# The current state of nonfinancial reporting in Switzerland and beyond

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Based on the increasing expectations from investors, regulators and society on firms to transparently report on their sustainability achievements, this article analyzes the current state of nonfinancial reporting in Switzerland and globally. The analysis is based on the reporting period 2017–18 regarding: (1) A global survey of institutional investors to examine their views on the use of nonfinancial information in investment decision making; (2) A snapshot on the uptake of the TCFD recommendations across 18 markets, 11 key sectors and over 500 companies; (3) How Switzerland's largest companies report on nonfinancial information. The results show that (1) investors increasingly rely on nonfinancial information while issuers are getting better at assessing materiality, but there is still considerable room for improvement. Further, investors report that the four main ESG factors considered are governance, supply chain, human rights and climate change. (2) Although an increasing share of corporations consider climate-related risks and opportunities, most companies are lacking high quality disclosures aligned to the TCFD recommendations. (3) The share of sustainability reporting and its (partial) integration in the annual report among the largest Swiss corporations is increasing, while also external assurance on nonfinancial information slightly increases.

Sustainability reporting, nonfinancial reporting, corporate sustainability, corporate social responsibility, sustainable development, climate change, Switzerland, TCFD, ESG

**Der aktuelle Stand der nichtfinanziellen Berichterstattung in der Schweiz und international**

*Basierend auf den steigenden Erwartungen von Investoren, Aufsichtsbehörden und der Gesellschaft an Unternehmen, transparent über ihre Nachhaltigkeitsleistung zu berichten, analysiert dieser Artikel den aktuellen Stand der nichtfinanziellen Berichterstattung in der Schweiz und auf globaler Ebene. Die Analyse bezieht sich dabei auf die Berichtsperiode 2017–18 bezüglich: (1) Einer internationalen Umfrage unter institutionellen Investoren, um deren Ansichten über die Verwendung nichtfinanzieller Informationen bei Anlageentscheidungen zu untersuchen; (2) einer Bestandsaufnahme der Umsetzung der TCFD-Empfehlungen in 18 Märkten, 11 Schlüsselsektoren und über 500 Unternehmen; (3) der Frage, wie die grössten Schweizer Unternehmen über nichtfinanzielle Informationen berichten. Die Ergebnisse zeigen, dass (1) Investoren sich zunehmend auf nichtfinanzielle Informationen verlassen, während die Unternehmen bei der Beurteilung der Wesentlichkeit von Nachhaltigkeitsthemen immer besser werden, allerdings besteht noch erheblicher Spiel-*

*raum für Verbesserungen. Des Weiteren berichten Investoren, dass die vier am häufigsten berücksichtigten Nachhaltigkeits- oder «ESG»-Faktoren gute Unternehmensführung, Lieferketten, Menschenrechte und der Klimawandel sind. (2) Obwohl ein zunehmender Anteil der Unternehmen klimabedingte Risiken und Chancen in Betracht zieht, mangelt es den meisten Unternehmen an qualitativ hochwertiger Berichterstattung entsprechend der TCFD-Empfehlungen. (3) Der Anteil der Nachhaltigkeitsberichterstattung und ihrer (teilweisen) Integration in den Jahresbericht nimmt bei den grössten Schweizer Unternehmen zu, während auch die externe Prüfung von nichtfinanziellen Informationen leicht zunimmt.*

*Nachhaltigkeitsberichterstattung, Nichtfinanzielle Berichterstattung, Unternehmerische Nachhaltigkeit, Unternehmerische Gesellschaftsverantwortung, Nachhaltige Entwicklung, Klimawandel, Schweiz, TCFD, ESG*

## 1. Introduction

There is increasing expectation from investors, regulators and society on firms to contribute to tackling societal challenges and then to transparently report on their achievements. Especially, investors increasingly consider ESG (Environment, Social, Governance) topics for their investment decisions. Additionally, there are various national and international regulatory developments and voluntary initiatives which influence sustainability management and reporting.

Investors around the world have come to expect useful reporting of material nonfinancial performance information. For example, Larry Fink, Chairman and CEO of BlackRock wrote in his annual letter 2020 to CEOs: *"Climate change has become a defining factor in companies' long-term prospects. […] a risk that markets to date have been slower to reflect. But awareness is rapidly changing, and I believe we are on the edge of a fundamental reshaping of finance."* In response, issuers have risen to the challenge of meeting investors' demands for disclosing measurable and comparable nonfinancial information.

In recent years, a range of mandatory and voluntary nonfinancial reporting frameworks and standards have emerged. Voluntary and widely used standard providers include the Global Reporting Initiative (GRI), Sustainability Accounting Standards Board (SASB) or the International Integrated Reporting Council (IIRC). Additionally, specific standards for climate-related reporting are for example the Greenhouse Gas (GHG) Protocol, or the Task Force on Climate-related Financial Disclosures (TCFD).

Thus, this paper aims at providing an understanding of the current state of global nonfinancial and climate risk reporting as well as analyzing how Swiss companies are reporting on these matters. The analysis for the reporting period 2017–18 is threefold. First (chapter 2), this article provides results of a global survey of institutional investors to examine their views on the use of nonfinancial information in investment decision making. Second (chapter 3), the article offers a snapshot on the uptake of the TCFD recommendations across 18 markets, 11 key sectors and over 500 companies. Thirdly (chapter 4), it is analyzed how Switzerland's largest companies report on sustainability matters such as environmental or social issues. Finally, the last section gives a brief outlook on future developments.

## 2. The importance of nonfinancial reporting for investors

*EY's* (2018a) global study of institutional investors reveals notable consensus that ESG information is critical to investors' decision-making.

### 2.1 Investors increasingly rely on nonfinancial information

Figure 1 shows that nearly all investors who responded to the survey (97 %) say they conduct either an informal evaluation (65 %) or a structured, methodical evaluation (32 %) of a target company's nonfinancial disclosures. Only 3 % say they conduct little or no review.

