Baker McKenzie.

Client Alert

ESG reporting and due diligence requirements — an update for Swiss companies

In brief

In this update, we set out the extent to which new Swiss ESG reporting, disclosure and due diligence requirements apply to Swiss companies and foreign companies operating in Switzerland. We also provide further details about the due diligence requirements in relation to conflict minerals and child labor, and give an overview of developments outside of Switzerland that are relevant for Swiss companies doing business abroad, including the recently proposed EU Directive on Corporate Sustainability Due Diligence and the German Supply Chain Act. Finally, we share some of the key points senior leadership should consider as extended ESG reporting and due diligence obligations take shape in Switzerland and abroad.

Contents

Where do we stand in Switzerland in terms of ESG reporting and due diligence requirements? The bigger picture

As we reported in our Client Alert of December 2020, on 29 November 2020, the Swiss electorate voted against the so-called Responsible Business Initiative, which would have opened up Swiss companies to litigation in Swiss courts for alleged violations of international human rights or environmental laws abroad. However, as a counter-proposal to this initiative, the Swiss Parliament introduced new *general* ESG reporting and *specific* reporting and due diligence requirements in the area of conflict minerals and child labour that are viewed as more moderate.

In the meantime, there have been a number of further developments, of which Swiss multinational companies and foreign companies with operations in Switzerland should be aware:

- In December 2021, the Swiss Federal Council issued an implementing ordinance on due diligence and transparency in relation to minerals and conflict-affected areas and child labour (DDTrO). This ordinance provides for further details with respect to the new specific ESG reporting and due diligence requirements in the area of conflict minerals and child labour. The DDTrO has entered into effect on 1 January 2022 together with the revision of the Swiss Code of Obligations introduced as counter-proposal to the Responsible Business Initiative. The new due diligence requirements will apply for the first time for the financial year beginning in 2023. This means that the first reports based on the new statutory ESG reporting and due diligence framework must be issued in 2024 with respect to financial year 2023.
- Already in May 2021, the Swiss Financial Market Supervisory Authority introduced reporting obligations for large banks and insurance companies (supervisory categories 1 and 2) in line with the Task Force on Climate-related Financial Disclosures (TCFD), by amending its Circulars "Disclosure - banks" (Circular 2016/1) and "Disclosure - insurers" (Circular 2016/2).
- In November 2021, the Swiss government tasked the Finance Department to propose, in consultation with the Department of the Environment, Transport, Energy and Communication, amendments to financial market legislation to prevent greenwashing. Additional disclosure requirements on financial institutions will certainly have a further impact on non-financial companies looking for financing.

- Lastly, in March 2022, the Swiss government published a draft ordinance, which specifies the climate-related reporting obligations, being part of the general ESG reporting requirements. The draft ordinance provides for the implementation of the recommendations of the TCFD by large Swiss companies. The ordinance is expected to come into force on 1 January 2023. The climate-related reporting will have to be integrated into the *general* ESG report, which has to be issued for the first time in 2024 with respect to financial year 2023.

With these developments, a comprehensive framework for ESG reporting and disclosure is now emerging in Switzerland. While these requirements are complemented with specific due diligence requirements only in certain areas, including conflict minerals and child labor, any reporting and disclosure should be supported by an assurance framework to avoid exposure to liability for inaccurate reports or disclosures.

Which companies do the new general ESG reporting requirements apply to?

To recap, the general non-financial or ESG reporting obligations under the counter-proposal to the Responsible Business Initiative, as integrated into the Swiss Code of Obligations (Article 964a-964c CO), apply to companies of public interest domiciled in Switzerland that, together with controlled companies in Switzerland and abroad, (i) have at least 500 FTEs on an annual average, and (ii) have assets of at least CHF 20 million or revenues of CHF 40 million in two consecutive years. Other than FINMA regulated financial institutions, companies of public interest include companies incorporated in Switzerland that are listed in Switzerland or abroad, have bonds outstanding, or contribute at least 20% of the assets or of the turnover to the consolidated accounts of such companies. However, companies that are controlled by a company to which the new reporting requirements apply, or that are subject to equivalent reporting under foreign law, are not required to prepare an additional report.

While Swiss subsidiaries of foreign companies would usually not be listed on any stock exchange, the ESG reporting obligations may apply to such subsidiary, if it has bonds outstanding, unless a direct or indirect parent company is subject to equivalent reporting obligations under foreign law, such as the EU Non-Financial Reporting Directive (Directive 2014/95).

Which companies will the expected TCFD-based reporting requirements apply to?

