Is your business ready for the Swiss climate ordinance?

As of January 1st, large Swiss businesses are required to report their climate risks as well as the plans to address them.

Learn more about our TCFD work from our insurance reports (here and here) prepared in collaboration with the United Nations Environment Program Financial Initiative (UNEP-FI).

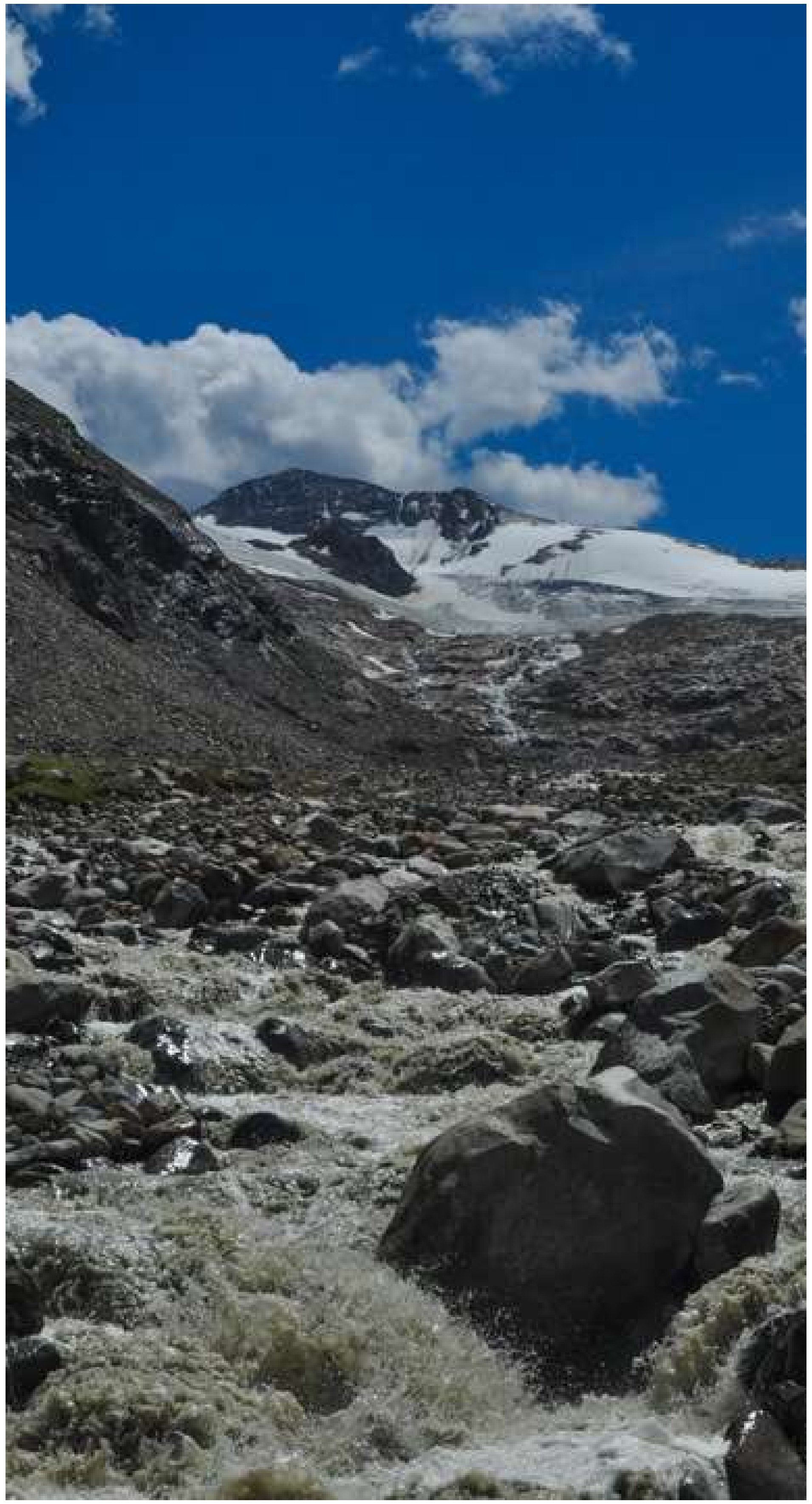
Part I

Executive summary

On November 23rd 2022, the Swiss Federal Council published an Ordinance mandating climate disclosures (1) for large Swiss companies. The requirements of the ordinance came into effect on January 1st, 2024. The ordinance describes the binding implementation of the recommendations of the Task Force on Climate-Related Disclosures (TCFD), an internationally recognized reporting framework that was first published in 2017 (2). Given the transition provision built in the ordinance, any company meeting the size criteria will be required to publish its climate-related risks and its strategy by January 1st, 2025, if it has not done so yet.