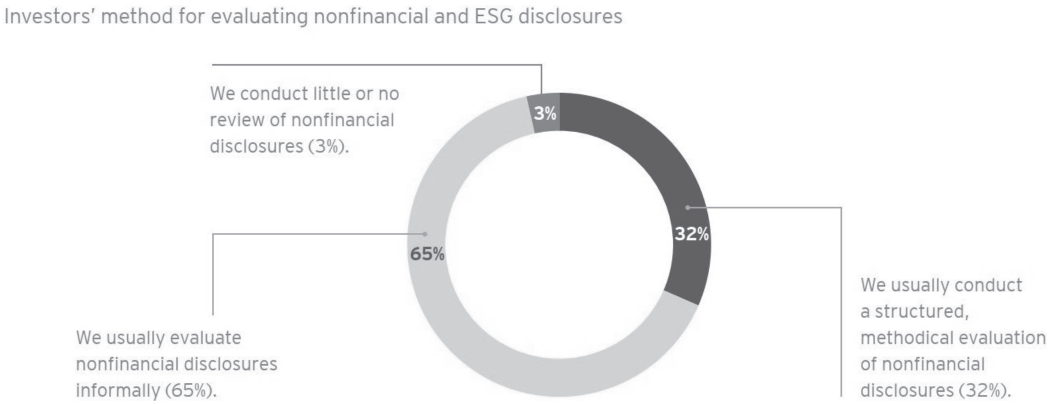


Figure 1: Investors' methods for evaluating nonfinancial and ESG disclosures

Investors emphasized that they are more likely to consider nonfinancial information occasionally or frequently when adjusting valuation for risk (70 %), examining industry dynamics and regulation (63 %), and when reviewing investment results (61 %).

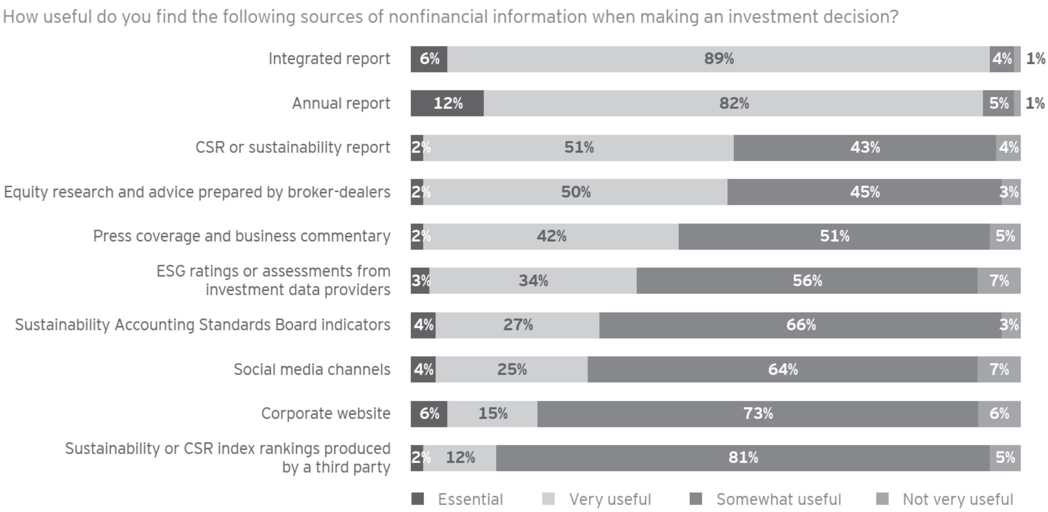


Figure 2: Usefulness of different sources of nonfinancial and ESG information

Nearly all respondents (94 %) reported that integrated reports are either very useful (88 %) or even essential (6 %) sources of nonfinancial information. Nearly the same percentage reported that annual reports are very useful (82 %) or essential (12 %) sources of nonfinancial information (figure 2). Further, results show investors' use of corporate social responsibility (CSR) or sustainability reports, equity research from broker-dealers, press coverage and other external sources.

Investors stated that the most useful ESG reports come from companies that understand the notion of materiality and can identify which nonfinancial factors are most important to their business model. More than half of respondents (56 %) say that companies' nonfinancial disclosures are either not available or inadequate for meaningful comparison with those of other companies. Investors report that the quality and relevance of nonfinancial data that companies provide can vary significantly by company, industry and region.

## 2.2 Issuers are getting better at assessing materiality, but there is a long way to go

Investors report that most companies disclose the ESG risks that could affect their current business models. Some investors say that information about corporate governance, such as a board's capacity and capability, the structure of executive compensation, transparency of accounting practices and capital allocation techniques, tends to be more complete because of accounting or exchange-listing requirements in place in many countries.

Investors also state that there can be large discrepancies between the quality of reporting in the environmental and social categories. Environmental metrics around GHG emissions tend to be more straightforward. Investors say that there are process-type metrics on environmental and social factors, whether it's employee turnover, injury rates, water or carbon emissions that they tend to get, but there are a lot of other environmental and social metrics that are more uneven. One such soft factor is for example the management of human capital.

Investors report that most (78 %) or nearly all (9 %) of the companies assess ESG materiality adequately (figure 3).

What proportion of the companies you follow adequately determine what environmental, social and governance issues and topics are truly material to their ability to create value in the long term?

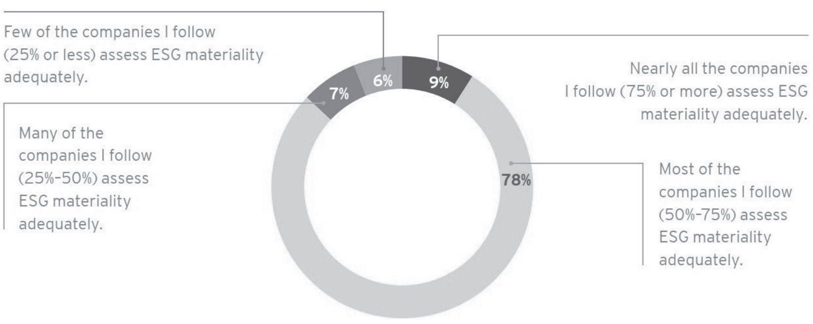


Figure 3: Investors' view on adequate determination of material ESG issues and topics

Further, investors rate companies' assessment of governance materiality best (8.28 on a scale of 1 to 10), followed by social (7.72) and environmental (6.19) (figure 4). However, while governance factors may be reported most thoroughly, it can be difficult to value and measure. In interviews, investors say that the concept of materiality, at least in its application to sustainability and ESG factors, is still not fully understood by some companies. Investors also stress that there is a long way to go in terms of understanding and reporting materiality.