Since the Federal Council intends to introduce the TCFD-based reporting requirements as part of the general reporting obligation pursuant to Art. 964b CO (in the area of climate-related issues), these requirements will apply to the same companies as the new general ESG reporting requirements. Furthermore, as mentioned above, the TCFD-based reporting requirements are already applicable to large banks and insurance companies under FINMA Circulars 2016/1 and 2016/2 (see above).

What are the new general ESG reporting requirements?

With respect to the substance of the *general* ESG reporting requirements, we refer to our previous Client Alert of December 2020 as those comments remain applicable.

In addition, as stated above, the Federal Council has in the meantime specified the requirements for climate-based reporting, which is part of the *general* ESG reporting requirements, in a draft ordinance. According to this draft ordinance, it is assumed that companies comply with their climate-based reporting obligations if they follow the recommendations of the TCFD as specified in Article 3 of the draft ordinance. This assumption does not prevent companies from reporting on the impact of the climate on its business and the impact of its business' activities on the climate in other ways, in particular by relying on other guidelines or standards. However, in such a case, the company must specifically demonstrate that it meets the obligation to report on climate issues or explain why it has no policies addressing climate-related issues ("comply or explain").

Which companies do the new specific reporting and due diligence requirements in the area of conflict minerals and child labour apply to?

In contrast to the new general ESG and the expected TCFD-based reporting requirements, the ESG due diligence and related reporting requirements in the area of conflict minerals and child labour (Article 964j-964l of the Swiss Code of Obligations) apply to a broader range of companies; namely, all companies with their registered office, central administration or principal place of business in Switzerland that (i) import or process certain minerals or metals from conflict or high-risk areas, or (ii) offer products or services for which there are reasonable grounds to suspect that child labour was involved, unless one of the following general or specific exemptions applies.

If companies adhere to the following equivalent internationally recognized standards listed in Annex 2 of the DDTrO, as updated from time to time, they are generally exempted from the Swiss due diligence and reporting obligations with regard to:

- Conflict minerals:
  - OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas; or
  - EU Regulation 2017/821 laying down supply chain due diligence obligations for importers of tin, tantalum, tungsten, their ores and gold originating from conflict-affected and high-risk areas.
- Child labour:
  - ILO-Conventions No. 138 and 182; and
  - ILO-IOE Child Labour Guidance Tool for Business; and
  - OECD Due Diligence Guidance for Responsible Business Conduct or the UN Guiding Principles on Business and Human Right.

To be exempt from the Swiss due diligence and reporting obligations, companies must comply with these internationally recognized standards and issue a report referring to these standards and the implemented compliance measures.

Further, the DDTrO specifies the import and processing quantities for minerals and metals up to which a company is exempt from the new specific due diligence and reporting requirements in connection with conflict minerals. In a group of companies, these import and processing quantities apply on a consolidated basis. If a company or group of companies exceeds the thresholds specified in Annex 1 of the DDTrO, they regularly have to assess, and document their assessment, whether the minerals and metals originate from conflict-affected or high-risk areas.[1] If they do not, companies are exempt from the due diligence and reporting obligations.

With regard to due diligence and reporting requirements in connection with child labour, the DDTrO provides for exemptions for small- and medium-sized enterprises (SMEs) that fall below two of the following thresholds in two consecutive years: balance sheet total of CHF 20 million, sales of CHF 40 million, 250 full-time employees. The requirements also do not apply, if companies document that the countries from which they source products or services have low child labour risks. Low risk is assumed, if the UNICEF Children's Rights in the Workplace Index rates the country as "basic". All other companies with a registered office, central administration or principle place of business have to assess, and document their assessment internally, whether there are reasonable grounds to suspect that child labour was involved in their supply chain. If there are no such grounds, companies are exempt from the due diligence and reporting obligations. However, if a company offers products or services that are obviously produced or provided using child labour, the above specific exemptions in the area of child labor do not apply.

What are the new specific due diligence requirements in the area of conflict minerals and child labour?

According to new Article 964k of the Swiss Code of Obligations, affected companies are obliged to implement a "management system" that, among others, includes policies and processes, including effective due diligence and tracing processes, addressing risks across the supply chain related to the sourcing of conflict minerals and metals or the involvement of child labour.

Articles 10 and 11 of the DDTrO specify the requirements for supply chain policies, referring, for example, to the following obligations:

- Establish internal documentation of the commitment to comply with the supply chain policy whenever the company procures minerals and metals from conflict-affected and high-risk areas or processes products or services that are reasonably suspected to have been produced or provided using child labour.
- Establish unambiguous and up-to-date communication of its supply chain policy to the public and suppliers (including its integration into supply contracts).

