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ILLUSTRATION OF THE NEW NON-FINANCIAL REPORTING REQUIREMENTS FOR SWISS COMPANIES

Extraterritorial reach of international regulations expands non-financial reporting

Regulators worldwide are responding to the increased focus on sustainability by introducing non-financial reporting requirements. The examples in this article show that the upcoming regulations are far-reaching and will increase non-financial reporting requirements for certain Swiss companies.

1. INTRODUCTION

The Swiss Parliament has enacted new reporting, transparency and due diligence obligations, which came into force in 2022. Art. 964*a–c* of the Swiss Code of Obligations (CO) relates to reporting obligations for environmental, social and governance (ESG) matters for large Swiss public interest entities (PIEs) [1]. These obligations begin to apply in calendar year 2023, with the reporting requirement commencing in 2024. To ensure future consistency and comparability of this reporting, companies are encouraged to apply the disclosure requirements of the Task Force on Climate-related Financial Disclosures (TCFD) to their reporting on environmental matters with effect from calendar year 2024.

New sustainability reporting requirements in the European Union (EU) have significant extraterritorial reach and are set to fundamentally change the reporting landscape. In November 2022, the European Council and the European Parliament approved the final text of the Corporate Sustainability Reporting Directive (CSRD), which will require sustainability reporting and assurance far beyond what most companies provide today and is more extensive than the CO reporting requirements. The CSRD captures all companies with significant operations in the EU, including non-listed Swiss companies with as few as one subsidiary or branch in the EU. The requirements will become effective in stages, starting on 1 January 2024 and continuing until 1 January 2028.

Furthermore, the IFRS Foundation's International Sustainability Standards Board (ISSB) is responsible for developing the IFRS Sustainability Disclosure Standards, which provide a global baseline for sustainability disclosures. The ISSB has international political support, and is backed by the G7, the G20, the International Organization of Securities Commissions (IOSCO) and the Financial Stability Board, as well as finance ministers and central bank governors from more than 40 jurisdictions. Its adoption in Switzerland depends on whether the ISSB Standards are mandated by the local laws and regulations.

The U.S. Securities and Exchange Commission (SEC) has also proposed rule changes that would require registrants to include certain climate-related disclosures in their registration statements and periodic reports, including information about climate-related risks and certain climate-related financial statement metrics in a note of the audited financial statements.

It may be a challenge for Swiss companies to identify which regulations will apply, and when. This publication describes the emerging landscape for standardised sustainability reporting and provides examples of which reporting regulations may apply to Swiss companies and when they will become applicable. These examples focus on the EU's CSRD and the CO, which are more likely to significantly affect Swiss companies.

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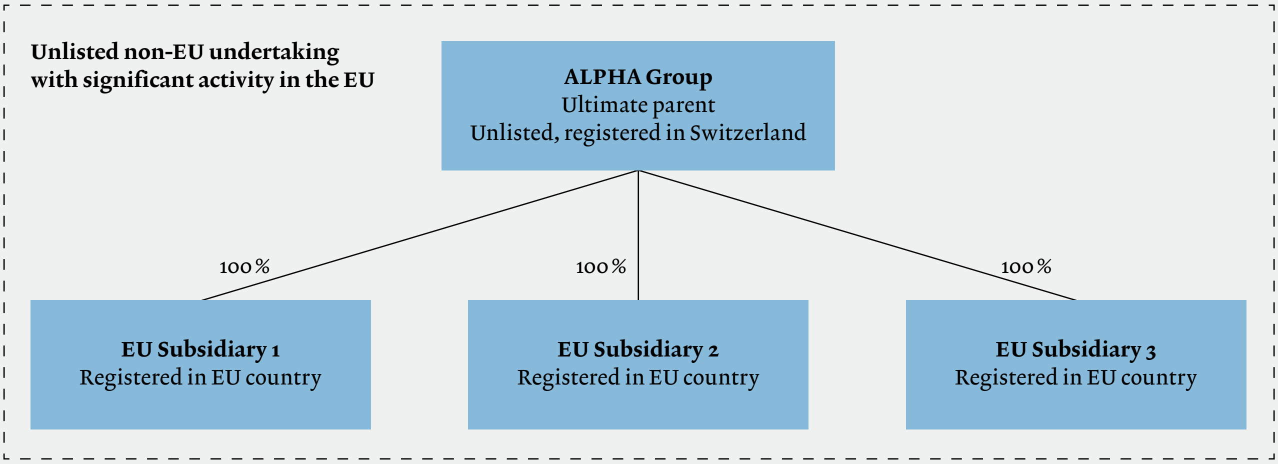
Diagram 1: **UNLISTED NON-EU UNDERTAKING WITH SIGNIFICANT ACTIVITY IN THE EU**