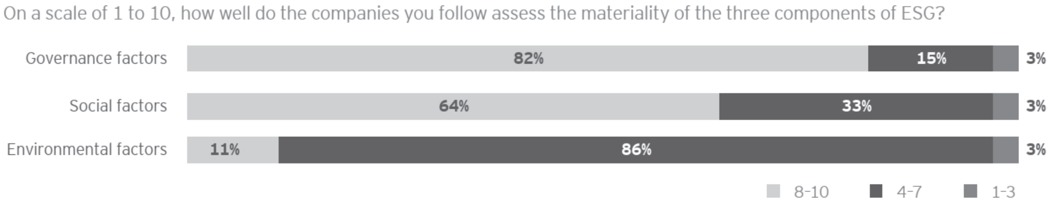


Figure 4: Investor's view on materiality assessment of three components of ESG

### 2.3 Four factors emerge as most important

Investors report that the main ESG factors in investment decision-making have to do with risks related to governance, supply chain, human rights and climate change (figure 5). The risk or history of poor governance practices would cause 62 % to rule out an investment immediately. Similarly, supply chain risks tied to ESG (52 %), risk or history of poor human rights practices (48 %), and risk from climate change (47 %) are also triggers to avoid an investment. From 2017 to 2018, especially ESG factors in supply chain and climate change risks rose in importance for decision-making.

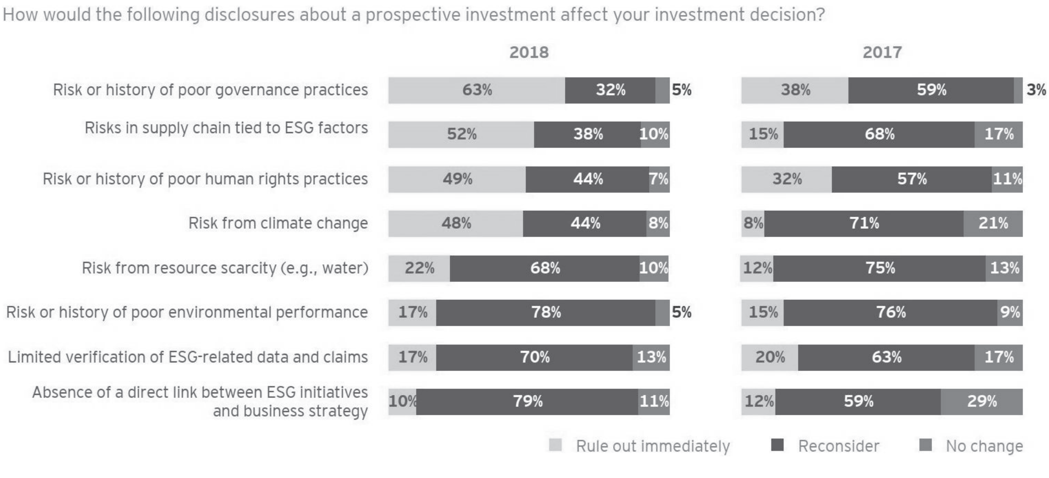


Figure 5: Most important ESG factors in investment decision-making

Climate change risk is consistently one of the most material issues identified by investors. These climate-related risks are generally divided in two major categories: (1) risks related to the *transition* to a low-carbon economy including extensive policy, legal, technology and market changes; and (2) risks related to *physical* impacts of acute and chronic climate change such as increased severity and likelihood of droughts, storms, floods and sustained higher temperatures. However, in this survey investors said that they are more concerned about the physical than the transitional risks. 70 % say that, over the next two years, they will pay a fair amount or a great deal of time and attention to physical risk (figure 6). 48 % say the same of transition risk. However, in interviews investors' perspectives on climate change risk are more balanced and nuanced suggesting that both risk types are important, and that the precedence depends on the investment strategy and the time horizon.

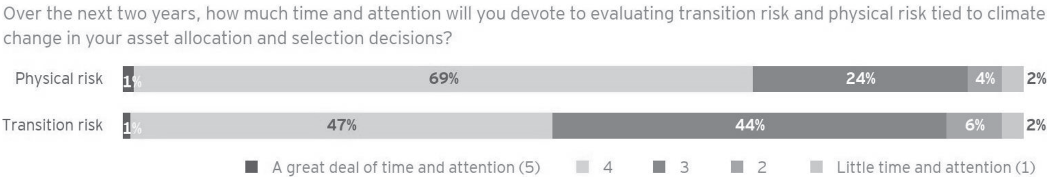


Figure 6: Investors' view on physical and transitional climate-related risks

### 3. Revealing true risks and opportunities with climate-related disclosures

With investors paying increasing attention to the impacts of climate change, it is important for businesses to be informed and to report on how they are managing climate-related risks, including financial implications. *EY's* (2018b) Global Climate Risk Disclosure Barometer provides a global snapshot on the uptake of the TCFD recommendations across 18 markets, 11 key sectors and over 500 companies. In doing so, the study looks at coverage and quality of climate risk disclosures. Coverage and quality are measured as a percentage score ranging from 0 % (not covered; no public disclosure) to 100 % (covered; all aspects and details publicly disclosed) based on the 11 TCFD recommendations.

### 3.1 Coverage and quality of disclosures aligned to the TCFD recommendations

Figure 7 shows that two out of three companies assessed (61 %) have started to disclose climate-related risks. However, the quality of the disclosures was relatively limited, with an average score of 31 %.

