ADVESTRA INSIGHTS

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Sustainability Report and Shareholder Meeting: Questions and Answers

The upcoming AGM season is only a few weeks away and Swiss listed companies and financial institutions are preparing to hold their first shareholder votes on their sustainability reports. Against this background, we have tried to provide some guidance and clarify some questions in the following Q&A.

1 WHAT IS THE LEGAL BASIS FOR SUSTAINABILITY REPORTS AND FOR SHAREHOLDER APPROVAL OF SUCH REPORTS UNDER SWISS LAW?

The legal regulations on sustainability reporting (transparency on non-financial matters in art. 964*a* to 964*c* of the Swiss Code of Obligations (CO) and due diligence obligations and transparency regarding minerals and metals from conflict areas and child labor in art. 964*j* – 964*l* CO) were introduced into the CO as an indirect counter-proposal to the "Responsible Business Initiative" (*Konzernverantwortungsinitiative*). These statutory provisions were enacted following the rejection of the Responsible Business Initiative and came into force on 1 January 2022 with a transition period of one year. Listed companies and financial institutions will therefore need from this year onwards to publish a report on non-financial matters and their compliance with the due diligence obligations regarding minerals and metals from conflict areas and child labour covering the past financial year.

Overall, Swiss law does not prescribe a specific reporting standard, except regarding climate matters, which are part of the environmental matters that must be included in the report on non-financial matters. The legal requirements regarding this specific area were set forth in the ordinance on mandatory climate disclosure (*Verordnung über die Berichterstattung*

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über Klimabelange), which came into force on 1 January 2024.

Art. 964*c* CO mandates that the report on non-financial matters has to be approved not only by the supreme managerial body (i.e., the board of the directors in a Swiss corporation (*Aktiengesellschaft*)) but also by the body competent to approve the annual accounts. This is the shareholder meeting (*Generalversammlung*) in case of a Swiss corporation.

2 DOES EU LAW AND INTERNATIONAL STANDARDS HAVE AN IMPACT ON THE SWISS RULES AND IF SO, HOW?

The short answer is yes. The Swiss legislator followed to a large extent the requirements of the Non-Financial Reporting Directive and is currently reviewing the regime in order to seek for an alignment of Swiss law with the more recent Corporate Sustainability Reporting Directive (CSRD) and Corporate Sustainability Due Diligence Directive (CSDDD).

Further, the future EU regime under the CSDDD will include non-EU enterprises, which achieve a turnover of more than EUR 150 million in the EU or which operate in defined high impact sectors (e.g., textiles, agriculture, extraction of minerals) and achieve a turnover of more than EUR 40 million in the EU. Hence, larger Swiss companies which have an international business might fall under the CSDDD even before the Swiss rules are overhauled.

Art. 964*b* para. 3 CO explicitly refers to the application of national, European or international regulations and names the principles of the Organisation for Economic Co-operation and Development (OECD) explicitly. The applicability of such regulations is subject to the conditions that (i) the report must mention the regulations applied and (ii) the requirements of Swiss law must be met by including the information required by Swiss law in the report or by preparing a supplementary report. In other words, this is not a substitute compliance regime and, if the applied regulations do not provide for a piece of information required by Swiss law, a company may not avoid the duty to report such information by applying a different standard. Rather it must add such information to the report. In practice, most of the subject companies follow an internationally recognized standard, such as GRI, which investors are already familiar with. The harmonization of different standards is a particular demand from the investor-side who has to deal with many different standards, making it difficult for investors to analyze and compare data.

3 IS THE INFORMATION PURSUANT TO ART. 964*B* CO SUBMITTED TO SHAREHOLDERS AS PART OF THE ANNUAL REPORT (MANAGEMENT REPORT) OR AS A SEPARATE DOCUMENT?

