivative suites of shareholders or creditors may follow. While shareholders and creditors still face significant legal and procedural hurdles in suing directors and officers of Swiss companies, D&O insurance companies already count in respective liability risks.

Challenges and further developments

One main challenge for companies will be measuring the generated greenhouse gas emissions and defining quantitative measurable targets to reduce emissions. There is much uncertainty about how companies should collect required data, in particular regarding scope 3 emissions. Unfortunately, the legislator dœs not specify how such measurement is meant to be carried out. Hopefully the companies will be provided with further guidance by the legislator or regulatory bodies by the time the new Ordinance enters into force on 1 January 2024.

On 28 November 2022, the Council of the European Union has adopted its Corporate Sustainability Reporting Directive (CSRD), which will amend and significantly extend the existing Non-Financial Reporting Directive (NFRD) and introduce more detailed reporting. The CSRD will also impact climate reporting of Swiss companies, in particular those companies maintaining a subsidiary in a EU member state and a net turnover of at least EUR 150 million from EU based activities.

On 25 November 2022, the Swiss Federal Council announced to assess an expansion of the Swiss obligations on sustainability reporting and due diligence obligations in the light of the recent developments in the European Union. The respective report of the Federal Office of Justice of the same date considers an alignment of the Swiss to the EU sustainability reporting regime. This would imply a lower threshold for companies to be subject to the sustainability reporting obligation, including climate reporting, and a broader range of data to be disclosed.