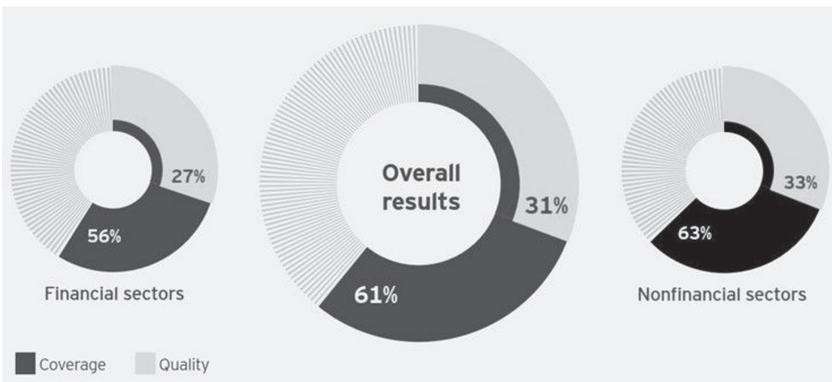


Figure 7: Coverage and quality of disclosures: Overall results

Across each of the four TCFD elements, results show that, on average, companies reported better on "targets and metrics" (mainly driven by reporting on GHG emissions) and "governance." Disclosures relating to "risk management" and "strategy" were the least developed. Arguably, as these components are more complex, they require detailed analysis on how climate change will impact a business and how the business is responding (figure 8).


Figure 8: Coverage and quality of disclosures: Breakdown by TCFD component

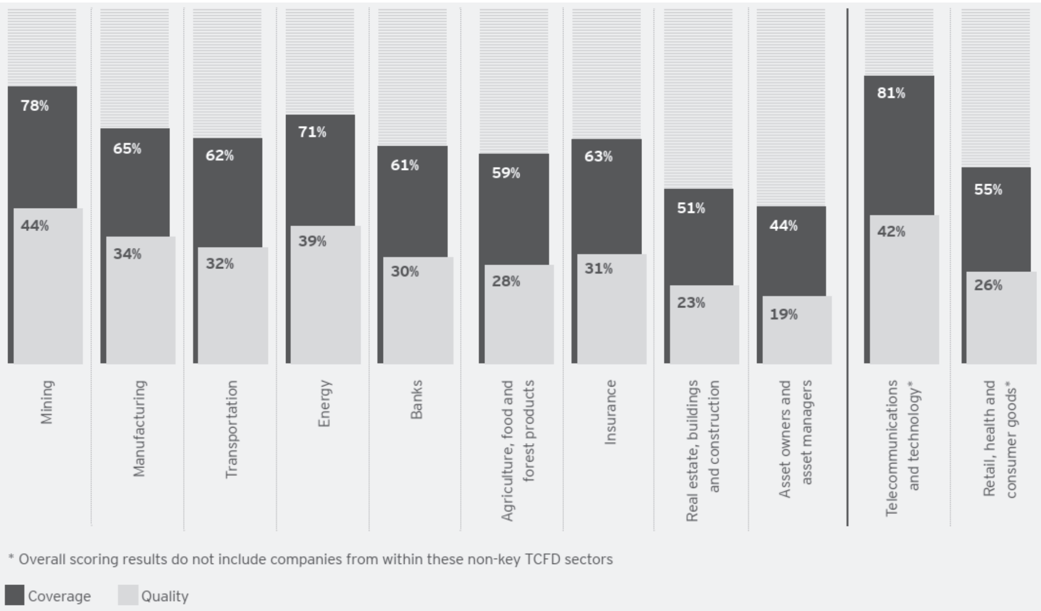


Figure 9: Coverage and quality of disclosures: Breakdown by sector

Figure 9 represents the analysis of coverage and quality of disclosures broken down by sector including key and non-key TCFD sectors. The sectors with the most significant exposure to transition risk (i.e. sectors with direct exposure to fossil fuel supply chains or with readily accessible low carbon substitutes), namely mining, manufacturing, transport and energy, generally scored higher. These sectors have faced the bulk of stakeholder activism around improved climate disclosures. Actions, such as lawsuits and shareholder resolutions relating to climate risk, have been directed toward the largest global organizations within these sectors. It appears that these actions have improved the level of disclosure compared with the other sectors in this analysis.

The manufacturing and transport sectors are large contributors to global GHG emissions. Certain industries within these sectors are also exposed to competition from low-carbon technologies, such as electrification and resource-efficient manufacturing. Responding to the challenges from these disruptive technologies appear to have led to better risk management and strategy disclosures from some companies within these sectors. These sectors had better-defined climate risks and opportunities, and, in some cases, they had included disclosures around time frames and quantification of the potential impacts.

Interestingly, the telecommunications sector (non-key TCFD sector) scored the highest for coverage and second-highest for quality. This may be because of the industry, more than any other, embracing the opportunities associated with an economy-wide low-carbon transformation, as well as the potential impacts on the sector's physical networks. Hence, the incentives for disclosure are as much about the upside as the downside. At the other end of the spectrum, asset owners and managers were the underperformers.

There are several potential reasons for this sector lagging behind others. A traditional focus on the disclosure of short-term risks and complexities in aggregating climate change risks across industries or organizations in a portfolio may have contributed to the sector's slow response. There may also be a view that this sector can more easily and rapidly respond to the risks. For example, it is easier to rebalance a portfolio for an asset manager than it would be for a fossil fuel-based power generator to shift to a lower carbon profile. However, the slower this sector is to respond to the systemic economic implications of climate change, the less likely it will be to manage the required transition. Asset owners and managers that respond early are more likely to derive value from this transition.

### 3.2 Quality of climate change disclosures across different markets

Figure 10 indicates that, on average, coverage scores for companies from markets (such as the UK, France, Germany and Australia), where climate change disclosures are relatively mature, were the highest. Interestingly, the US scored highly, despite a lack of coordinated economy-wide policy directives.

One of the key questions coming out of the analysis is whether the high scores are primarily because of an economy being more developed, or whether there are other factors at play. The fact that Scandinavian countries scored noticeably lower, while South Africa scored comparatively higher suggests there is more to it than the maturity of the economy. UK, France, Germany and Australia have had mandatory reporting regulations in place for some time, while South Africa has also implemented mandatory integrated reporting requirements. Although the driver in the US hasn't necessarily been regulation, the prevalence of shareholder resolutions and the threat of class actions has had a similar impact.

So, perhaps prior regulations for nonfinancial reporting is the critical factor. This is likely true in economies, such as India and UAE. However, this is perhaps not the full story.