2. EXAMPLES OF COMPANIES THAT MAY FALL UNDER THE EU'S CSRD AND THE CO

2.1 Scenario: unlisted non-EU undertaking with significant activity in the EU *(Diagram 1)***.** ALPHA is an unlisted multinational company (ALPHA Group) with worldwide operations [2]. The ultimate parent is incorporated in Switzerland. In the two most recent reporting periods, ALPHA Group had:

- EUR 400m balance sheet total;
- EUR 600m sales revenue/net turnover [3] with EUR 200m generated in the EU;
- 1,000 employees.

The Group has three wholly owned, unlisted subsidiaries that are registered and operating in the EU, and which consolidate into the Swiss Group under IFRS. In the most recent reporting period, each of the distinct EU subsidiaries had:

- less than EUR 20m balance sheet total;
- less than EUR 40m sales revenue/net turnover;
- fewer than 250 employees.

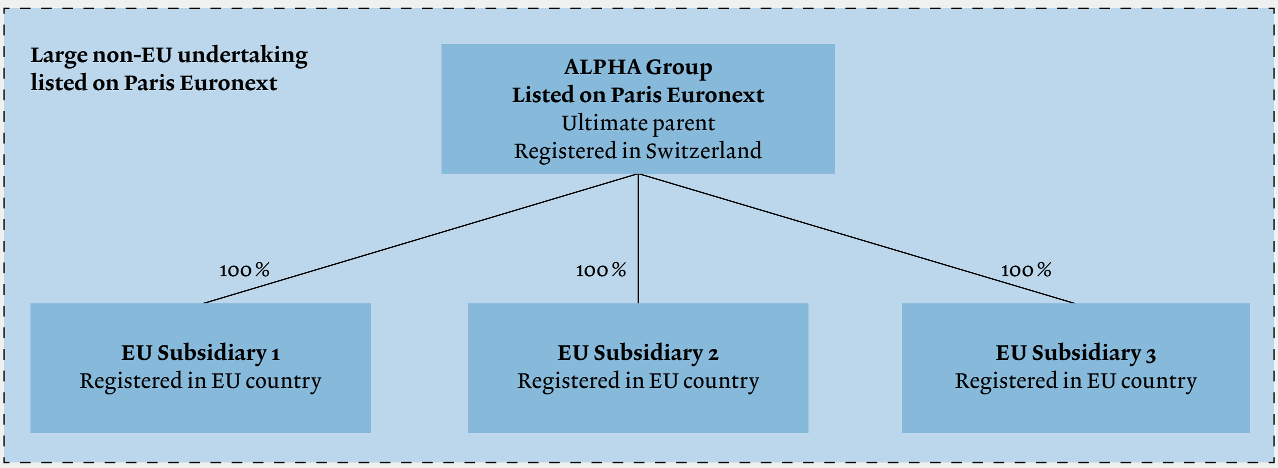
ALPHA Group is registered in Switzerland, but it is not in scope of Art. 964*a–c* CO because it is not a PIE. ALPHA Group does not have to provide a non-financial report under the CO.

ALPHA Group and its subsidiaries are not listed on an EU-regulated market and its EU subsidiaries do not meet any of the three criteria to qualify as a "large EU undertaking" [4]. Therefore, ALPHA Group will not come within scope of the CSRD until 1 January 2028 because the Group generated a net turnover in the EU of more than EUR 150m in each of the last two financial years.

The final text of the CSRD requires that the sustainability report provides information at the Group level of the ultimate, non-EU, parent. This will bring the whole of the Swiss parent and its worldwide operations within the scope of the CSRD from 1 January 2028. The EU subsidiary of the Swiss undertaking will be responsible for publishing the sustainability information [5].

2.2 Scenario: non-EU undertaking listed on an EU-regulated exchange *(Diagram 2)***.** In this modified scenario,

Diagram 2: **LARGE NON-EU UNDERTAKING LISTED ON PARIS EURONEXT**



ALPHA Group is listed on Paris Euronext. Therefore, the Group is in scope of Art. 964*a–c* CO for the financial year 2023 because it is a Swiss PIE and fulfils the size criterion. The Group shall prepare a report on non-financial matters as required in the CO.