- Establish a point of contact for reporting concerns (early warning system).
- Take appropriate measures to identify, assess, eliminate or mitigate adverse impacts, which may include tools such as on-site inspections, information from public authorities, international organisations and civil society, consulting experts and specialist literature, obtain assurances from business partners, or use recognised standards and certification systems.

The supply chain policy has to be based on the above internationally recognized standards as listed in Annex 2 of the DDTrO. This does not mean that the companies have to follow each letter of these standards; rather, they are meant to serve as general guidance.

Articles 12 and 13 of the DDTrO provide further details on what information has to be included and documented in the required traceability system. The information listed there must be documented in writing and be accompanied by supporting evidence. If a company demonstrates that it imports or processes metals that originate exclusively from recycling, the due diligence obligations pursuant to Articles 14 to 16 of the DDTrO (reporting procedure, risk management and review of the report by an auditing company) do not apply.

According to Article 15 of the DDTrO, companies have to specify and assess the risks they have identified based on the aforementioned supply chain policy and traceability system in a risk management plan. The assessment has to take into account the likelihood of occurrence and the severity of the adverse impacts. Companies have to use the standards set out in Annex 2 of the DDTrO as a guideline for their risk management.

Based on their risk management plan, companies have to take measures to eliminate, prevent or minimize the risks identified in their supply chains in the areas of conflict minerals and child labor. Following the risk-based approach, the elimination, prevention or minimization is performed according to the likelihood of occurrence and the severity of the potential impact. With regard to minerals and metals, companies should take the measures listed in the OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas and its Annex III. With regard to child labor, the measures should follow the standards set out in Annex 2 Part B of the DDTrO, in particular the ILO-IOE Child Labour Guidance Tool for Business. Companies must regularly review the effectiveness of the measures they have taken, at least once a year.

As outlined in our previous Client Alert, affected companies have to publish a report on their compliance with these due diligence measures once a year within six months of the end of the financial year. The report in relation to conflict minerals has to be audited by an audit firm licensed as an audit expert. Companies that are required to prepare consolidated financial statements must prepare a consolidated report where companies covered by that report are exempt from their otherwise existing reporting obligation. Furthermore, companies that are controlled by a legal entity registered abroad that prepare an equivalent report, do not have to prepare a separate report. These companies have to indicate in the notes to their financial statements the legal entity in whose report they are included, and publish this report.

What are some of the important international developments that matter most for Swiss companies doing business abroad?

In addition to these developments in Switzerland, there have been important international developments that are relevant for Swiss multinational companies. In the international context, we have seen a trend where ESG legislation has been moving increasingly away from pure reporting obligations toward mandatory due diligence requirements.

On 23 February 2022, the European Commission adopted a proposal for a Directive on Corporate Sustainability Due Diligence. The European Commission proposes that the Directive will be applicable for (i) large EU companies with more than 500 employees and a net worldwide turnover of more than EUR 150 million; and (ii) EU companies with more than 250 employees and a net worldwide turnover of more than EUR 40 million, provided that at least 50% of this net turnover was generated in a "high-impact" sector (which includes the manufacturing and wholesale trading of textiles, clothing and footwear, agriculture, forestry, fishery, the manufacturing of food products and the wholesale trade of live animals, wood and food products, the extraction of mineral resources, the manufacture of metal products and the wholesale trade of such resources and products). Furthermore, the Directive will also apply to non-EU companies, including Swiss companies, provided that such companies meet the thresholds and requirements mentioned under (i) or (ii) above within the EU.

The draft Directive includes an obligation for companies to identify and, where necessary, prevent, end or mitigate actual and potential adverse human rights impacts and adverse environmental impacts arising from their own operations or those of their subsidiaries and, where related to their value chains, from their established business relationships. If the affected companies do not comply with their obligations, the supervisory authorities set up by the EU member states will sanction them. In addition, the proposal also provides for civil liability for damages that could have been avoided with appropriate due diligence measures. The draft Directive will now be presented to the European Parliament and the Council for approval. Once adopted, the EU member states will have two years to transpose the Directive into national law. More information on the EU Commission's proposal can be found in the Client Alert of our EU colleagues.

Germany has already charged ahead and adopted a far-reaching Act on Due Diligence in Supply Chains (Lieferkettengesetz). Under the German Supply Chain Act, which will enter into force for German companies with at least 3,000 employees from 1 January 2023 and for companies with at least 1,000 employees from 1 January 2024, companies have to identify risks of human rights and environmental law violations within their supply chain, take preventive and corrective measures and document and report their compliance with the due diligence obligations. The requirements under the German Supply Chain Act go well beyond the requirements under the new ESG legislation in Switzerland. For instance:

- The affected companies have to implement measures to identify and minimize risks to people and the environment (with regard to not only conflict minerals and child labour).
- The companies have to determine who is responsible for monitoring risk management within the company (e.g., by naming a human rights officer).
- The companies have to implement prevention measures not only in their own business operation but also for their direct suppliers.