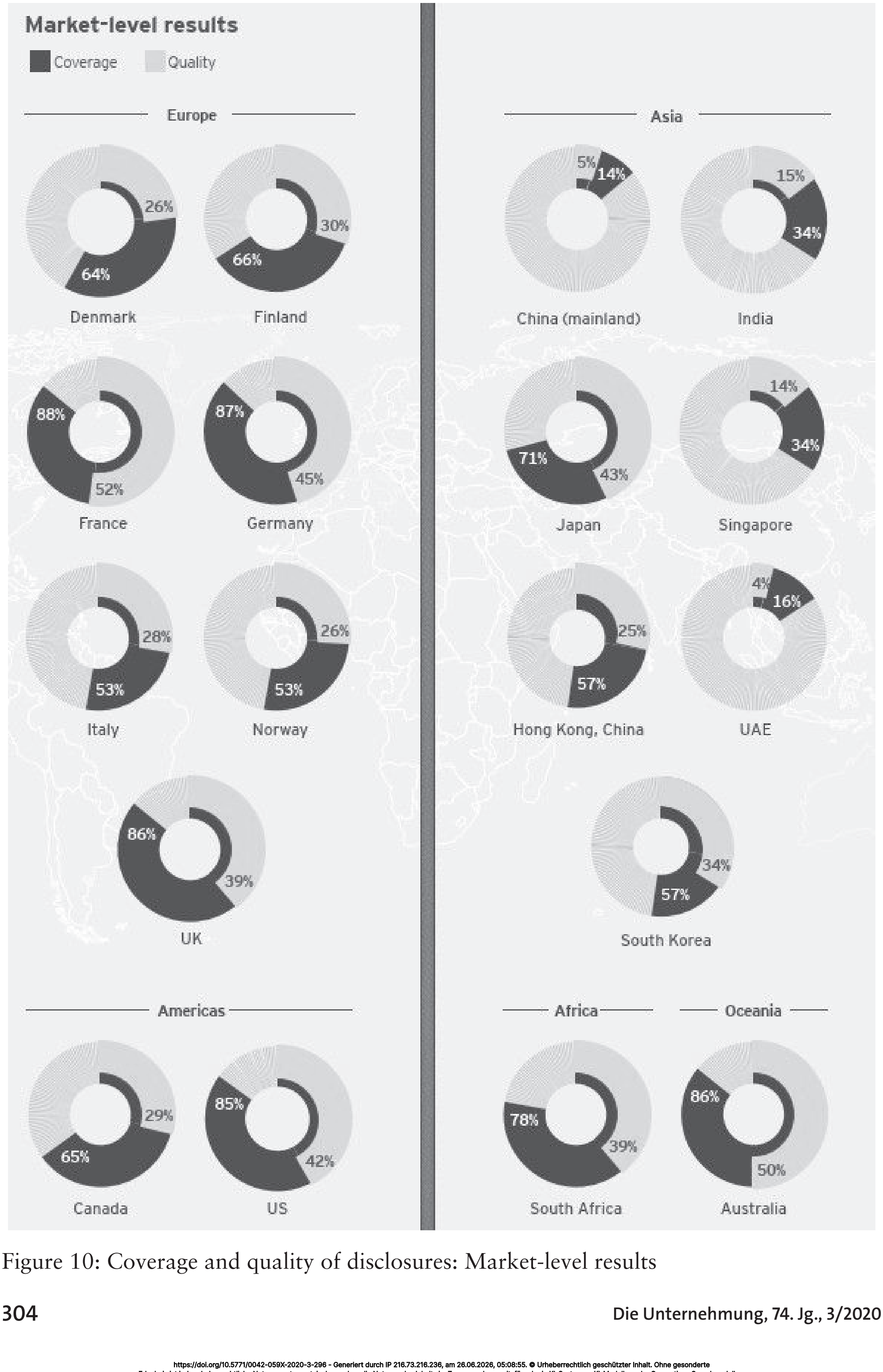


Figure 10: Coverage and quality of disclosures: Market-level results

In markets, such as mainland China, Singapore, Hong Kong and South Korea, companies scored on average significantly lower than other regions, despite having some mandatory reporting requirements. It also doesn't explain why the Scandinavian countries' scores are lower. The reality is that other contributing factors include:

- The maturity of the regulation and whether it is specific to climate change (e.g. mainland China, Singapore and Hong Kong, where the mandatory reporting requirements are quite general)
- The maturity of reporting across companies, rather than just the market leaders (e.g. in Australia, France, UK and Germany, where there is more depth in maturity of reporting)
- The potential risk of litigation in an economy (e.g., why the litigation risk is high in the US and low in China)

The story for quality is not nearly as good as it is for coverage. Even in highest-performing countries, such as Australia and France, there is a long way to go for companies to meet the majority of the TCFD recommendations. The extremely low scores in critical countries, such as India, China and South Korea, as well as even lower scores in parts of Europe, US and Canada mean that investors are unlikely to have the information they need to make decisions for the bulk of their portfolios.

### 3.3 Comparing physical and transitional risk disclosures

The most common disclosures identified were related to the monitoring and management of an entity's own emissions. Many companies also identified transition risks that either directly impact their sector or the supply chains they rely upon. These transition risks were generally the risks modeled in scenario analysis (where undertaken). One of the key reasons for a more consistent consideration of transition risk is that the time-scales over which companies and sectors are likely to feel the consequences are more immediate. Transition risks are generally associated with "mitigation" action, which means actions taken to reduce the likelihood and significance of future physical impacts. So, although in some sectors, companies have considered the physical implications of a changing climate, they are yet to fully integrate these risks into their valuation models.

Our analysis identified, however, that the physical risks are not only overlooked in valuation models, but often completely omitted from forward-looking strategic and risk management disclosures. Physical risk is the key risk to many high-risk sectors over the long-term, and this lack of understanding and disclosure highlights a significant gap in the quality of current disclosures.

## 4. Nonfinancial reporting in Switzerland

This chapter provides an overview of the results of the analysis of sustainability reporting in Switzerland. The analysis covers the sustainability reporting of Switzerland's 100 largest companies[1], five largest banks[2] and five largest insurers[3] as well as the companies in the

1 According to Handelszeitung "Die grössten Industrie-, Handels- und Dienstleistungsunternehmen in der Schweiz 2017" [the largest industrial, trade and service companies in Switzerland in 2017].
2 According to Handelszeitung "Die grössten Banken in der Schweiz 2016" [the largest banks in Switzerland in 2017].
3 According to Handelszeitung "Die grössten Versicherungsgesellschaften in der Schweiz 2017" [the largest insurers in Switzerland in 2017].

