



Harmonization of Non-financial Reporting and Supply Chain Due Diligence

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Key Take-aways

- 1.** Rejection of the Responsible Business Initiative paved the way for the Counterproject adopted by the Swiss Parliament to become effective subject to a 100-day referendum period.
- 2.** The Counterproject introduces reporting obligations for large, public interest companies on environmental and social matters that mirror the regime prevailing in the EU.
- 3.** The Counterproject further introduces supply chain due diligence obligations regarding conflict materials and child labor. These will apply to some of the most important industries in Switzerland.

On November 29, 2020, the popular initiative "For responsible businesses – protecting human rights and the environment" was rejected. The initiative however ignited – or at least accelerated – harmonization efforts with international standards on non-financial reporting and supply chain due diligence. In light of the considerable weight given to ESG by the market and stakeholders, it is an important development for Swiss companies.

Rejection of the popular initiative paved the way for the Counterproject adopted by the Swiss Parliament on June 19, 2020 to become effective. However, before that happens, the Counterproject is subject to a 100-day referendum period. That period will start as soon as the final text of the Counterproject is published in the Federal Gazette (expected at some point in January).

Non-financial reporting and supply chain due diligence are highly technical areas, translating into voluminous and fast changing implementing regulation and guidance in the European Union – a reflection of investors, governments, and stakeholders' intense scrutiny over the impact of companies on the environment and social issues. We expect similarly important implementing regulation in Switzerland.

On December 11, 2020, the Swiss government announced that it would prepare binding implementation of the recommendations of the Task Force on Climate-related Financial Disclosure ("TCFD") by Swiss companies in all sectors of the economy. TCFD recommendations are concerned with how companies deal with climate risks in the areas of governance, strategy, and risk management, as well as reporting on key performance indicators (or "KPIs").

Public and private companies affected by the Counterproject are advised to start work on aligning with the new rules early on and monitor closely implementing regulation, including in light of their existing obligations in other jurisdictions. In this briefing, we provide an overview of the key features of the Counterproject.

1 Non-financial reporting

In the EU, since January 1, 2017, large public interest entities¹ are required to report on non-financial matters, including environmental, social and employee matters, respect for human rights, anti-corruption and bribery matters.²

To flesh out these requirements, the EU commission issued guidance in 2017 on key principles underpinning non-financial disclosure, with examples of KPIs and types of specific disclosure, and in 2019 on climate change reporting, proposing climate-related disclosure for each of the reporting areas, using a similar structure to the TCFD recommendations.

The Counterproject mirrors EU law by introducing non-financial reporting obligations into the Swiss Code of Obligations:

- Similarly to EU law, the new provisions are concerned with **large firms of "public interest"**. These include companies that have equity securities listed on a stock exchange or have bonds outstanding, as well as certain entities subject to the Swiss

FINMA's supervision. These "public interest" companies will only be subject to the new non-financial reporting if, during two consecutive financial years, they meet or exceed, on a consolidated basis, a number of 500 full-time employees on a yearly average and a balance sheet total of CHF 20 million or revenue of CHF 40 million. Companies that are controlled by a company that is subject to the non-financial reporting obligation and companies that are already subject to an equivalent form of control in another country (such as the EU directive) will be exempted from this obligation.

- Companies that fall within the scope of the new regime will have to publish yearly reports on non-financial matters, which are listed as **environmental** (especially in terms of CO₂ objectives), **social and employee matters**, **respect for human rights and fight against corruption matters**. The report will have to extend to all Swiss and foreign companies controlled, in whole or jointly, by the reporting company.
- Non-financial disclosure will be required to report on the **business model** of the company, its **policies and due diligence procedures**, the **measures** taken in application of these policies and the **evaluation system to assess the efficiency** of these measures, the **principal risks** in relation to non-financial matters, whether arising from the company's own operations or, when relevant and proportionate, those arising from the company's business relationships, products or services, as well as **KPIs** that are relevant to the particular business.
- If companies base their reports on national, European or international regulations (such as the OECD guidelines for multinational enterprises), such regulation will have to be expressly specified in the report and companies will have to ensure that Swiss law requirements are covered by the regulation used or include supplementary information.
- The report on non-financial questions will have to be approved and signed by the board of directors and submitted to the general meeting for approval. The board of directors will then be required to ensure that the report be published electronically immediately after its approval and remain accessible to the public for ten years after its publication.

¹ In broad terms, "large public interest entities" are EU-incorporated companies with securities admitted to trading on an EU regulated market and credit/insurance institutions, in each case with more than 500 employees and a balance sheet of more than EUR 20 million or net turnover of more than EUR 40 million.

² See EU Directive 2014/95/EU.

It is important to note that the EU regime is about to be significantly beefed up by the so-called taxonomy regulation. That regulation will require large public interest entities to include additional standardized information on how and to what extent their activities are associated with environmentally sustainable economic activities. It will start to come into effect on January 1, 2022 (insofar as climate change mitigation and climate change adaptation are concerned).