CSRD requires a "dedicated section" on sustainability matters in the management report (art. 19a para. 1 CSRD). By contrast, even though not expressly set out in a statutory provision, the Swiss legislator intended the report on non-financial matters – in conscious deviation from EU law – to be a standalone report that should not be part of any management report.[1] Whether the report is a dedicated section of the management report or a standalone report is a mere question of formal presentation. In order to avoid conflicts with EU law and in light of substance over form, the requirements of art. 964*b* CO must also be satisfied if the content required therein is disclosed as part of the management report or – more relevant for Swiss listed companies that are the parent of a group – the consolidated accounts (or in a separate document that is

[1] Report of Federal Office of Justice regarding non-financial reporting and due diligence obligations and disclosure regarding conflict minerals and child labor (Transparenz bezüglich nichtfinanzieller Belange und Sorgfaltspflichten und Transparenz bezüglich Mineralien und Metallen aus Konfliktgebieten und Kinderarbeit) dated 19 November 2019, p. 17

designated to be part of the annual consolidated accounts).

The more interesting question is whether Swiss law currently also allows for the information required by art. 964*b* CO to be spread out throughout a company's annual report. Again, in favor of substance over form, and even though not ideal for a reader, this should be permissible in our view; in particular also in light of the criminal provision of art. 325ter of the Swiss Penal Code (SPC; see Question 12 below) which does not penalize the omission of a specific report but refers to the omission of "reporting" (*Berichterstattung*) more generally.

4 WHAT INFORMATION OR DOCUMENT SHOULD BE SUBMITTED TO SHAREHOLDERS FOR APPROVAL?

The answer depends on how the company has decided to prepare its report on non-financial matters (see Question 3). If a separate report has been prepared the question arises whether the entire sustainability report (such as the full GRI report) should be subject to the shareholder vote or a shorter separate section, or whether it would be even sufficient to designate specific information items (e.g., in an index) that satisfy the disclosure requirements of art. 964*b* CO.

The vote of shareholders should encompass all the information that needs to be disclosed under art. 964*b* CO. In practice, further or more granular non-financial information will be disclosed as part of the ESG disclosures or sustainability reporting (e.g., TCFD disclosures). In our view, companies are free to submit just the minimum information to a shareholder vote or the more comprehensive set including documents or separate ancillary reports referenced in any designated report on non-financial matters. However, if a company considers the separate reports or information referenced in the main report on non-financial matters as essential parts thereof, the vote of shareholders should also extend to such ancillary reports.

If no dedicated section is included in the annual report, the sections comprising the relevant information on non-financial matters should be clearly marked and an index should be included tracking the information required by art. 964*b* CO in order to enable shareholders to assess what information they are expected to vote on.

It is currently unclear whether two separate reports, one with the minimum information required under art. 964*b* CO and to be submitted to shareholders for approval and another more comprehensive report along international standards such as GRI will be welcomed by proxy advisers. Ethos, for example, has stated in its 2024 guidelines that it will issue a vote against a report that does not follow recognized standards (*anerkannter Standard*) on non-financial reporting. However, we assume this does not mean an international standard should be used and the Swiss statutory standard set out in art. 964*b* CO will satisfy Ethos' voting guidelines.

Finally, it should be noted that the criminal sanctions for omitting to publish reporting on non-financial matters (see Question 12) are not applicable in case a report is produced but not submitted to shareholders for approval.

5 IS THE SHAREHOLDER VOTE ON THE REPORT ON NON-FINANCIAL MATTERS "BINDING" OR "CONSULTATIVE"?

The legislative materials are elusive on this question, but they reveal that there was clear legislative intent to submit the non-financial report to the approval of the general meeting. The idea was to hold the board of directors accountable to the shareholders, following the same blueprint as the management report.