SMI Expanded[4]. The survey did not consider reports of subsidiaries controlled by a parent in Switzerland or abroad as they could potentially be included in the parent's reporting scope. For each segment, we looked at the number of sustainability reports, the form of reporting, whether the guidelines of the GRI were applied and whether companies had sought external assurance. The analysis is based on the companies' 2017 annual reports and sustainability reports (available as of August 2018).

### 4.1 GRI Reports in comparison

Worldwide, the GRI reporting framework remains the most widely used standard for sustainability reporting. In 2017, 81 Swiss companies applied the GRI reporting guidelines. This is a continuous decreasing trend of Swiss companies applying GRI. Generally, the number of Swiss sustainability reports on the GRI database (GRI and non-GRI) considerably decrease from 168 in 2016 to 134 for the reporting period 2017–2018 (figure 11).

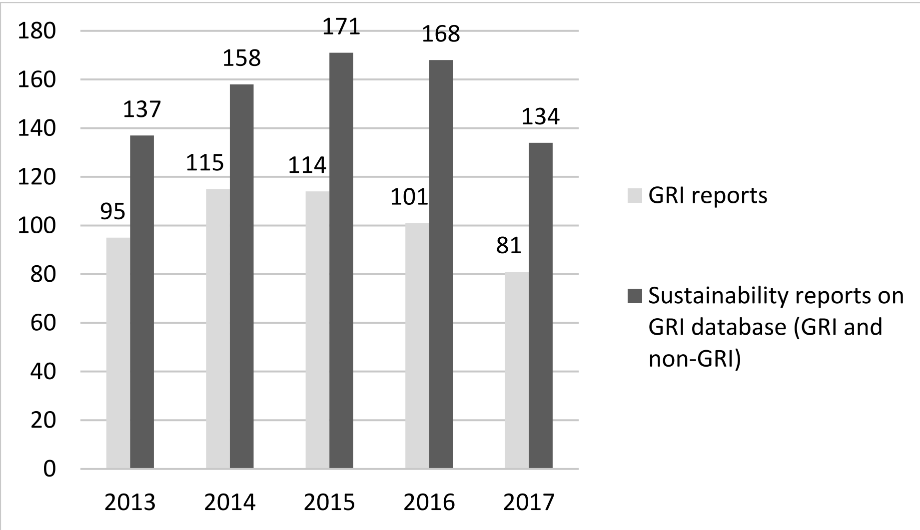


Figure 11: GRI and sustainability (GRI and non-GRI) reports on GRI database for Swiss companies

Worldwide, the number of sustainability reports on the GRI database (GRI and non-GRI) constantly increased between 2013 to 2017. This contrasts with the decreasing amount of Swiss sustainability reports. However, for GRI report, the number decreased the first time for the reporting year 2017. While 4,578 GRI reports were published for the reporting year 2016, there were 4,203 for 2017, indicating a somewhat similar, but lagging trend which was observed for Swiss companies (figure 12).

4 SIX Swiss Exchange Indices, "SMI Expanded per 2018" http://www.six-swiss-exchange.com/indices/data_centre/shares/smi_expanded_en.html.

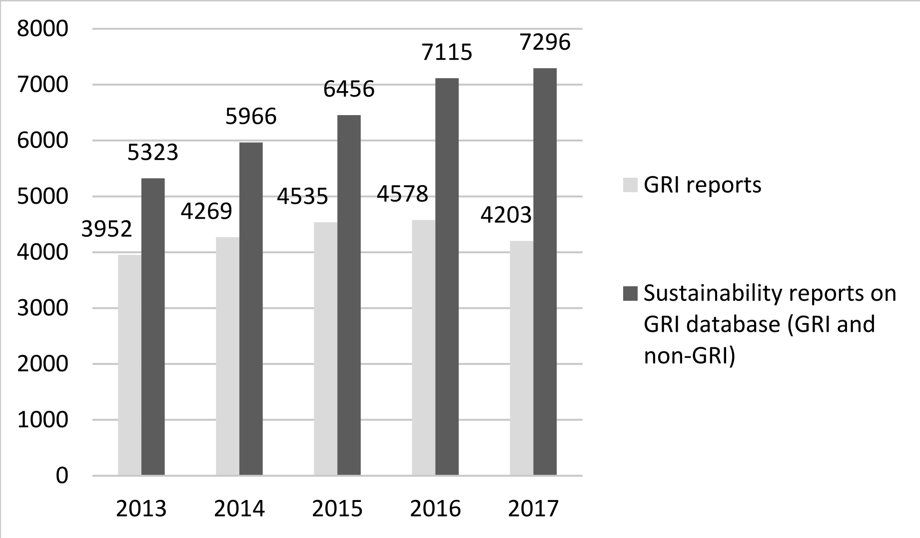


Figure 12: GRI and sustainability (GRI and non-GRI) reports on GRI database worldwide

### 4.2 Share and scope of nonfinancial reporting in Switzerland

Overall, 83 of Switzerland's 110 largest companies, banks and insurers (76 %) published a sustainability report for the reporting year 2017 (figure 13). This is an increase of 10 reports (10 percentage points) compared to the previous reporting year. Among the companies in this segment, 58 published a comprehensive sustainability report that covers at least 10 KPIs (53 %). A basic sustainability report with around five to nine KPIs as well as respective development over time was published by 25 companies (23 %).

