ADVESTRA INSIGHTS

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Federal Council Proposes More Stringent Rules on Sustainability Reporting to Align with EU Law

As previously announced, the Federal Council proposes to overhaul the Swiss legal regime on sustainability reporting to align it with EU law. Although the Federal Council does not propose to fully transpose the EU legal regime, the proposed rules would result in a more stringent regime with a broader scope of application. In the following, we will examine some of the new rules and their potential effects on subject entities.

1 INTRODUCTION

On 26 June 2024, the Federal Council published for consultation its proposed amendments of the Swiss Code of Obligations' ("CO") provisions on the transparency on non-financial matters (which are now referred to as "sustainability matters") contained in articles 964a to 964c CO.

The current sustainability reporting rules have been in force for less than three years. Nevertheless, the Federal Council proposes that the provisions be amended for the first time to adapt Swiss law to the ever-changing regulatory landscape in the European Union ("EU"). In particular, the proposed changes aim to align Switzerland's legislation to the EU's Corporate Sustainability Reporting Directive ("CSRD"). The Federal Council, in established Swiss tradition, chose a middle-of-the-road solution by proposing to only implement some of the principles of the CSRD rather than a full replication.

The primary impact of the changes, if implemented as proposed, would be the increase in the number of companies subject to the sustainability reporting obligations under the CO. The explanatory report published along with

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the draft provisions ("Explanatory Report") estimates that the number of companies would increase to 3,300-3,500 from approx. 200 companies under the law currently in force.

2 COMPANIES SUBJECT TO THE SUSTAINABILITY REPORTING REQUIREMENT

Currently, only public interest companies with (i) more than 500 full-time equivalents (FTE) on annual average and (ii) either exceeding CHF 20 million of balance sheet total or CHF 40 million, in each case of (i) and (ii) during two consecutive business years, are subject to the sustainability reporting duty.

Under the proposed new law, the scope would be expanded significantly by applying the criteria alternatively instead of cumulatively and dropping the requirement of having more than 500 FTE. The revised CO would comprise all of the following companies, subject to an exemption for micro-enterprises described further below:

- Public interest companies: These include in particular listed companies, companies with bonds outstanding (whether listed or unlisted) as well as FINMA supervised institutions such as banks, insurance companies, asset managers and portfolio managers. By contrast to the current law, the duties would apply to these entities irrespective of any quantitative thresholds;
- Large undertakings which exceed two of the following three thresholds in two consecutive business years: (i) CHF 25 million of balance sheet total, (ii) CHF 50 million of revenue and (iii) 250 FTE in annual average;
- Undertakings which are required to issue consolidated financial statements and who, together with controlled entities, exceed two of the three thresholds listed in the previous paragraph.

3 EXEMPTION FROM THE SUSTAINABILITY REPORTING DUTY FOR CONTROLLED COMPANIES

The draft bill provides for exemptions for controlled companies from the duty to prepare a sustainability report.

First, no reporting would be required by companies who are controlled by another entity who issues a sustainability report pursuant to article 964a CO. This mirrors the exemption currently contained in article 964a para. 2(1) CO.

Second, companies can also dispense with the reporting under the CO if a controlling entity issues an equivalent report pursuant to foreign law. The Explanatory Report states that this exemption corresponds to the current law. However, this is not entirely accurate. The current provision of article 964a para. 2(2) CO exempts a company if it is controlled by another undertaking that *is required* to issue an equivalent report pursuant to foreign law. The new article 964 para. 1(1)(a) CO states that the exemption applies if the controlling company *issues* such a report. This suggests, on the one hand, that the reporting duty under the CO also applies if the controlling company fails to issue a report despite being required to do so by foreign law. On the other hand, if the controlling company is not obligated to issue a report under foreign law but chooses to do so on a voluntary basis, this would imply that the sustainability reporting requirement under the CO falls away.

Undertakings who, pursuant to one of the exemptions above, do not issue their own sustainability report must indicate in the notes of their annual financial statements the name of the controlling company and must publish the sustainability report of such controlling company.

4 EXEMPTION FROM THE SUSTAINABILITY REPORTING DUTY FOR MICRO-UNDERTAKINGS

The amended law would also exempt micro-undertakings from the reporting requirement. Micro-undertakings are companies that do not exceed (together with any companies controlled by them) during two consecutive business years two of the following three thresholds: (i) CHF 450,000 of balance sheet total, (ii) revenue of CHF 900,000 and (iii) 10 FTE on annual average. Except for the change of currency to CHF, these thresholds are identical to the CSRD (though effectively they are slightly higher at the current exchange rate).

The exemption for micro-undertakings will be important for small companies that lack the resources and know-how that would be required to prepare a sustainability report. By contrast, due to its calibration, it will not be available for banks, insurance companies and most financial institutions, except small portfolio managers.

5 SCOPE OF INFORMATION OF SUSTAINABILITY REPORTING

Article 964c CO of the draft provisions on the purpose and content of the report, which would replace the current article 964b CO, is significantly more detailed and also more comprehensive as to what information is required to be disclosed. Among other disclosure items, reporting would be expanded with respect to the following:

- Broader reporting on the governance of sustainability matters generally, including disclosure of the supreme management or governing body's role in the context of sustainability. This focus translates into specific reporting requirements on the corporate strategy and policy regarding sustainability as well as risk-management in this area;
- Information on incentive schemes which are tied to sustainability which are offered to members of the supreme management or governing body;
- The status of reaching net zero greenhouse gas (GHG) emissions by 2050;
- A description of the sustainability goals including the expected timeline to achieve them;
- A description of the real or potential negative impact of the activities of the undertaking and its value chain on sustainability and measures taken to identify and monitor these effects, thus expressly expanding the scope of the report to so-called scope 3 effects.