Nevertheless, the rationale of shareholder approval remains fuzzy. Indeed, shareholders are not required to explain why they vote in favor or against a report and a rejection may seek to convey various messages: one rationale may be an objection to the disclosure, because it does not meet the expectations of the shareholders in terms of transparency. Another distinct rationale can also be that the shareholders are looking to censure the performance of the company in non-financial matters. At this level, shareholders may have diametrically different reasons to vote against a report on non-financial matters: Some may want to voice their conviction that the company did not do enough on non-financial matters, while want to let the board of directors know that they believe that they are doing too much. Furthermore, ESG topics are multi-dimensional and the opposition may relate to any one of these facets of the report.

More generally, the question may indeed be asked whether shareholders are the right "guardian" on ESG matters that affect and relate to the wider audience of stakeholders given the complexity and the required knowledge for this matter. However, holding a vote is in line with Swiss traditions and the Swiss legislator made a conscious policy decision (contrary to the EU legislator, which did not impose a specific shareholder vote) and empowered the shareholders with a say on ESG matters.

There is no formal distinction between a "consultative" and a "binding vote". A binding vote is generally understood as being a condition for a report to be finally approved, whereas a consultative vote does not have any legal effect but has merely an expressive function to allow the shareholders to let the board of directors and the world more generally to know what they think. In some cases the distinction between a binding and a consultative vote have legal implications: for instance, until the entity-level annual accounts of a company have not been approved, the company cannot distribute a dividend or take other corporate actions based on the annual accounts. As no corporate actions hinge on having the non-financial report approved by the general meeting, the distinction is purely rhetorical. Nevertheless, absent a formal designation as "consultative" as is the case with the vote on the compensation report (see art. 735 para. 3 no. 4 CO), we would caution against explicitly labeling the vote as being "consultative".

This being said, looking at the management report, which was the blue print for the non-financial report, the main practical question is whether, in case of a rejection by shareholders, the vote will have to be repeated (see below) and whether the board of directors may be exposed to director's liability claims in such case (see Questions 11 and 12).

Some commentators argue that strategy, including strategy on sustainability matters, is an inalienable and non-transferrable duty of the board of directors, and that therefore, the vote on the non-financial report should be consultative only. While we believe the vote has a legal effect similar to a "consultative" vote (see Question 6), we are cautious to follow this argumentation because the CO tends to expressly designate a vote as "consultative", such as the vote on the compensation report (see art. 735 para. 3 no. 4 CO), which was not the case for the vote on non-financial matters. In addition – although not explicitly stated in proxy guidelines – we would expect that proxy advisors interpret the label "consultative" as a downgrade of the vote. We therefore do not recommend to designate the vote as "consultative".

6 WHAT HAPPENS IF THE REPORT IS NOT APPROVED BY SHAREHOLDERS?

The non-financial matter report provides disclosure on a group's activities and performance in ESG related topics of a specific year. The report mainly describes events and facts that happened in the previous year. These *faits accomplis* will not be undone by a vote of rejection of shareholders (see also Question 7). Also, shareholders may have different reasons for a no-vote. For some, the company's ESG performance may not be good enough, others may think the company has done too much in terms of ESG efforts. Even within the ESG believers among no-voters, different ESG aspects may be approved or disapproved of and due to the lack of an obligation to state a reason for a no-vote, it seems virtually impossible for the board of directors to draw a conclusion on things that would have to be changed as a result of a no-vote.

As a non-financial report can be rejected for a number of reasons, we believe that it is not necessary to hold a new vote on a report that has been rejected possibly after having reviewed it. The underlying data (again assuming the report was correctly drafted) has not changed and, as mentioned, the reasons for rejection will not be uniform and will be hard to identify reliably. In exceptional cases, e.g. where a report is manifestly in breach of the substantive legal requirements of Art. 964*b* CO or if a report could, unless corrected, create an exposure, the board of directors may, however, want to revise the report and submit to a new shareholder ballot.

Our view that, absent special circumstances, a rejected report does not have to be submitted again for shareholder approval does not mean that the vote of shareholders is legally a non-event. A negative outcome of the vote on non-financial matters clearly implies a mandate – albeit a non-enforceable one – to the board of directors to talk to shareholders and try to submit a report that describes targets, activities and performance that is better aligned with the interests of shareholders.