ALPHA Group is in scope of the CSRD from 1 January 2024 because ALPHA Group is listed on an EU-regulated market and has more than 500 employees.

The CSRD requires that the sustainability report provides information at the group level. This brings the whole of the non-EU parent and its worldwide operations within the scope of the CSRD from 1 January 2024. The information required in these sustainability reports should be prepared in accordance with European Sustainability Reporting Standards (ESRS) or standards deemed to be equivalent.

It is possible that the EFRAG regulation might be considered equivalent to the requirements of the CO, as this was largely based on the Non-financial Reporting Directive (NFRD), the predecessor of the CSRD. If the EFRAG's ESRS were to be considered equivalent in Switzerland, the company would be able to report under ESRS only.

2.3 Scenario: EU subsidiary meets the criteria to be considered a "large EU undertaking" *(Diagram 3)*. In this modified scenario, one of the unlisted EU subsidiaries meets two of the three criteria to be considered a "large EU undertaking" and would therefore be in scope of the CSRD from 1 January 2025 [6]. ALPHA Group is in scope of the CSRD from 1 January 2028 because the Group generated a net turnover in the EU of more than EUR 150m in each of the last two financial years (same as for scenario 2.1). For the purposes of the CO, ALPHA Group is not a PIE and does not have to provide a non-financial report under the CO.

Transitional provision: the CSRD contains a transitional provision that would exempt the non-PIE EU subsidiary from preparing separate subsidiary sustainability reports for seven years if the subsidiary is included in a "consolidated sustainability report" of another EU subsidiary of the same ultimate non-EU parent [7].

ALPHA Group does not have an intermediate EU parent preparing consolidated reports at the EU level, which would permit this exemption. However, it might be possible for ALPHA to voluntarily prepare Group consolidated sustainability reports from 1 January 2025 so that the exemption would be available to the large EU subsidiary. There are two key considerations in this scenario:

→ The Group's consolidated sustainability information must be prepared in accordance with the ESRS or standards deemed to be equivalent. What might be deemed "equivalent" is yet to be determined by the EU. ALPHA Group may prepare the consolidated sustainability report using a framework other than ESRS. In practice, this means that it is uncertain whether Group consolidated reports prepared on a basis other than the ESRS would be accepted as equivalent and would permit an EU subsidiary exemption from 2025 onwards.

→ The Group's early adoption of the CSRD sustainability reporting requirements would bring ALPHA's worldwide operations within scope from 1 January 2025, which is three years earlier than the mandatory requirement for non-EU undertakings from 1 January 2028. Depending on the Group structure and other factors, the potentially onerous and costly exercise of producing consolidated sustainability reports for worldwide operations three years earlier than required in order to make the exemption available to the large EU subsidiary might not be feasible for ALPHA Group.

2.4 Scenario: EU subsidiaries consolidate as a "large EU group" *(Diagram 4)*. In this scenario, two of the three EU subsidiaries consolidate into the third EU subsidiary and the resulting EU group meets two of the three criteria to be considered a "large EU group" [8]. The large EU group is in scope of the CSRD from 1 January 2025. If one of the consolidating EU subsidiaries meets the criteria to be considered a large EU undertaking (such as in example 2.3) then this EU subsidiary could apply the transitional provision for exemption from the requirement to prepare a standalone sustainability report, since it is now included in the consolidated sustaina-