Companies must report under a "double materiality" assessment. First, the impact of the business on sustainability, such as damage to the environment, must be assessed (inside-out view). Second, the impact of sustainability aspects on the organization also forms part of the reporting (outside-in view). The draft amendments (article 964c para. 2 CO) seek to state more clearly that information that is material under both aspects of the assessment as well as information that is material under only one of the aspects must be disclosed. Moreover, the reference to the value chain emphasizes that the sustainability report should cover not only the impact of the activity of the undertaking and its supply chain, but also cover effects of downstream activities, e.g. by clients and consumers.

Application of a national, European or international standard would no longer be optional. The eligible sustainability reporting standards would be determined by the Federal Council. The supreme management or governing body (typically the board of directors) would be responsible for choosing the standard to be applied unless the determination is put to the general meeting's vote or the articles of association allocate the responsibility to another body.

The standard adopted by the company must be applied in its entirety. The proposed amendments also no longer foresee a "comply or explain" approach.

6 FORMAT OF REPORT

The revised law will also include more stringent format requirements based on the draft of the amendments. By contrast to the relative freedom under the current law, article 964c^{ter} para. 1 CO requires the use of an electronic reporting format. To ensure comparability among sustainability reports, reports must follow an internationally recognized standard. The amendments do not stipulate that the sustainability report must be issued as a separate, standalone document. Accordingly, companies would still be free to include a dedicated section in their annual report.

7 AUDIT REQUIREMENT

The Federal Council proposes that article 964c^{bis} CO be introduced, which would submit reports to an audit requirement either by an audit firm or a specialized conformity assessment body ("CAB"). In both cases, the audit firm and the CAB will need to be approved and supervised by the Federal Audit Oversight Authority.

The determination whether a *reasonable* or *positive assurance* standard is required or a *limited* or *negative assurance* is sufficient would be delegated to the Federal Council, who would have to consider international developments. Reasonable/positive assurance is a more extensive form of assurance and would require the audit firm or CAB to confirm that the information contained in the sustainability report is true and correct. By contrast, under a limited/negative assurance the audit report would only confirm that nothing has come to its attention that would indicate any material misstatement in the report.

In addition, article 728a para. 1 CO would be amended to require a company's (ordinary) auditors to examine whether there are any discrepancies between the annual financial statements and consolidated financial statements (if any) and the sustainability report.

8 APPROVAL

Both under the current law and the amended provisions, sustainability reports must be approved by the supreme management or governing body as well as the body that is responsible for the approval of the financial statements, i.e., the general meeting.

Even though the current law does not (by contrast to the vote on the remuneration report) designate the approval by the general meeting as a consultative vote, many legal practitioners and companies (among them the majority of SMI companies) took the view that the vote was of an advisory, non-binding nature only given the apparent lack of any legal consequences in case of non-approval. This interpretation prompted strong reactions from organizations such as Ethos Foundation, who called out companies such as Novartis and Roche on what it deemed a breach of the law.

The Explanatory Report now clearly states that the vote of the general meeting on the sustainability report is not consultative but binding. At the same time, the Federal Council did not propose any changes to the wording of the relevant provision and does not clarify the consequences of a negative vote. We view this as a clear indication that the vote under the current law was never intended to be non-binding and expect that the companies who in the 2024 AGM season decided to submit their sustainability reports for a consultative vote only will revise their stance.

9 CONCLUSION AND OUTLOOK

Not very surprisingly, the proposal intends to primarily align current Swiss law with the more stringent rules of EU law, namely the CSRD. Although the Explanatory Report includes a section on comparative law, the comparison and alignment are with the EU law only, without even mentioning US laws, which take a quite different approach. Given that US investors are an important base for many Swiss companies, it is somewhat surprising that the Federal Council does not deem it necessary to analyze any potential flexibility, which some Swiss companies may wish to have to address expectations from US investors also.

We expect that the new rules, once in effect, will pose challenges in particular for smaller companies, which are currently not subject to the reporting obligations and will struggle to have the requisite know-how and resources.

The consultation period for the Federal Council's proposal will be open until 17 October 2024. It therefore seems unlikely that the changes will become effective before 1 January 2026.

There will be a minimum two-year transition period during which the current law will continue to apply. For companies whose business year corresponds to the calendar year the new reporting requirements will therefore apply at the earliest for the business year starting 1 January 2028 for the first time.

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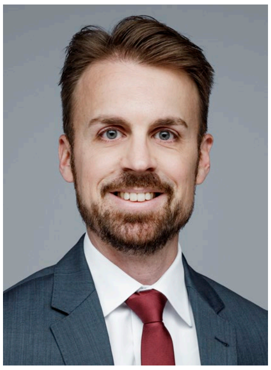

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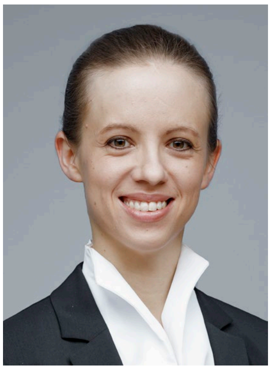

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