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Editors:
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Insurance

Risk-Absorbing Capital Instruments under the Revised Insurance Regulations
By Hansjürg Appenzeller / Vanessa Isler 2

Securities

Listing and Trading of GDRs on the SIX Swiss Exchange by Chinese Companies under SER's revised Regulatory Framework
By Christian Schneiter 13

Transactions on carbon rights in Switzerland: Legislative landscape and perspectives
By François Rayroux / Delphine Meylan / Laure Prevignano 20

Regulatory

Corporate ESG Reporting
By Patrick Schärli 28

News | Deals & Cases

Spin-off and Listing of Accelleron Industries 36
Nestlé issued an aggregate of USD 4 bn notes 37
Finalization of Vifor Pharma acquisition by CSL Limited 37
Public tender offer for Bobst Group SA by its largest shareholder, JBF Finance SA 37
GDR offerings and listings on SIX Swiss Exchange 38
Zur Rose Group completes CHF 95 m Convertible Bonds and the CHF 44 m Capital Increase 38

Corporate ESG Reporting

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Over recent years ESG (environmental, social and governance) matters have increasingly become the focus of a wide-range of investors, and corporates are expected to comprehensively report on these type of topics. In line with this general development and on the back of the so-called "Responsible Business Initiative", Swiss corporate law has been amended over the recent years to provide for specific ESG-related due diligence obligations and reporting requirements. These reporting requirements will apply for most part for the first time for the 2023 financial year (with some of the rules already applying to the 2022 financial year). This article provides and overview of the Swiss corporate law ESG due diligence and reporting obligations.

By Patrick Schärli

1) Swiss Corporate Law Rules on ESG Due Diligence Obligations and Reporting

Until recently Swiss corporate law did not provide for a significant number of ESG-related requirements. In fact, ESG matters in Swiss corporate law were essentially limited to compensation-related disclosures under the Swiss "say on pay" regulations that apply exclusively to Swiss listed companies. Additionally, Swiss-listed companies are also subject to disclosure rules around governance matters under the SIX Swiss Exchange's directive on corporate governance. Already today, a good number of Swiss listed companies prepare sustainability reports on a voluntary basis.

With recent amendments to the Code of Obligations, things are about to change. On 1 January 2021 and 1 January 2022, respectively, new due diligence obligations and reporting requirements relating to ESG matters have entered into force and these new rules will apply for the first time for the 2023 financial year (with the

commodities-related transparency rules already applying for the 2022 financial year). These new rules cover a wide-range of topics, namely:

- Reporting on **non-financial matters**, which focuses on climate-related disclosures, but also requires disclosures on social issues and other topics (see paragraph 2 below).
- **Supply-chain due diligence and reporting** requirements aimed at the prevention of child labor and use of conflict minerals (see paragraph 3 below).
- **Transparency rules for commodities firms**, aiming to increase transparency on payments to government bodies (see paragraph 4 below).

Effective as of 1 January 2021, Swiss corporate law also requires large corporates to ensure that each gender is adequately represented in the board of directors and the executive board with the relevant representation quotas being 30% (board of directors) and 20% (executive board). Failure to comply with the gender representation quotas requires additional "comply or explain" type of disclosure. These gender representation rules are, however, subject to rather long transitional periods and apply for the first time for the 2026 financial year (with respect to the composition of the board of directors) and 2031 financial year (with respect to the composition of the executive board). Given these long transitional period, these gender representation requirements are not discussed further in this article.

2) Reporting on Non-Financial Matters

The reporting obligations on non-financial matters were introduced as part of a counterproposal to the failed "Responsible Business Initiative". With these new reporting obligations certain larger companies will have to report on a wide range of non-financial matters in the areas of environment, social responsibility and human rights. The Swiss rules generally follow similar regulations that apply in the European Union (in particular those laid out in the EU Directive 2014/95/EU (Non-Financial Reporting Directive)).

The Swiss non-financial reporting obligations apply only to so-called "companies of public interests". A "company of public interests" is a company that meets the following cumulative criteria:

- it is either (i) a listed company or (ii) a company subject to supervision by the Financial Markets Supervisory Authority FINMA (e.g. banks, securities firms, asset managers, insurance companies);
- it employs at least 500 FTE on average over the last two financial years (such number being calculated on a consolidated basis); and

- it exceeds at least one of the following financial threshold in two successive financial years: total assets of CHF 20 million or revenues of CHF 40 million. The financial thresholds have to be calculated on a consolidated basis.

