ESG reporting in Switzerland: an initial assessment, one year in

Annette Weber of Advestra addresses the key questions concerning the new Swiss requirement for certain companies to provide annual reports on non-financial matters

Switzerland introduced an obligation to report on non-financial (ESG) matters in 2022 (later than its neighbouring EU countries), with a transitional period of a year. Hence, 2024 marks the first year for certain Swiss companies to report on non-financial matters concerning financial year 2023.

Although the Swiss legislator applied largely the same concepts as under the previous EU regulation (NFRD), Swiss companies face an additional challenge: the approval of the non-financial report at the annual general meeting, after its mandatory submission by the board of directors. This obligation raised, and still raises, several questions, some of which will be discussed in this article. Due to its complexity, it is not possible to cover all aspects of the new regime. This article will focus on selected questions that are worth addressing.

Before jumping into the questions, below is a quick reminder as to which companies fall under the new rules regarding non-financial reporting, and what they have to report.

Subject companies

The rule applies to prudentially supervised financial institutions and Swiss public enterprises:

- That have at least 500 full-time employees per year in two consecutive years; and

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- A balance sheet total of at least CHF 20 million or a turnover of at least CHF 40 million (in each case, calculated on a consolidated basis).

Public enterprises comprise not only companies with equity securities listed on a stock exchange but also Swiss companies with bonds outstanding or companies contributing at least 20% of the assets or turnover to the consolidated accounts of companies with equity securities listed on a stock exchange or with bonds outstanding.

The thresholds under (i) and (ii) aim to exclude smaller companies to which such reporting might constitute an undue burden. Nevertheless, due to investor demands, smaller companies are increasingly publishing a non-financial report. However, these companies do not necessarily submit the report to their shareholders for approval.

Exempted from the obligation to report on non-financial matters are enterprises controlled by another company that is a subject enterprise or that is required to produce a similar report under foreign law. This is in view of eliminating duplications devoid of added value.

Content of the report

A report on non-financial matters must comprise information about:

- Environmental matters; in particular, about CO2 targets;
- Social and employment matters;
- Respect of human rights; and
- Combating corruption.

In addition, Swiss law requires the report to outline details that are necessary for understanding the business's performance and results, the situation of the enterprise, and the impact of its actions on the matters listed above.

The Swiss Code of Obligations provides a non-exhaustive list of matters that are to be covered by the report. Among others, it requires a description of the business model, a description of the concepts used in respect of the above-mentioned matters, the measures taken, and their effectiveness.

A subject enterprise must describe the main risks in connection with its business and, where relevant and proportionate, the risks in its supply chain, as well as performance indicators in respect of the above-mentioned matters. A subject enterprise may follow internationally recognised reporting standards, such as the guidelines of the OECD, provided that it indicates the applied reporting standards and supplements the report if the report does not cover all the line items required by Swiss law.

Selected questions and answers

Is the shareholders' vote binding or consultative?

The question of whether a report on non-financial matters is binding or only consultative was debated well in advance of implementation of the new regulations. Some argue that it is consultative because a 'no' by shareholders does not have any direct consequences for the board of directors. Others point out that the Swiss Code of Obligations tends to expressly designate a vote as "consultative". For example, a vote on a compensation report is expressly flagged as a consultative vote, which is not the case for a vote on non-financial reporting.

For this year, it seems that, in particular, some larger Swiss listed companies intend to submit the non-financial report to their shareholders by way of a consultative vote. Unsurprisingly, the Swiss proxy adviser, Ethos, publicly announced in the case of Novartis and Roche, both Swiss pharmaceutical corporations, that it urges companies to submit the vote as a binding vote. It remains to be seen how companies will address this request in 2024 and in the upcoming years.

In what form should a report on non-financial matters be submitted?

The Swiss legislator consciously deviated from the relevant EU regulation by requiring subject enterprises to issue a separate report. According to the opinion expressed here, whether the report is part of a management report, as required by **the EU's Corporate Sustainability Reporting Directive** (see Article 19a, paragraph 1), or a standalone report, as intended by the Swiss legislator, is a formal question, which should not be of relevance as long as the content of the report and the submission to the shareholders' vote is conducted in accordance with the Swiss law requirements.