7 WHAT HAPPENS IF THE REPORT TURNS OUT TO BE INCORRECT AFTER SHAREHOLDER APPROVAL?

The company will have to correct the information and will have to designate and flag what information has been corrected.

Some commentators argue that the report would have to be submitted again for shareholder approval if it is manifestly incomplete or factually wrong even though they consider the vote on the report as "consultative" only. Apart from the fact that a report that is manifestly incomplete will hardly ever be submitted for shareholder approval (in particular in light of the impending audit assurance requirement), it is questionable if another shareholder vote is required (and useful). In our view, this depends in particular on whether substantive legal requirements have been manifestly breached and whether the board of directors could be exposed to liability.

Incorrect statements, however, could lead to a sanction pursuant to art. 325ter SPC (see Question 12 below).

8 WHAT HAPPENS IF SHAREHOLDERS VOTE DOWN A REPORT THAT DESCRIBES AMBITIOUS ESG GOALS?

As mentioned, it will be difficult to identify the reasons for rejection but for the purposes of this question we assume the reason of rejection were ESG goals that were too ambitious and therefore probably too costly from the perspective of shareholders. As also mentioned above, the shareholder vote does not bear any legal consequence in the sense that the board of directors would not be obligated to change its ESG strategy after a report is refused. However, the board of directors should clearly weigh whether its approach favoring stakeholders or society or the environment at large is sustainable absent a "mandate" from the constituency that is ultimately expected to bear the costs thereof.

9 DOES THE REPORT HAVE TO BE AUDITED?

No, but given the requirements of the CSRD and the potential changes in Swiss legislation, it is recommendable to have the non-financial report audited (limited assurance; in the long term reasonable assurance will likely be required). In particular, it will be easier to defend against accusations of negligent breaches of art. 325ter SPC if the non-financial report has undergone an audit. Further, at least some investors would like to have some kind of an assurance from a third party as a quality check. Ethos, for example, has stated in its 2024 guidelines that it will issue a vote against a report if such report and/or the relevant indicators are not audited by an independent third party. A similar request has been observed in the case of green finance frameworks with second party opinions.

9 WILL SIX SWISS EXCHANGE REVIEW OR APPROVE OR DISAPPROVE THE REPORT?

No. SIX Swiss Exchange (SIX) has stated that their current intention is not to review non-financial reports. Hence, no sanctions for non-compliance are to be expected from SIX either. This is in contrast to financial reports which are reviewed by SIX for compliance with applicable accounting and auditing standards.

10 WILL FINMA SCRUTINIZE ESG REPORTS AND CAN IT IMPOSE SANCTIONS?

FINMA only supervises directly banks and insurance companies. It does not supervise listed companies and other market participants.

We expect FINMA to scrutinize ESG reports of supervised entities (banks and insurers) and it can impose order enforcement measures in cases of non-compliance and violations. FINMA considers the private law obligations in ESG reporting to be part of the requirement of proper business conduct which is part of its supervision. It has also been pro-active in imposing disclosure of climate-related financial risks and supervising compliance with these requirements.

Beyond the world of supervised entities, FINMA could also take action against listed companies if a false report could constitute a case of market manipulation under art. 143 of the Financial Market Infrastructure Act. However, FINMA has until recently not used this instrument to scrutinize other reports of listed companies and has not signaled that it would depart from its practice in connection with non-financial reporting.

11 WHO IS LIABLE FOR MISSTATEMENTS IN THE REPORT?

Aside from the criminal provisions (see Question 12 below), no provisions regarding liability in connection with non-financial reporting were introduced. Moreover, one key difference between the present regulations and the Responsible Business Initiative was the fact that the present regulations only impose transparency and, in connection with metals and minerals from conflict areas and child labour, due diligence requirements but do not constitute a cause for civil liability.