Companies that are controlled by (i) another entity that is itself a "company of public interest" or (ii) by a company that prepares an equivalent non-financial matters report under applicable foreign law, are exempt from the Swiss reporting rules on non-financial matters.

Companies subject to the non-financial reporting obligations have to prepare a report on environmental matters (in particular with respect to CO_2 goals), social and employment aspects, human rights and anti-corruption. Such report has to include information on (i) the Company's business model, (ii) concepts that are followed, including with respect to due diligence measures, (iii) implementation measures and assessment of efficiency, (iv) description of risks and mitigation measures; and (v) the Company's key performance indicators (KPIs) for the subject matters.

With respect to climate-related reporting matters, the reporting obligations will be further specified in an implementing ordinance. Based on the initial draft of such ordinance, the climate-related reporting will have to be made on the basis of the principles of the Task Force on Climate-related Financial Disclosures (TCFD).

The yearly report on non-financial matters has to be approved by the Company's board of directors and must be submitted for approval to the Company's annual general meeting of shareholders. Moreover, the report has to be published online (on the Company's website) immediately following its approval, and needs to remain publicly accessible for at least ten years.

The reporting obligations on non-financial matters apply for the first time for the 2023 financial year of in-scope companies. Failure to comply with these new reporting obligations (no reporting or false information) may be sanctioned with fines of up to CHF 100,000 under the Criminal Code.

3) Supply Chain Due Diligence and Reporting

The supply chain due diligence obligations (and related reporting requirements) were also introduced as part of a counterproposal to the failed "Responsible Business Initiative". With these new due diligence and reporting obligations, the Swiss legislator aims to prevent child labor and the use of so-called conflicts materials. It does so by imposing on certain Swiss-based companies a wide range of supply chain due diligence obligations. These obligations apply to the companies that:

- have their registered seat, head office or principal place of business in Switzerland;
- engage either in (i) the placing in free circulation or processing in Switzerland minerals containing conflict minerals, or (ii) the offering products or services for which there is a reasonable suspicion regarding child labor; and
- cannot benefit from one or several exemptions from the supply chain due diligence obligations.

The new diligence obligations are regulated in detail in the Ordinance on Due Diligence and Transparency in relation to Minerals and Metals from Conflict-Affected Areas and Child Labor (DDTrO).

a) Due Diligence Obligations with respect to Child Labor

Not all Swiss companies have to review their supply chain for child labor related issues. Rather, the due diligence obligations with respect to child labor provide for two specific exemptions from the due diligence requirements. The below listed exemptions, are, however, not available if the company offers products or services that have evidently been produced or provided using child labor:

- **Small and medium enterprises (SME)**: Under the DDTrO, a SME is defined as a companies that, on a consolidated basis, do not exceed two of the following thresholds in two successive business years: (i) total assets of CHF 20 million, (ii) revenue of CHF 40 million, and (iii) 250 FTE on an annual average.
- Companies with a **low risk of child labor** are also exempt from the due diligence obligations. A low risk in relation to child labor can be assumed if a company operates only in countries whose due diligence response is rated as "basic" by UNICEF in its Children's Rights in the Workplace Index. For purposes of this analysis, the relevant countries are the countries in which the company (i) purchases or manufactures products (based on the indication of origin of the relevant products, i.e. limited to the "made in" country), or (ii) primarily procures or provides services.

  The relevant UNICEF index can be accessed online at https://www.childrensrightsatlas.org/country-data/workplace/. It is worth noting that, for example, the United States do not meet the criteria for the "low risk" exemption. The same is generally true for countries in Latin America, Africa and large parts of Asia.

  With respect to the exemption for low risk of child labor, the relevant company has to document how it reached the conclusion that there is only a low risk of child labor. This can be done, for example, by documenting the relevant countries (and its corresponding rating under the UNICEF index) in which it manufactures products or provides services or from which it purchases products and procures services.

Moreover, it is recommended that exempted companies regularly review whether the risk ratings and list of relevant countries is still up to date (the explanatory report to the DDTrO sets forth an expectation that such review is performed at least on an annual basis).

If a company falls within one of the above exemptions, it is exempt from the due diligence and reporting obligations with respect to child labor.