Diagram 3: **LARGE EU UNDERTAKING AS A SUBSIDIARY OF A NON-EU PARENT**

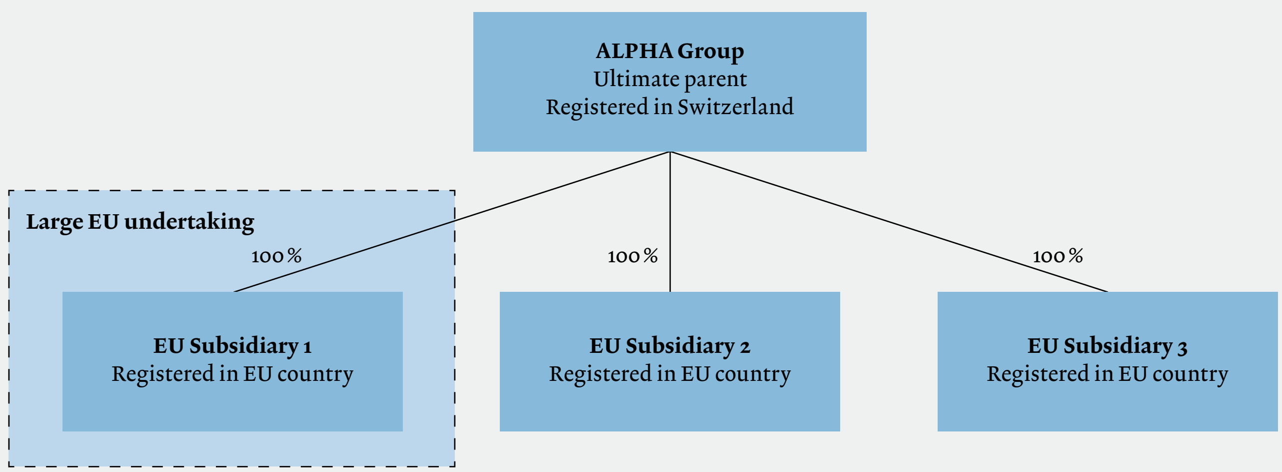
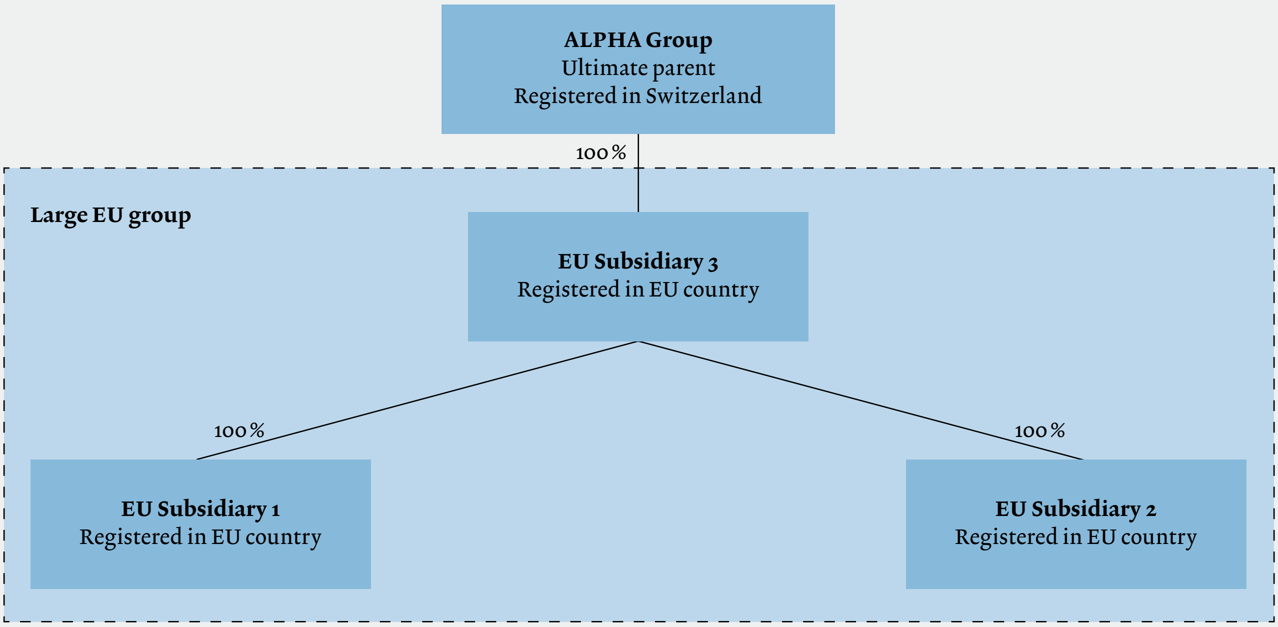


Diagram 4: **EU SUBSIDIARIES CONSOLIDATE AS A "LARGE EU GROUP"**



bility report of another EU subsidiary of the same ultimate non-EU parent.

3. ISSB STANDARDS AND SEC DISCLOSURE RULE

ALPHA Group will be in scope of the ISSB Standards only if these are adopted in Switzerland's local laws and regulations, or if the Group has a listing in an overseas jurisdiction that has mandated the ISSB Standards. The three unlisted EU subsidiaries may also come within scope of the ISSB Standards individually if these standards are adopted in the respective national laws and regulations of the EU country where the subsidiaries are registered. The effective date of the ISSB for IFRS S1 and IFRS S2 is 1 January 2024, but local regulators may choose a different effective date.