Accordingly, any claims for civil liability would have to be based on existing remedies, the director liability provisions of art. 754 CO ff. being the most relevant. Claims against members of the board of directors and management would need to satisfy the requirements generally applicable to director liability claims. In particular, a claimant would need to prove that such individuals intentionally or negligently violated their duties and that the violation resulted in damages incurred at the level of the company and/or by the shareholder itself. Outside of bankruptcy scenarios it is notoriously difficult under Swiss law for claimants to establish that these requirements are met.

Further, directors are only liable for violations of provisions that seek to protect against the type of damage that occurred (*Schutznorm*). In our view, the rules on non-financial reporting do not constitute protective provisions in the aforementioned sense as they do not primarily serve to protect the interests of individual shareholders, creditors or other stakeholders, but to create a level playing field and as such protect the capital market at large. As a result and apart from criminal liability (see Question 12), the quantitative exposure of the board of directors for misstatements or omissions in the report on non-financial matters is rather limited. However, in light of increased ESG-litigation, there is an actual risk that suits may be initiated to put companies in the spotlight.

12 IS THERE CRIMINAL LIABILITY FOR ACTS OR OMISSIONS IN RELATION TO THE REPORT?

Art. 325ter SPC stipulates criminal liability for anyone who makes false statements in the non-financial report willfully or negligently. The same applies if no reporting is made at all. The sanction is a fine of up to CHF 100,000 in case of willful misconduct and up to CHF 50,000 in case of negligence. Only individuals may be liable (not the company itself). In practice, absent rare cases of complete omission of reporting, primarily persons actually involved in drafting the report and providing the data for the report will be somewhat exposed.

13 DO SHAREHOLDERS HAVE ACCESS TO SOURCE OR SUPPORTING DOCUMENTS OF THE NON-FINANCIAL REPORT?

Shareholders have a right to have access to information on ESG or non-financial matters within the scope of their general information rights: At a general meeting, a shareholder has the right to receive information on company matters to the extent relevant for the exercise of its shareholder rights and provided that no legitimate business secrets of the company would be infringed by disclosure (art. 697 CO). However, this is generally understood not to confer a right to inspect or receive any underlying documents. Hence, shareholders generally do not have access to source or supporting documents of the non-financial report.

However, if a shareholder or a group of shareholders holds a stake of 5% or more in a listed company, such shareholder (or group of shareholders) has pursuant to art. 697*a* CO the right to inspect business records and files of the company under the same pre-requisites as the previously mentioned shareholder information right (relevant for the exercise of shareholder rights and no legitimate business secrets). Hence, a shareholder or group of shareholders holding a stake of 5% or more in the company will have access to source or supporting materials unless the company can invoke that such information or document is not needed for the exercise of shareholder rights (which will be difficult in our view) or alleges legitimate business secrets.

14 DO OTHER STAKEHOLDERS HAVE ACCESS TO SOURCE OR SUPPORTING DOCUMENTS OF THE NON-FINANCIAL REPORT?

Swiss corporate law does not provide a basis for non-shareholders to have access to or the right to receive non-public ESG related information of a Swiss company.

We are not aware of any other legal basis under Swiss law that would allow non-shareholders to claim access to such information or the production of documents in relation thereto. In particular, other stakeholders are not "victims" of a breach of art. 325ter SPC accordingly, they will not have standing as a private claimant in a criminal investigation and, consequently, will not be able to access the evidentiary records collected in a criminal investigation.

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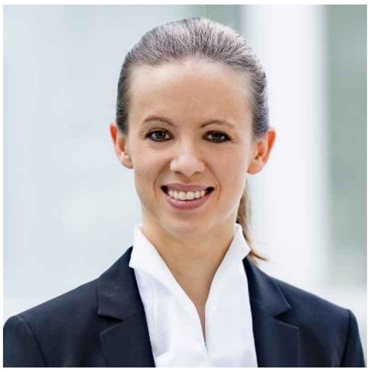

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