Companies that are not per se exempted (i.e. they are not an SME or they do not have a low risk of child labor) are required to assess if there are reasonable grounds to suspect child labor in supply chain. Under the DDTrO, supply chain is defined as the company's own operations and business activities as well as those of the company's direct and indirect suppliers. If, based on the company's assessment, there are no reasonable grounds to suspect child labor, it has to document such finding in writing and it is then exempt from the due diligence and reporting obligations. While the relevant Swiss corporate law provisions and the DDTrO do not further specify what this initial assessment should encompass, the explanatory report to the DDTrO states that such initial assessment should be made by using the same tools as those for the regular supply chain diligence (i.e. site visits, use of certifications and international standards, representations from suppliers, or review of expert reports). The mere fact that a company has business activities or parts of its supply chain in a "at-risk country" is not in itself sufficient for establishing "reasonable grounds" to suspect child labor.

All other companies, i.e. companies that are not per se exempted and companies that have reasonable grounds for suspecting child labor in its supply chain, are required to comply with the supply chain due diligence and reporting obligations. Under these obligations, companies need to maintain a risk management system with a supply chain policy for products or services in relation to which there is a reasonable suspicion of child labor; and a system by which the supply chain can be traced. These companies are required to (i) identify and assess the risks of harmful impacts in their supply chain, (ii) draw up a risk management plan (with a risk-based approach), and (iii) take measures to minimize the identified risks, including, for example, site visits, use of certifications and international standards, or representations from suppliers. Moreover, companies have to maintain an internal system for reporting issues.

Companies that are obligated to comply with the Swiss supply chain due diligence and reporting requirements, can forego compliance with the specific Swiss rules if they already comply with an equivalent non-Swiss set of rules. The DDTrO sets out those non-Swiss rules that are currently considered equivalent, namely (i) ILO Conventions Nos 1389 and 18210 and the ILO-IOE Child Labour Guidance Tool for Business of 15 December 2015, and (ii) the OECD Due Diligence Guidance for Responsible Business of 30 May 2018 or the UN Guiding Principles on Business and Human Rights.

b) Due Diligence Obligations with respect to Conflict Minerals

Companies that are placing in free circulation or processing in Switzerland minerals containing tin, tantalum, tungsten or gold or metals from conflict-affected and high-risk areas, are required also required to put in place a risk management system, a supply chain policy with respect to minerals and metals that potentially originate from conflict-affected and high-risk areas, and a system by which the supply chain can be traced. Similar to the supply chain diligence obligations with respect to child labor, these companies are required to (i) identify and assess the risks of harmful impacts in their supply chain, (ii) draw up a risk management plan (with a risk-based approach), and (iii) take measures to minimize the identified risks, including, for example, site visits, use of certifications and international standards, or representations from suppliers. Moreover, companies have to maintain an internal system for reporting issues with respect to conflict minerals and metals.

The DDTrO specifies the relevant types of metals and minerals (and compounds thereof) in its Annex 1. The DDTrO defines "conflict-affected and high risk areas" as areas in a state of armed conflict or fragile post-conflict as well as 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.

Unlike the child labor related due diligence obligations (see paragraph 3a) above), the due diligence obligations with respect to conflict minerals do not provide for an SME exemption. However, the conflict minerals rules provide for a de minimis exemption for those companies that only import or process smaller amounts of the relevant minerals and metals. The thresholds for the de minimis exemption are set out in Annex 1 of the DDTrO.

Companies that are obligated to comply with the Swiss conflict minerals related supply chain due diligence and reporting requirements, can forego compliance with the specific Swiss rules if they already comply with an equivalent non-Swiss set of rules. The DDTrO sets out those non-Swiss rules that are currently considered equivalent, namely (i) the OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict and High-Risk Areas (OECD Conflict Minerals Guidance), dated April 2016, including all annexes and supplements; or (ii) Regulation (EU) 2017/821.

c) Reporting and Audit Requirements / Entry into Force / Criminal Sanction

Affected companies have to report (on a "comply or explain" basis) on their compliance with the diligence obligations in a separate report, which has to be approved by the board of directors (but not by the annual general meeting of shareholders). Such report has to be prepared in a Swiss national language or in English. The report has to be

published online within six months of the end of the financial year and it must remain publicly accessible for at least ten years.