Another question is whether the information may be spread out throughout an annual report of a company or whether Swiss law requires the non-financial report to be included in a dedicated section. This is not clear. It should, in the author's opinion, be permissible to have different pieces of the non-financial report in the annual report, as long as the content is not spread out in a way that a reader may not trace it as such anymore. In any case, the board of directors must ensure that it is clear what belongs to the non-financial report in order to submit the report to the shareholders' meeting.

It is expected that many companies will produce a separate report on non-financial matters, either as a standalone report or as a dedicated section in the annual report. Some companies indicate the pages that are subject to a shareholders' vote when they publish a sustainability report according to an international standard, such as the Global Reporting Initiative (GRI), which contains additional information not required under Swiss law.

Is a separate vote on a report on non-financial matters required?

Swiss law does not explicitly require that a report is submitted to a separate vote. However, Swiss law follows the general concept concerning cohesion of the subject matter to be submitted to a vote, meaning that each agenda item to be voted on must pertain to one subject matter. In light of this concept, it might be defendable to submit the annual financial statements to a vote with the report on non-financial matters.

Given that approval by the shareholders of the annual financial statements is a prerequisite for the distribution of a dividend, it is recommended to divide the vote on the annual financial statements and the report on non-financial matters to avoid shareholders not approving the annual financial statements only because of the report on non-financial matters.

Unsurprisingly, to combine the approval of the annual financial statements and the report on non-financial matters is not in line with the recommendations of certain proxy advisers. They claim that it is more shareholder friendly to hold separate votes, as that provides the shareholders the opportunity to better express their views on these matters.

May Swiss companies apply international standards to their non-financial reporting?

Swiss law explicitly allows and accommodates the application of international standards, such as the principles of the OECD. It also permits the application of national or European regulations. In such a case, the company is required to disclose the applied standard.

The application of a standard does not relieve a company from the application of Swiss law; if the application of a standard does not cover all the line items required by Swiss law, the company must supplement the information, if necessary, by way of a separate report.

Many companies apply international standards; in particular, the GRI and the Task Force on Climate-Related Financial Disclosures for climate reporting (TCFD). The latter is in some cases driven by the Swiss legal framework, as it makes it easier for companies to show compliance in reporting on climate matters.

The Swiss government has enacted an ordinance regarding climate reporting (the Ordinance on Reporting on Climate Matters, or the Ordinance), which entered into force on January 1, 2024. The Ordinance provides for an assumption that companies reporting according to the framework of the TCFD fulfil the climate reporting part under the reporting obligations on non-financial matters. Hence, the Ordinance does not require companies to report according to the TCFD, but indirectly encourages the use thereof as companies do not need to have any further evidence on record that they complied with the requirements on the climate reporting part, if they apply the TCFD.

What auditing is required on a report of non-financial matters?

Swiss law does not require a report on non-financial matters to be audited. An assurance or similar review by an independent third party can nevertheless be advantageous.

Should the obligation to report on non-financial matters become subject to a judicial assessment, the defence on negligent breaches might be easier. Furthermore, it is advantageous for investors who like to see some form of a quality check from a third party. For example, Ethos, a Swiss proxy advisor, has stated in its guidelines that it will vote against a report on non-financial matters if the report and/or relevant indicators are not audited by an independent third party.

It is expected that a number of Swiss companies will publish their non-financial report together with an assurance report from an audit firm. This will most likely be a growing trend, due to investor demand.

When does the report on non-financial matters have to be published?

Swiss law requires electronic publication of the non-financial report only after the approval of the shareholders' meeting. The report must remain publicly accessible for ten years. That said, listed companies publish their report at the same time as the invitation to the shareholders' meeting, as they have to make the report available to its shareholders for the shareholder vote. As a result, the publication is, in practice, earlier than required by Swiss law for listed companies.

How do non-listed companies address reporting on non-financial matters?

