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A Brief Overview On The Impact Of The European Directive CsrD On Swiss Companies

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A BRIEF OVERVIEW ON THE IMPACT OF THE EUROPEAN DIRECTIVE CSRD ON SWISS COMPANIES



On 28 November 2022, the European Commission (« EC ») approved the final text of the Corporate Sustainability Reporting Directive (« CSRD »), published on 16 December in the European Union (« EU ») official journal. This Directive builds on the Non-Financial Reporting Directive (« NFRD ») which required reporting on environmental and diverse social matters and expands (i) the scope of the covered entities as well as (ii) their reporting requirements. The novelty of the European legislation is that it caught non-EU Companies operating in the EU if they meet certain thresholds.

The ambition of this article is to provide an overview of questions Swiss Companies may have to think about, even to anticipate, to comply with these requirements within the timeframe designed in the text.

1) Which non-EU Companies will be in the scope of the CSRD ?

The scope of the CSRD covers EU large undertakings, defined as undertakings that meet at least two of the following criteria on their balance sheet:

- Greater than EUR 20 million balance sheet total;
- Greater than EUR 40 million net turnover;
- Greater than 250 employees (FTE).

Non-EU Companies generating a turnover of more than EUR 150 million in the EU for each of the last two consecutive financial years if at least one European subsidiary is large or listed or at least, one EU branch generates more than EUR 40 million in the EU.

Nevertheless, subsidiaries of a non-EU Company are exempt from disclosing information if:

- i. The parent reports under **European Sustainability Reporting Standards** (« ESRS ») drafted by the European Financial Reporting Advisory Group (« EFRAG ») or standards that the EC deems to be equivalent and
- ii. The assurance statement or a conclusion on the sustainability reporting is publicly available

2) What time frame ?

The EU subsidiaries will have to comply with the new sustainability reporting obligation as early as:

- 2025 if they have a large company status and a stock-listing on an EU-regulated market
- 2026 if they have a large company status and no such stock listing
- 2029 if the non-EU company has a net turnover within the EU above EUR 150 million for two consecutive financial year and if they have one subsidiary (which is large or public) or a branch generating in the EU EUR 40 million net turn over in the preceding financial year. 2027 and 2028

are the two financial years which will trigger the application of the Directive in this case.

3) What are the expected disclosures?

All Large Companies and Listed SMEs are required to report according to the concept of double materiality both on (1) how their business model impacts Sustainability Matters (“inside-out perspective”) and (2) how Sustainability Matters influence their undertaking’s development, performance, and position (“outside-in perspective »).

This information must be presented in a dedicated section of the management report and must cover, sustainability disclosures of key topic areas, including environmental and social factors. Among others, the following aspects with regards to both the company’s own operations and its value chain must be disclosed:

- Description of the business model and strategy and to what extent it is compatible with the transition to a sustainable economy and with the limiting of global warming to 1,5°C in line with the Paris Agreement.
- How the company’s business model and strategy consider the interests of the undertaking’s stakeholders and of the impacts of the undertaking on Sustainability Matters.
- A description of the time-bound targets related to Sustainability Matters set by the company.
- A description of the due diligence process implemented by the company with regard to Sustainability Matters, and, where applicable, in line with requirements of the EU on undertakings to conduct a due diligence process.
- A description of the management and of the principal risks to the company related to Sustainability Matters.

Reporting companies will therefore be required to report information on the material impacts, risks, and opportunities regarding the covered company through its relationships in the upstream and/or downstream value chain.

This extension of reporting requirements to include the broader value chain is a true key point as it will lead to potentially significant ESG data requests of companies that are themselves not within the scope of the CSRD, typically non-EU SME’s. This will likely extend to entities in the value chain of in-scope entities that have no business operations within the EU at all, such as Swiss Companies. In this regard, Companies should disclose any actions taken to prevent, mitigate, remediate or end actual or potential adverse effects. Therefore, Companies will therefore need to engage with their value chains including suppliers (the scope of which will certainly need to be defined at some point). However, a transition period of three years will allow companies which could not provide the value chain information to explain their inability to provide such information rather than comply.

4) Which standard of reporting are expected ?

While the CSRD itself describes the high-level reporting requirements that applies to companies, the specific information that is to be reported will be described in a number of ESRS to be adopted by the European Commission over the coming years.

Otherwise, considerable discretion as to the content of the ESRS is left to the Commission. The first core

set is due to be finalized by 30 June 2023. The EFRAG has produced 12 ESRS in the first set of drafts. These ESRS consist of two “cross-cutting” ESRS, and 10 sector-agnostic “topical” ESRS, which themselves consist of five environmental ESRS, four social ESRS, and one governance ESRS. A second set is due by 30 June 2024.

It is interesting to put these standards in perspective with other initiatives and to note that for several years, Europe, through the NFRD and then the CSRD, has been pushing other initiatives to accelerate towards standardization of sustainability information and to ask how companies will navigate through this.

In the United States, the Securities and Exchange Commission (SEC) published draft rules in April 2022 on climate-related information to be published in registration documents for listed companies. It is also considering human capital-related information.

