BÄR & KARRER

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NEW SWISS ESG DUE DILIGENCE AND DISCLOSURE REQUIREMENTS – UPDATES

The new ESG (environmental, social and governance) due diligence and reporting obligations that were introduced into the Swiss Code of Obligations in January 2022 will start applying for the financial year beginning in 2023. This briefing addresses certain misperceptions and pitfalls to be avoided in connection with these new rules. Further, it provides a synopsis of the Ordinance on Climate Reporting enacted by the Federal Council in November 2022, which will enter into force in January 2024.

For a comprehensive overview on the new ESG due diligence and reporting obligations and the related criminal provisions, please refer to our earlier briefing.

INTRODUCTION

The Swiss rules adopted as a counter-proposal to the 'Responsible Business Initiative' that was rejected by Swiss voters in November 2020, and which are often summarised under the term 'ESG requirements', have been in force since January 2022. However, they will only start applying as of the financial year beginning in 2023 – which, for companies whose financial year corresponds to the calendar year, will be January 1, 2023.

As a result, given that there are so far no Swiss precedents that could be used as guidance, it may be difficult for companies to implement and ensure compliance with these provisions. We have been advising our clients and supporting them throughout the year to navigate the Swiss reporting obligations regarding non-financial matters, as well as the due diligence and reporting requirements on child labour and conflict minerals and metals. In doing so, we encountered some common misperceptions which we will address selectively in the form of FAQ in the following paragraphs, along with providing an update on the Ordinance on the Reporting regarding Climate Matters recently adopted by the Federal Council.

SELECTIVE FREQUENTLY ASKED QUESTIONS

OUR COMPANY DOES NOT HAVE PRODUCTION FACILITIES IN DEVELOPING COUNTRIES – HENCE, THE RULES ON CHILD LABOUR DO NOT APPLY TO US, CORRECT?

It is a common misperception that the rules on due diligence and disclosure regarding child labour are only relevant for companies with production facilities in developing countries or which work with suppliers from such regions.

On the contrary, the rules regarding child labour are probably the ones which apply to and should be of concern for most companies in Switzerland, as long as they are large enough and exceed two out of three of the following threshold criteria over two successive financial years: (a) a balance sheet total of CHF 20 million; (b) sales revenues of CHF 40 million; and (c) 250 FTEs on annual average (art. 964j para. 3 CO and art. 6 of the Ordinance on Due Diligence and Transparency in relation to Minerals and Metals from Conflict-Affected Areas and Child Labour [DDTrO]).

All companies exceeding two of these thresholds whose seat, head office or principal place of business is located in Switzerland must comply with the due diligence obligations throughout their supply chain and produce a respective report if they offer products or services in relation to which there is a reasonable suspicion that they have been manufactured or provided using child labour (art. 964j para. 1 no. 2 CO). This requires an assessment on whether there are reasonable suspicions of child labour in the supply chain, unless a company qualifies as a 'low-risk undertaking' as defined in art. 7 DDTrO, which in turn follows from a risk assessment. It is therefore important to note that all large Swiss companies must perform at least the initial risk assessment on an annual basis and document the findings.

Therefore, effectively, companies need to establish a list of all countries they operate in, where they purchase or manufacture products in accordance with the indication of origin ('made in'), and where they primarily procure or provide services (art. 7 para. 2 DDTrO). They then need to verify on an annual basis what rating each of these countries has in the UNICEF Children's Rights in the Workplace Index, and document their findings (risk assessment). The due diligence and reporting obligations do not apply for countries with the rating "basic" (unless there is an obvious involvement of child labour, art. 8 DDTrO) or for countries with the rating "enhanced" or "heightened" when there is no reasonable suspicion of child labour.

This annual risk assessment will likely become much less burdensome once the initial processes are in place, and presuming that companies also establish a process for adding countries to or removing them from the risk assessment as their supply chain changes over time.