For further detail, we refer to a Client Alert prepared by our German partner Anahita Thoms. Upon request, we will also be happy to share a detailed synopsis of the requirements under the German Supply Chain Act.

The ESG due diligence and reporting landscape is also evolving outside of Europe. For example, a new law is currently being debated in the State of New York that would require fashion retail sellers and manufacturers doing business in New York to map suppliers across all tiers of production, publish an impact and due diligence disclosure and disclose its targets for improvement. Furthermore, there have also been several bills introduced in the U.S. Congress related to ESG due diligence, reporting and disclosure; and, recently, the U.S. Securities and Exchange Commission released its long-awaited proposed rule changes that will require listed companies to disclose climate-related risks that are reasonably likely to have a material impact on the registrant. For more information on this, see the respective Client Alert of our U.S. colleagues.

To summarize, in addition to the laws and regulations already in force[2], numerous legislative efforts are underway that will increase the accountability of businesses for violations of human rights or negative environmental impact related to their activities.

To stay up to date on these new developments, we encourage you to follow our Global Supply Chain Compliance Blog offering legal insights from practitioners around the globe. Even though the German and other non-Swiss legislations may not directly apply to companies based in Switzerland, Swiss companies may still be affected by the new foreign due diligence and reporting requirements through their local subsidiaries in the jurisdictions with new requirements or if they offer goods or services in these countries or supply goods to companies there.

What should senior leadership consider as the ESG reporting, disclosure and due diligence framework is taking shape?

What we suggested in our Client Alert in December 2020 remains valid, although we would emphasize again the importance of a review and, if required, amendment of your company's third party intermediary due diligence framework to account for ESG risk factors. In addition, we would suggest that senior leadership considers the following:

- As the ESG reporting and disclosure framework is emerging, **develop an integrated ESG reporting strategy** as opposed to an opportunistic response to individual requirements that enter into force over time. This will increase efficiencies and mitigate the risk of inconsistencies.
- Although the 'ESG reputation' of companies has become increasingly important to success in the market place and is used as a differentiator to gain market share, **resist the temptation to use ESG reporting as a branding and marketing tool**. ESG-related enforcement activity and litigation is on the rise and, therefore, restraint and precision in your reporting supported by solid assurance mechanisms is key to avoid future exposure to liability for misleading, unsupported or downright inaccurate disclosure. This imperative should inform governance and processes around ESG reporting with the marketing and branding departments taking a back seat.

Baker McKenzie.

- Given that financial institutions are subject to their own ever increasing risk assessment and reporting requirements, and drive their own ESG agendas, **engage with your lenders and other financial sponsors** to anticipate their requirements well ahead of your funding needs.
- We have historically seen (and still do so today) the risk of assuming potentially damaging legacies buried in M&A targets in more 'traditional' areas of compliance, such as ABC, sanctions, etc. Today, you should **adjust the scope of your due diligence in M&A** to avoid successor liability in the area of ESG compliance across the supply chain of your targets, and their previous ESG disclosures.
- As, in addition to the reporting obligations, increasingly stringent diligence requirements are being made into law, review your business processes, policy and control environment to **identify opportunities to embed new requirements into your existing processes and compliance program**, or to put in place additional processes, policies and controls where required.

---

[1] Conflict-affected and high-risk areas means areas in a state of armed conflict or fragile post-conflict, and areas witnessing weak or non-existent governance and security, such as failed states, and in which there are widespread and systematic violations of international law, including human rights abuses (cf. https://www.cahraslist.net/cahras for an indicative, non-exhaustive list of conflict-affected and high-risk areas).

[2] For example, the German Supply Chain Act, the UK Modern Slavery Act, the Dutch Law on Child Labour (Wet Zorgplicht Kinderarbeid), the French law on vigilance obligations (Loi de vigilance), the Norwegian Law on Transparancy (Lov om virksomheters åpenhet og arbeid med grunnleggende menneskerettigheter og anstendige arbeidsforhold), the Italian changes in corporate liability law, the Australian Commonwealth Modern Slavery Act, the US Trade Facilitation and Trade Enforcement Act or the Californian Transparency in Supply Chains Act.

Contact Us

Christoph Kurth
Partner
Zurich
christoph.kurth
@bakermckenzie.com

Philippe Reich
Partner
Zurich
philippe.reich
@bakermckenzie.com

Corinne Nacht
Associate
Zurich
corinne.nacht
@bakermckenzie.com