The IFRS Foundation, for its part, decided in 2021 to create the International Sustainability Standard Board (ISSB), a second leg alongside the IASB. The ISSB is expected to finalize two draft standards on sustainability disclosures in 2023: one on general rules and one on climate. The scope is therefore limited at this stage in relation to the ESRS and these two draft standards resulting from a private initiative will have to be adopted by jurisdictions in order to be applied, bearing in mind that Europe and the United States have already chosen to develop their own standards for reasons of sovereignty on subjects that affect public policy. This would also include 77 industry-standard and this set of rules should be that they interlink with IFRS and other applicable standards like US GAAP.

In this context, interoperability between these different standards is an important issue to reduce the reporting burden of global companies. The three climate initiatives are inspired by the Taskforce on Climate Related Financial Disclosures (TCFD) and are therefore relatively convergent.

The CSRD and the ESRS are nevertheless more ambitious by definition: firstly because they already cover all ESG issues as well as material information for the company and for society and the environment, whereas the ISSB and the SEC are only interested in the financial materiality (for investors) of the climate; secondly, because Europe is seeking to combat greenwashing by strengthening the comparability, reliability and auditability of ESG information. In doing so, it tends to be naturally more granular and more precise in its requirements. For all these reasons, Europe’s objective would be to be able to get a European company that meets the ESRS requirements to be recognized as complying with the transparency requirements of the SEC and the ISSB.

5) The Assurance in the CSRD Reporting

A key aspect of CSRD reporting is the requirement that it be assured by an independent third party. From 2025, an independent third party must provide limited assurance as to the compliance of an in scope entity’s reporting with the requirements of the CSRD (including the ESRS), the process carried out by the entity to identify the information reported according to the ESRS, and certain other issues. The CSRD empowers the Commission to adopt, by means of delegated acts, specific assurance standards in relation to the CSRD. Moreover, until the EU adopts such standards, Member States may apply national assurance standards, procedures, or requirements.

6) Point of attention :

Member states have 18 months to implement the directive into national legislation. This process will be crucial for companies with subsidiaries in multiple EU Member States to observe, as national governments have the ability to “gold plate” EU legislation when adopting it into their own legal system. Indeed, national legislation could render the EU requirements stricter, such as bringing forward the timeline, or lowering the thresholds at which companies are in the scope of the law. Such actions could have significant impacts and will be a key area to monitor throughout 2023.

7) What steps should Swiss Companies take ?

The first step to take is unquestionably the mapping of which and when entities will be caught by the CSRD. Aware of the deadlines, companies will have to carry out a gap analysis to identify what processes or information and data flow should be adjusted or put in place.

Based on this analysis, they will be able to implement new internal processes and responsibilities.

Finally, considering the specific rules applicable to non-EU entities, foreign companies will focus on analyzing the equivalence of the reporting standards of the parent companies compared to the CSRD and EFRAG standards.

8) What impact of the differences between the CSRD and the swiss law ?

From a Swiss point of view, it is interesting to analyze the differences between the directive and the Swiss law to determine the discrepancies between these two sets of law to which certain Swiss groups will have to comply with. These discrepancies could involve some risks and some competitive disadvantages.

First of all, Swiss listed companies will mainly be caught by the directive, already caught by the Code des obligations (art. 964a to 964c CO). The main differences with regard to Swiss law have been highlighted by the Report of the Swiss Department of Justice (dated 25 November 2022) :

The scope of companies is extended with an average of 250 or more employees per financial year.

The principle of “double materiality” is fully applicable (sustainability and environmental impacts of the company’s activity in terms of sustainability and the impact of sustainability issues on the company).

Then, the approach “complex or explain” is definitely eliminated.

This is important to note that Companies will have to provide comprehensive, prospective, and retrospective, qualitative and quantitative information, covering the short, medium and long term and the entire value chain, knowing that this information will have to be compliant with the Commission’s standards for sustainability reporting.

To be complete, the sustainability reporting will be audited in the annual report by a statutory auditor or an independent audit firm meeting the required requirements.

Finally, in case of non-respect of these provisions, extended sanctions could apply, including a public statement of the identity of the person responsible and the nature of the breach.

Even if most of the Swiss SME's won't be covered directly by the directive, given the thresholds, they would be indirectly covered as sub-contractors of covered entities and consequently will have to publish in a simplified way, sustainability information to the extent that the covered entities will have to disclose information regarding the whole value chain.

This could lead to competitive disadvantages for Swiss SME's compare to EU's SME's given that the European companies will benefit from support the European Commission is currently designing. Moreover, the Member states shall provide technical support, may provide financial support to facilitate adaptation. It is worth noting that the proposal will contain provisions to protect SMEs from excessive requirements from large companies.

Finally, the report concludes that if the Swiss law is less strict than the EU law, a detailed analysis of the involvement of the EU law on the Swiss law and on its undertakings would be useful as well as monitoring the international evolutions to adapt the analysis.

At this stage, no decision to adapt the Swiss law has been taken on a political level.

This is though not the end of the story... as the Council of the European Union adopted his last position on the CSDDD, Corporate sustainability due diligence directive in December 2022. Once again, The Directive will also apply to non-EU companies active in the EU with a turnover threshold aligned with the above, generated in the EU. SMEs do not fall under the scope of the Directive. Nevertheless, they might be indirectly affected by the new rules as a result of the value chain's requirements. An anticipated look to the human rights and environmental due diligence requirements contained in the draft EU Directive on Corporate Sustainability Due Diligence which are indicative of emerging regulatory and stakeholder expectations will probably worth it.

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