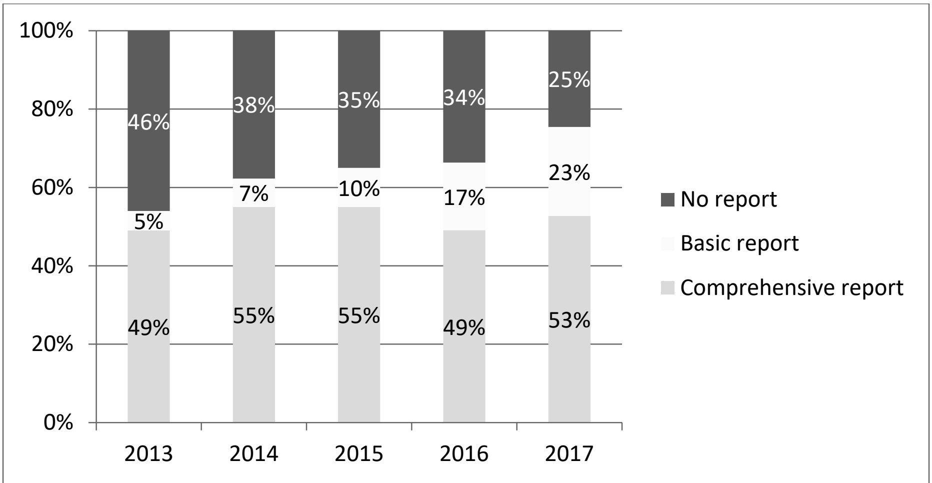


Figure 13: Share and scope of sustainability reporting for largest Swiss companies, banks and insurers

Looking at the SMI Expanded, a sustainability report for the reporting period 2017–2018 was published by 48 of the 50 or 96 % of the companies in the index. This is a further increase compared to the previous reporting year, when 45 companies (90 %) published a sustainability report (figure 14). 38 companies published a comprehensive sustainability report including at least 10 KPIs (76 %). 10 companies published a basic sustainability report with around 5 to 9 KPIs and respective development over time (20 %).

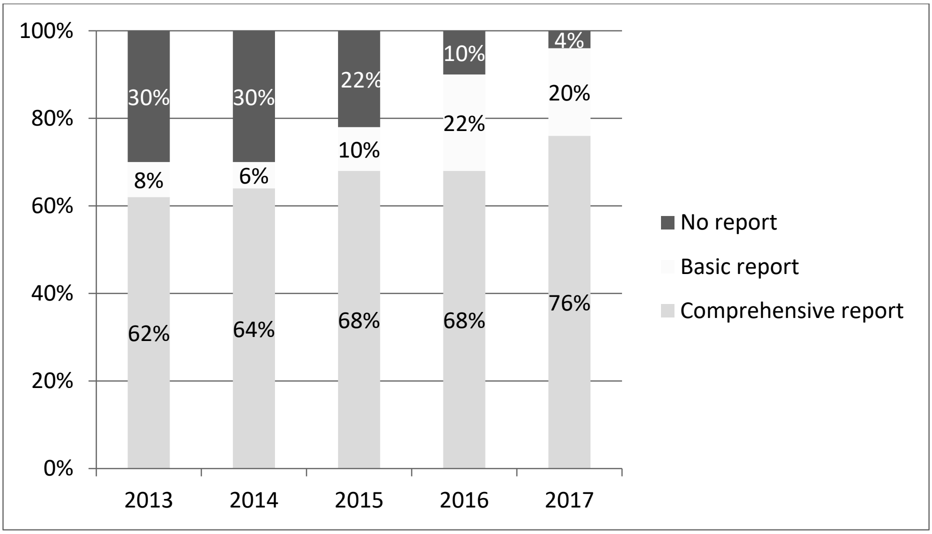


Figure 14: Share and scope of sustainability reporting for SMI Expanded

Figure 15 shows that 72 % of the largest Swiss companies have integrated a basic (29 %) or a comprehensive (43 %) sustainability report in their annual reporting, while 28 % only reported about their sustainability performance in a separate sustainability report. This is a slight increase in integration compared to 70 % in the previous reporting year.

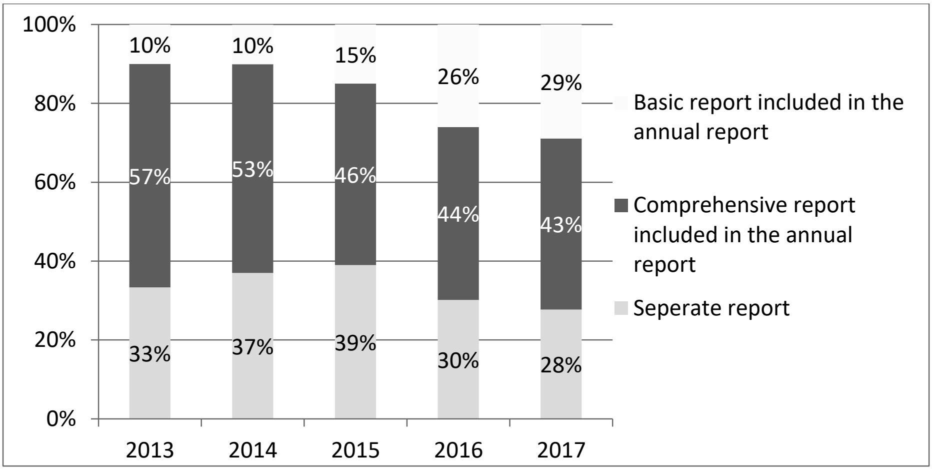


Figure 15: Integration in the annual report for largest companies, banks and insurers

65 % of reporting companies in the SMI Expanded included a comprehensive (44 %) or a basic (21 %) sustainability report in their annual reporting, while 35 % solely reported in a separate sustainability report (figure 16).