While the majority of the subject enterprises are listed companies, there are companies that fall under the duty to report on non-financial matters even though their shares are not listed on a stock exchange. These include companies that are supervised financial institutions and companies that have issued bonds, provided that they meet all the other requirements (i.e., more than 500 employees and a balance sheet total of at least CHF 20 million or a turnover of at least CHF 40 million; see above *Introduction*).

Although the same regime applies to these companies, their approach to the reporting might be slightly different. For example, they will likely prefer to have a separate report on non-financial matters because the report on non-financial matters must be published, whereas there is no requirement under Swiss law to publish an annual report for privately held companies.

Furthermore, while public companies publish the report on non-financial matters together with the invitation to the annual general meeting to make the report accessible to all shareholders for the shareholders' vote, privately held companies may opt to publish the report on non-financial matters only after the approval of the shareholders' meeting, as required under Swiss law.

Privately held companies are not exposed to proxy advisers and may be more flexible in their application of Swiss law, as long as their shareholder base is satisfied with its approach.

What happens if a report is not approved by the shareholders' meeting?

In contrast to other shareholder votes, a 'no' by shareholders on the report on non-financial matters does not trigger any immediate consequences for boards of directors in the sense that Swiss law does not require boards of directors to improve the report and resubmit it to shareholders. As the report primarily describes events and facts of the previous year, this would also not be meaningful, as the board of directors cannot undo past events. Furthermore, shareholders might have different motivations for a 'no' vote, which they are not required to disclose. This would also make it difficult to adjust the report.

However, boards of directors whose non-financial report was not approved by the shareholders' meeting are well advised to ascertain the reason(s) for the negative outcome. The shareholders' rejection implies a mandate (although not enforceable) to the board of directors to enquire as to the reasons for such a vote and to try to align the report on non-financial matters with the interests of the shareholders. A negative outcome might harm the company's reputation significantly.

What happens if the report on non-financial matters turns out to be incorrect after the approval of shareholders?

The company is required to correct the information and flag what information has been corrected. In the author's interpretation, the report has to be resubmitted to a shareholders' vote only if it was substantially incorrect and the false information might have impacted the shareholders in their decision-making process for voting.

Incorrect statements in the report could lead to criminal liability. The Swiss Penal Code stipulates criminal liability for anyone who makes false statements in the non-financial report wilfully or negligently. The same applies if no reporting is made at all.

Does Swiss law provide for liability provisions in the context of non-financial reporting?

As mentioned in the previous question, Swiss law has introduced a criminal liability for misstatements or the omission of the reporting on non-financial matters. In addition, the board of directors may be held liable based on existing remedies, such as that concerning director liability. Director liability requires, among others, that the individual acted with intent or negligently violated their duties, and these actions resulted in damage at the level of the company and/or by the shareholder itself. In order for a director to be held liable, it is further required that they acted in violation of a provision intended to protect against precisely the type of damage that occurred.

In the author's opinion, as the rules on non-financial reporting do not constitute protective provisions, the quantitative exposure of members of the board of directors will not significantly increase. However, against the background of increased ESG litigation, there is a significant risk that investors may initiate lawsuits, which may significantly harm the reputation of the accused.

Outlook for Swiss non-financial reporting

Companies are increasingly subject to investor and public scrutiny. This first year of non-financial reporting is likely to be the toughest year for subject enterprises as there is no benchmark yet. It is expected that in the coming years, standard practice will be established, which will help companies to address certain challenges.

That said, Swiss enterprises may not rest on the status quo, given that the Swiss government intends to extend the reporting to keep up with evolution at the EU. Looking at the developments in the EU, the current overhaul of the Swiss rules on non-financial reporting will likely not be the last one.

The extensive reporting requirements of the EU might meet investors' demands in the EU but not necessarily in the US. Certain Swiss companies have to balance their European investor base, which would like to see companies having ESG principles fully integrated in their business model, with US investors, who tend to accommodate ESG only if it makes the company more profitable.

This gap makes it difficult for companies to address all investor concerns equally. Given the trend in the EU, this gap will likely grow. As ESG is still an evolving topic, it is worth keeping an eye on it.