ALPHA Group and its subsidiaries are not in scope of the SEC climate disclosure rules in their current form because none of the companies are listed on a US-regulated market. The effective date for the SEC climate-disclosure rule has not yet been announced.

4. INTERACTION BETWEEN THE INTERNATIONAL REGULATORY FRAMEWORKS

There are differences between the sustainability standards proposed by EFRAG, ISSB and SEC.

Stakeholders: Some of these regulations have a different audience. The ISSB and SEC regulations are designed to meet the needs of investors. However, the EFRAG regulations address a wider range of stakeholders and are designed to meet the needs of more than just investors.

Materiality: One of the implications of having a different audience is that there is a different definition of materiality; this may be a particular challenge when it comes to practical applications. The ISSB Standards use the same definition of materiality as exists for the IFRS accounting standards. Similarly, the SEC rule proposes to use its definition of financial materiality for sustainability reporting. However, EFRAG proposes the concept of double materiality, which includes financial and impact materiality. A company must report on how its business is affected by sustainability-related matters and how its activities impact society and the environment.

Approach to standard-setting: The ISSB Standards are principles-based and high-level. In contrast, the ESRS require extensive, detailed disclosures and data points.

Scope: we expect the application of the respective regulations in Switzerland to play out as follows:

→ *EFRAG:* The scope of the ESRS is defined in the CSRD. EU countries have 18 months to transpose the CSRD into their local laws and regulations. The challenge for Swiss companies is that the CSRD has significant extraterritorial reach. We can therefore expect that certain Swiss companies will be required to report in accordance with the ESRS.

→ *ISSB:* The applicability of the ISSB depends on whether these standards are adopted in local laws and regulations. For example, if the ISSB Standards become a requirement of the UK securities regulator, then Swiss companies with a listing in the UK could be in scope.

→ *SEC:* Only Swiss companies that are US-listed public companies are in scope.

5. CONCLUSION

The upcoming non-financial reporting regulations have significant extraterritorial reach and it might be a challenge for Swiss companies to identify which of them will apply. Consequently, Swiss companies will need to become familiar with the different regulations and carefully evaluate the resulting impact on their reporting. Different sustainability regulations also come with different assurance regulations,

e. g. there is currently no requirement to gain assurance over the sustainability reporting provided under the CO, but there is a need to gain assurance if a Swiss company comes within scope of the CSRD.

There are concerns from companies that they may potentially be required to adopt more than one set of standards. In theory, a company could fall within scope of the CO, EFRAG, ISSB and SEC regulations. Alignment between the standards is a continuing and important area of debate amongst the standard-setters. It will be important for affected companies to understand how these standards link together and to establish consistencies between them. ■

Footnotes: 1) Art. 2 lit. c Audit Oversight Act defines PIEs as (a) publicly traded companies, i. e. companies (i) whose equity securities are listed on a stock exchange; (ii) that have bonds outstanding; or (iii) that contribute at least 20% of assets or revenues to the consolidated accounts of a company under (i) or (ii), and (b) regulated entities supervised by the Swiss Financial Market Supervisory Authority FINMA, such as banks or insurance companies. **2)** The diagram is simplified to show only the Swiss parent and EU subsidiaries and exclude other worldwide operations. **3)** "Net turnover" means the amounts derived from the sale of products and the provision of services after deducting sales rebates, value added tax and other taxes directly linked to turnover. The definition is modified for insurance undertakings, credit institutions and undertakings in scope of Article 40a (1) of the CSRD. **4)** "Large" EU undertakings (whether listed or not and including subsidiaries of non-EU parents) are those that meet two of the following criteria: more than EUR 20m total assets; more than EUR 40m net turnover; more than 250 employees. **5)** The EU subsidiary preparing this consolidated sustainability report must be one of the EU subsidiaries that generated the greatest turnover in the EU in at least one of the preceding five financial years, on a consolidated basis where applicable. Such a consolidated sustainability report would be required to include all EU subsidiaries of the non-EU parent that are in scope of the CSRD. **6)** For example, assume that EU Subsidiary 1 had EUR 30m total assets and 400 employees in the most recent financial reporting period. This EU subsidiary will be in scope of the CSRD from 1 January 2025 and will be required to publish EU subsidiary sustainability reporting. **7)** See fn. 5. **8)** Whether such undertakings are large is determined by reference to the same thresholds for large EU undertakings, with the criterion for net turnover adapted for such undertakings.