ARE ALL SWISS COMPANIES OBLIGED TO PUBLISH A REPORT ON NON-FINANCIAL MATTERS?

No. A report on non-financial matters must only be produced and published by companies organised under the laws of Switzerland which (a) are companies of public interest; and (b) fulfil certain criteria relating to their size (art. 964a CO).

Companies of public interest are defined in art. 2 lit. c of the Swiss Auditor Oversight Act and include all Swiss companies that are: (a) public companies (i.e., have equity securities listed on a stock exchange anywhere in the world, have bonds outstanding, or contribute at least 20% of the assets or turnover to the consolidated accounts of such a company, see art. 727 para. 1 no. 1 CO); or (b) supervised by the Financial Market Supervisory Authority (FINMA) and required to perform an audit by an approved auditing company.

In terms of size, only those companies must produce and publish a report on non-financial matters which, together with the Swiss and foreign entities that they control: (a) have at least 500 FTEs on average; and (b) exceed either a balance sheet total of CHF 20 million or sales revenues of CHF 40 million, each over two successive financial years.

If a Swiss company is part of an international group, the holding company of which is listed, the rules regarding the report on non-financial matters do not apply if the Swiss entity is not itself a company of public interest as described above. On the other hand, if a Swiss company is of public interest and meets the size criteria, the report on non-financial matters as per art. 964a ff. CO must also cover any (foreign or domestic) subsidiaries to the extent that this is required to understand the operations of the business, its financial performance and the effects of the company on the non-financial matters (art. 964b paras. 1 and 4 CO). Consequently, the report on non-financial matters is a consolidated report (see also the explicit exemptions for controlled companies as per art. 964a para. 2 CO discussed further below).

CAN WE INCLUDE THE REPORT ON NON-FINANCIAL MATTERS OR THE REPORT ON CHILD LABOUR OR CONFLICT MINERALS IN OUR ANNUAL REPORT?

No. These reports must be published as separate reports, given that the obligation to publish them is more extensive than for the annual report under art. 958e CO, since the report on non-financial matters or any reports regarding due diligence on child labour or conflict minerals and metals must be published electronically on

the company's website and remain accessible for ten years. The Swiss regulation therewith deliberately deviates from the corresponding EU regulation, according to which the report on non-financial matters is supposed to be part of the management report of the relevant company. The reason for this, according to the explanatory note of the Federal Department of Justice (*Bundesamt für Justiz*, BJ), is that more people and stakeholders are expected to be interested in these non-financial reports than in annual reports.

If a company publishes its annual report electronically, it will technically comply with the publication requirements by including any non-financial reports therein (as long as the annual report remains accessible for ten years). However, in light of the clear guidance of the BJ, it is uncertain whether this would be accepted. Given the criminal liability for failure to comply with the reporting obligation as per art. 325ter of the Swiss Criminal Code (CC), publishing separate non-financial reports is in our view advisable for the time being.

DO ALL REPORTS HAVE TO BE REVIEWED BY AN EXTERNAL AUDITOR?

No. The only report which must undergo an assessment by an independent auditor is the report on the due diligence regarding conflict minerals and metals (art. 964*k* para. 3 CO and art. 16 DDTrO). The auditor must give a so-called 'negative assurance', which means that it must assess whether there are any indications suggesting that the due diligence obligations have not been fulfilled.

The other reports (i.e., reports on non-financial matters according to art. 964*a* ff. CO and reports on the due diligence regarding child labour according to art. 964*j* ff. CO) do not require an audit. However, it is possible to obtain a voluntary audit or to have an assurance performed on these reports, in particular as a protective measure for the board of directors and the individuals involved in the preparation of the reports from criminal liability (art. 352ter CC). We also observe audit firms increasingly offering just such services.

THE GROUP ALREADY PUBLISHES A SUSTAINABILITY REPORT – DO WE HAVE TO VERIFY WHETHER IT MEETS THE SWISS STANDARDS?