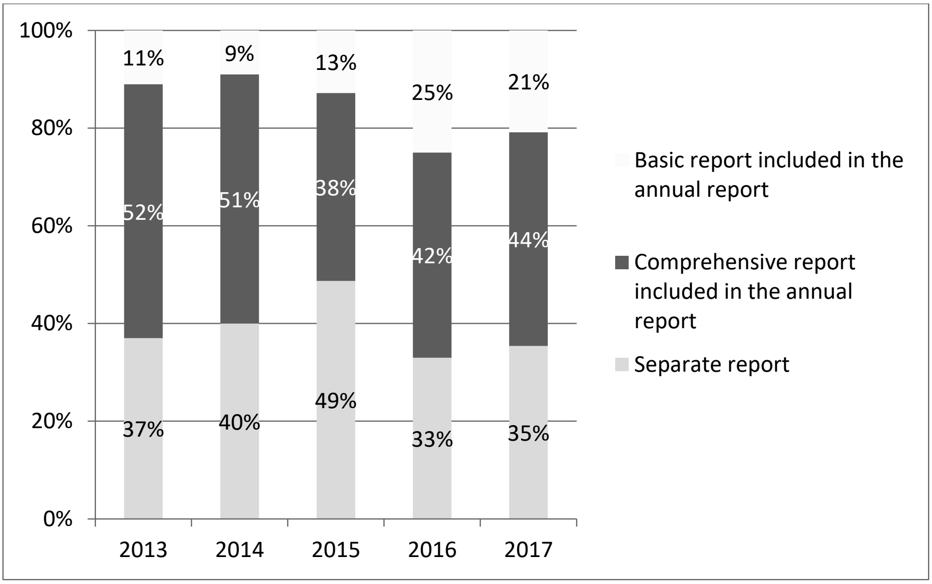


Figure 16: Integration in the annual report for the SMI expanded

### 4.3 External assurance of nonfinancial information in Switzerland

In total, 25 out of the 83 largest Swiss companies with a sustainability report and therefore 30 % of reporting companies sought external assurance for their sustainability report. In the SMI Expanded, 21 of the sustainability reports (44 %) were externally assured (figure 17).

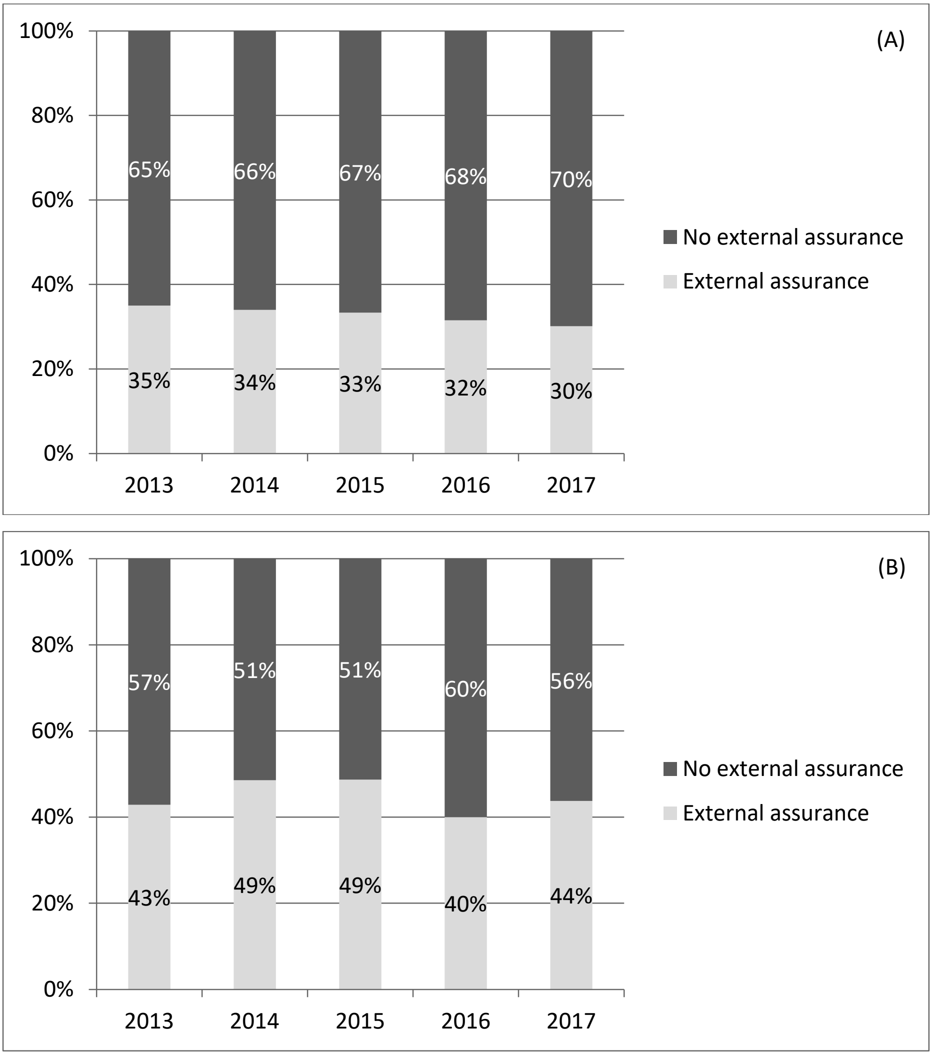


Figure 17: External assurance for the largest companies, banks and insurers (A) and SMI Expanded (B)

This analysis shows that generally, listed companies tend to be more transparent and demand higher robustness for their nonfinancial disclosures.

## 5. Outlook

Investors affirm that, while companies have improved their ability to discern what is and what is not material to valuation, both issuers and investors look forward to consensus on how to report and value performance on these material topics. Such consensus is likely to require intelligent collaboration between governments, standard setters, industry groups and investors in the years ahead. A further increase in regulations in sustainability management and reporting as well as considerations of ESG factors by investors is expected in the upcoming years. An example in this area is the implementation of the EU Action Plan on Financing Sustainable Growth and upcoming Renewed Sustainability Finance Strategy, which entails three pillars:

I. Strengthening the foundations for sustainable investment by creating an enabling framework, with appropriate tools and structures
II. Increased opportunities to have a positive impact on sustainability for citizens, financial institutions and corporates
III. Climate and environmental risks will need to be fully managed and integrated into financial institutions and the financial system as a whole

In this context, the increase in company sustainability disclosure requirements in Europe is worth mentioning. Due to the raising importance of ESG factors, it is expected that investors will increasingly evaluate relevant factors on a structured basis and across all asset classes.

Thus, a holistic view of companies' value creation as proposed by the Integrated Reporting Framework and the Embankment Project for Inclusive Capitalism will be increasingly important. This is accompanied by a growing link between financial and nonfinancial factors as promoted by TCFD, Double Materiality concept and the Natural and Social Capital Protocol. For companies, this development does not necessarily mean extending their nonfinancial reporting, but first and foremost increasingly linking disclosed information with the business model and the corporate strategy. From a management and a reporting perspective, this leads to increasing requirements on the quality of gathered nonfinancial data.

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