As potential harbinger for what may happen in Switzerland, in November 2020, the Chancellor of the Exchequer announced that the UK government intended to implement a new "green taxonomy" and thus to align with the EU.

Non-financial reporting obligation will mirror EU Law.

2 Conflict mineral and child labor due diligence

The EU Conflict Minerals Regulation (EU 2017/821) seeks to address the risks of financing armed groups and human rights abuses through sourcing and trading minerals from conflict-affected area. Its key requirements apply in the EU since January 1, 2021. Conflict minerals and their derivatives include the so-called "**3TG**" (tin / cassiterite, tantalum / coltan, and tungsten / wolframite) and **gold**. These metals are frequently used in automotive, electronics, aerospace, tooling, and jewelry, and so feature heavily in the most important industries in Switzerland.

The EU regulation applies to union importers, i.e., those who declare conflict minerals or metals for release for free circulation in the EU (or on whose behalf such a declaration is made), and smelters and refiners. Swiss groups in affected industries, whether public or private, are thus oftentimes already subject to that regulation.

Key obligations include (i) the establishment of a management system, (ii) risk management (assessing and managing risks in the supply chain, including consultation with stakeholders), (iii) third-party audit (to ensure credibility), and (iv) disclosure (to ensure necessary transparency and generate public confidence in the measures companies are taking).

The EU Regulation heavily refers to the OECD Due Diligence Guidance for responsible supply chains of minerals from conflict-affected and high-risk areas (initially adopted in December 2010). It has given rise to significant guidance, including the EU Commission recommendation (EU) 2018/1149 providing guidelines on the general concept of due diligence in supply chains and key principles for identifying conflict-affected and high-risk areas.

In Switzerland, the Counterproject is modelled on the

EU Regulation and extends the due diligence and transparency obligations to child labor as well. It currently consists of "bare bone" provisions to be embedded in the Swiss Code of Obligations but we expect that, if and when it becomes effective, it will be fleshed out by significant implementing regulation.

- The new set of due diligence and transparency rules will apply to **all companies** (and not only large public interest entities), whose seat, headquarters or main establishment is or are in Switzerland and that introduce into circulation in Switzerland or smelt, refine, etc., ores or metals containing one of the 3TG or gold originating from conflict zones or high-risk areas or that offer goods or services for which it can legitimately be suspected that child labor may have been involved.
- There will however be exceptions to the scope of application of the new rules. The Federal Council will have to define the **minimal threshold** for import of ores and metals from which companies will be subject to the due diligence and transparency rules. SMEs will also, under certain conditions, benefit from exemption if they present a low risk of child labor in their supply chain. Finally, companies already complying with an internationally recognized and equivalent regulation will also, under certain conditions, be exempt.
- If a company falls within the scope, it will first have **due diligence obligations**. These involve setting up a management system (laying out the company's policy relating to its supply chain, whether in relation to ores and metals potentially coming from conflict or high-risk areas or to suspicion of child labor, as well as a system to establish traceability of the supply chain) and a risk management plan allowing the company to identify and evaluate and manage or mitigate the risks of adverse effects in its supply chain.
- Both the management system and the risk management plan will be subject to an **independent audit**.
- In order to ensure transparency and a diligent set-up, in-scope companies will be required to publish a **report annually**. This report, which can be in English, will have to contain information relating to the implementation of their management system and risk management plan and thus compliance with their due diligence obligations. As in the case of non-financial disclosure, this report will have to be approved by the board of directors, be published electronically and remain accessible for ten years. It will however not be subject to the approval of the general meeting.

Conflict metals feature heavily in the most important industries in Switzerland.

3 Liability regime

The central focus of the popular initiative revolved around creating a new liability regime for multinational companies having their seat in Switzerland. A number of countries, such as France, in fact have introduced tougher liability regimes. The Counterproject does not follow that path.

The non-financial disclosure and transparency obligations outlined above, however, may give rise to criminal liability in the event of non-compliance. The new provisions introduced by the Counterproject will, if adopted, punish anyone giving wrong indications in the reports required to be published or breaching the obligations of keeping and documenting the reports with fines of up to CHF 100,000 (in case of willful breach) or CHF 50,000 (in case of negligent breach).

4 Conclusion

Given the environmental and social challenges facing our society, there is now a relentless focus on ESG. Underperforming companies may be subject to shareholder activism. Many Swiss companies already report on sustainability matters, including in stand-alone sustainability reports under the SIX opt-in regime. Given their footprint, Swiss companies are already well familiar with the numerous standards that may apply internationally to non-financial reporting and supply chains. There are however divergences and the rulebook is often refreshed. Swiss companies will have to quickly align with the new rules, if they become effective, on non-financial disclosure and supply chain due diligence and pay close attention to the implementing regulation that the Swiss government is likely to adopt.

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