The Swiss non-financial reporting rules were designed to avoid 'double reporting' and therefore include several provisions on consolidated reporting within a group and the acceptability of reports under foreign law or standards.

In particular, the reporting requirements do not apply to companies that are controlled by another company which has to produce: (i) a Swiss report on non-financial matters or a report on due diligence regarding conflict minerals and metals or child labour (since the controlled entities should be included in such reports), or (ii) an equivalent report under foreign law (art. 964*a* para. 2 and art. 17 DDTrO). According to the BJ's explanatory note, an example of such equivalent report under foreign law would be a report based on Directive 2014/95/EU. With respect to reports that may be produced under a different law (outside of the EU), the 'equivalence' of such report must be assessed on a case-by-case basis.

With respect to the reporting requirements on due diligence regarding conflict minerals and metals as well as child labour, there is an additional exemption for companies that adhere to internationally recognised equivalent regulations, which must be named in the report produced and applied in their entirety (art. 964*j* para. 4 CO in connection with art. 9 DDTrO). The 'internationally recognised regulations' are conclusively defined in Annex 2 to the DDTrO:

For conflict minerals and metals, companies can *either* follow

- the OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict and High-Risk Areas dated April 2016 (including all annexes and supplements); *or*
- Regulation (EU) 2017/821.

With respect to child labour, companies would need to comply (cumulatively) with:

- ILO Conventions No. 138 and 182 and the ILO-IOE Child Labor Guidance Tool for Business of 15 December 2015; and
- the OECD Due Diligence Guidance for Responsible Business of 30 May 2018 or the UN Guiding Principles on Business and Human Rights.

If these requirements are met, a company indicates the regulations it follows and applies them in their entirety; it does not additionally have to assess whether standards on the content of the due diligence and reporting prescribed by Swiss law are met.

THE NEW ORDINANCE ON REPORTING REGARDING CLIMATE MATTERS

On November 23, 2022, the Federal Council enacted the Ordinance on the Reporting of Climate Matters (ORCM) regarding the implementation of the non-financial reporting (art. 964*a*-964*c* CO) with respect to climate. In particular, its purpose is to clarify the obligations of affected companies (i.e., companies of public interest as described above) with respect to the required disclosures and to enable better comparability of climate reports.

The core provision of the ORCM is art. 2 para. 1, which establishes the presumption that the obligation to report on climate matters as per art. 964*a*-964*c* CO is fulfilled if the report is based on the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD). It is still possible to follow guidelines other than the TCFD recommendations (or not to use any guidelines), but in such cases the company needs to provide evidence that it complies with the reporting requirements – which is particularly important in view of the criminal liability as per art. 325ter CC.

The ORCM defines the term 'climate matters' as follows (art. 1 para. 2): Climate matters include the impacts of climate change on companies as well as companies' impacts on climate change, and therewith reflects the concept of 'double materiality' applied within the EU. The focus on climate change was newly introduced as a result of the consultation process; the draft ordinance was broader and referred to the impacts of and on 'climate' in general.

In addition, the ORCM repeats the concept of 'comply-or-explain' already included in art. 964*b* para. 5 CO, according to which companies need to state clearly in their reports on non-financial matters if they do not follow a policy with respect to any of the matters to be covered and to indicate the reasons for such an approach (art. 2 para. 2 ORCM).

A new feature of the ORCM (which had also not been foreseen in the draft) is that the report on climate matters must be published electronically on the company's website in at least one format that is legible for humans, such as a PDF, and one that is readable for machines (e.g., XBRL). Given that the climate report is part of the broader report on non-financial matters (which also covers the other matters, including social issues, employee-related issues, respect for human rights and combating corruption), this effectively establishes a new requirement for the entire report.

The ORCM enters into force on January 1, 2024, whereas the obligation to publish the report in a format that is readable for machines only applies as of 2025. Although the ORCM does therefore not apply to the first reports to be produced for the financial year starting in 2023, it may already provide some guidance for companies who are setting up their reporting processes for the longer term.

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