As regards the due diligence obligations for conflict minerals, the new Swiss corporate law rules also require that compliance with these rules is verified by an independent auditor.

The supply chain due diligence obligations and related reporting requirements apply for the first time for the 2023 financial year of in-scope companies. Failure to comply with these obligations may be sanctioned with fines of up to CHF 100,000 under the Criminal Code.

4) Transparency Rules for Commodities Companies

With these new rules for commodities companies, the Swiss legislator aims to increase transparency around payments to government bodies in connection with the exploitation of commodities. These transparency rules apply to Swiss-based companies that meet the following criteria:

- they are subject to ordinary audit requirements, i.e. they are either (i) public companies, or (ii) they exceed two of the following thresholds: (a) total assets of more than CHF 20 million, (b) sales of more than CHF 40 million, or (c) more than 250 FTE; and
- they are either themselves or through a company that they control active in the area of extracting minerals, oil or natural gas, or in the harvesting of timber in primary forests.

While the transparency rules aims to cover companies that are active in any type of activity leading up to the actual extraction or harvesting of commodities, including exploration, prospecting, discovery, or development of an extraction sites, the transparency rules do not apply to commodities trading companies. As a result, the Swiss transparency rules currently only cover a fairly small number of companies, namely Swiss-based commodities groups that have subsidiaries engaged in extraction or harvesting of commodities.

In-scope companies have to prepare a so-called payments report. Such report has to disclose any payments (cash or in kind) in excess of CHF 100,000 per year that have been made to state bodies (i.e. national, regional or local authorities in a third country, including departments and businesses controlled by such authorities) in connection with business operations in the mineral, petroleum or natural gas extraction industry or to the harvesting of timber in primary forests. Such report has to include in particular the following type of payments:

- payments for production rights;
- taxes on production, revenues or profits (other than value added, sales taxes or similar taxes on consumption);
- user charges;
- dividends (other than dividends paid to shareholders in general);
- signing, discovery and production bonuses;
- license, rental and access fees or other considerations for permits or concessions; and
- payments for improvements to the infrastructure.

The payments report has to be drawn up on a consolidated basis. If the relevant Swiss-based company is part of a larger group of companies that has prepared its own consolidated payments report (which covers also the Swiss company) and further provided such report is drawn-up in accordance with Swiss law or an equivalent regulation, then such Swiss-based company is exempt from preparing and publishing its own report. In such a scenario, the Swiss-based company will, however, have to include information on such report (including indications as to where it is published) in the notes to its own financial statements.

The payments report must be prepared in a Swiss national language or in English and has to be approved by the board of directors (or similar body), but not by the shareholders' meeting. The payments report has to be published online within six months of the end of the financial year and it must remain publicly accessible for at least ten years.

The transparency rules for commodities companies entered into force already on 1 January 2021 and they apply for the first time for the current 2022 financial year of in-scope companies. Should internationally coordinated developments in the future result in further transparency expectations for the commodities sector, the Federal Council may then decide to expand the scope of the Swiss transparency rules to encompass also other companies, e.g. commodities trading businesses.

Failure to comply with these transparency and reporting obligations may be sanctioned with fines under the Criminal Code.

5) Conclusion

With the amendments on ESG-related matters, Swiss corporate law now provides for a set of rules requiring reporting and other obligations on a number of different ESG

matters. While large corporates with an international investor base already nowadays report on many of these matters on either a voluntary basis or due to applicable non-Swiss regulations, the new Swiss corporate law disclosures will require also smaller public companies to expand their reporting (and implement the related internal measurement processes and procedures) rather significantly in order to comply with these new rules.

Some of the new ESG-related requirements will also apply to non-listed companies (in particular those related to supply chain due diligence obligations and reporting requirements) and thus, Swiss-based companies should carefully assess whether or not they are in scope of one or several of the new Swiss corporate law rules on ESG matters, not at least in view of possible criminal sanctions in case of non-compliance.

Finally, while the corporate law rules on ESG reporting have only recently introduced, it is worth noting that the Swiss system on corporate ESG disclosure is still developing. It is likely that the future will hold further regulations on ESG disclosure that may both broaden the scope of in-scope companies and provide further standardization on the type and level of detail of this type of disclosure.

Patrick Schärli (patrick.schaerli@lenzstaehelin.com)