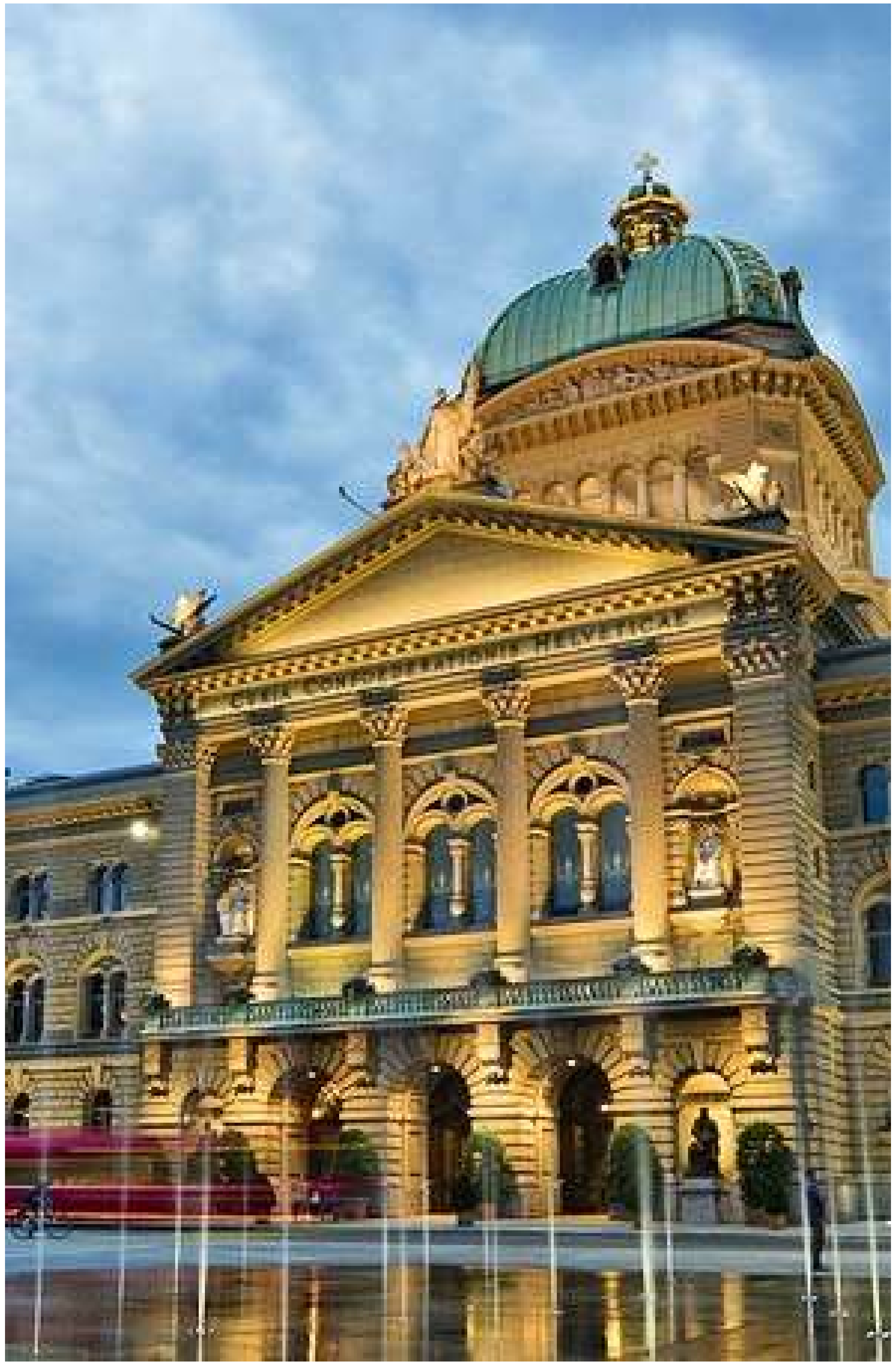
Swiss public companies with at least 500 employees, CHF 20 million in assets and CHF 40 million in annual turnover, are now required to assess the climate-related risks they are exposed and to integrate climate actions in their operations and policies. It also impacts companies looking to do business in Switzerland. The work needed to fulfill the ordinance requirements is complex, technical, and multi-faceted. When used correctly, the framework requires the implementation of climate scenarios, as risks need to be quantified and managed against sectorial reduction pathways aligned with the targets of the Paris agreement. Climate scenarios are representations of how the future climate and economic conditions may look based on various increases in global temperatures. Climate scenarios specific to Switzerland can be found here (3, 4).

While the Swiss ordinance targets only the largest companies at this time, one should expect the Swiss government to expend its scope over time in order to meet the hard realities of its international climate commitments (5), that is to halve its 1990 emission levels by 2030. Besides regulatory considerations, taking an active role on climate issues is also good for businesses of any size, and represents a competitive necessity for many. As a supplier to large companies for instance, or as a bidder on governmental contracts, even smaller companies are already being asked about their emissions and transition plans. Furthermore, companies doing business abroad might already be asked to comply with international climate frameworks (including TCDF), independently of their size. And for those looking to expand abroad, it might be requirement. Therefore, even privately held companies, companies with assets, annual turnover, or teams smaller than the ordinance prescribed sizes should evaluate the framework and understand the requirements of the climate ordinance.



Part II

The climate ordinance



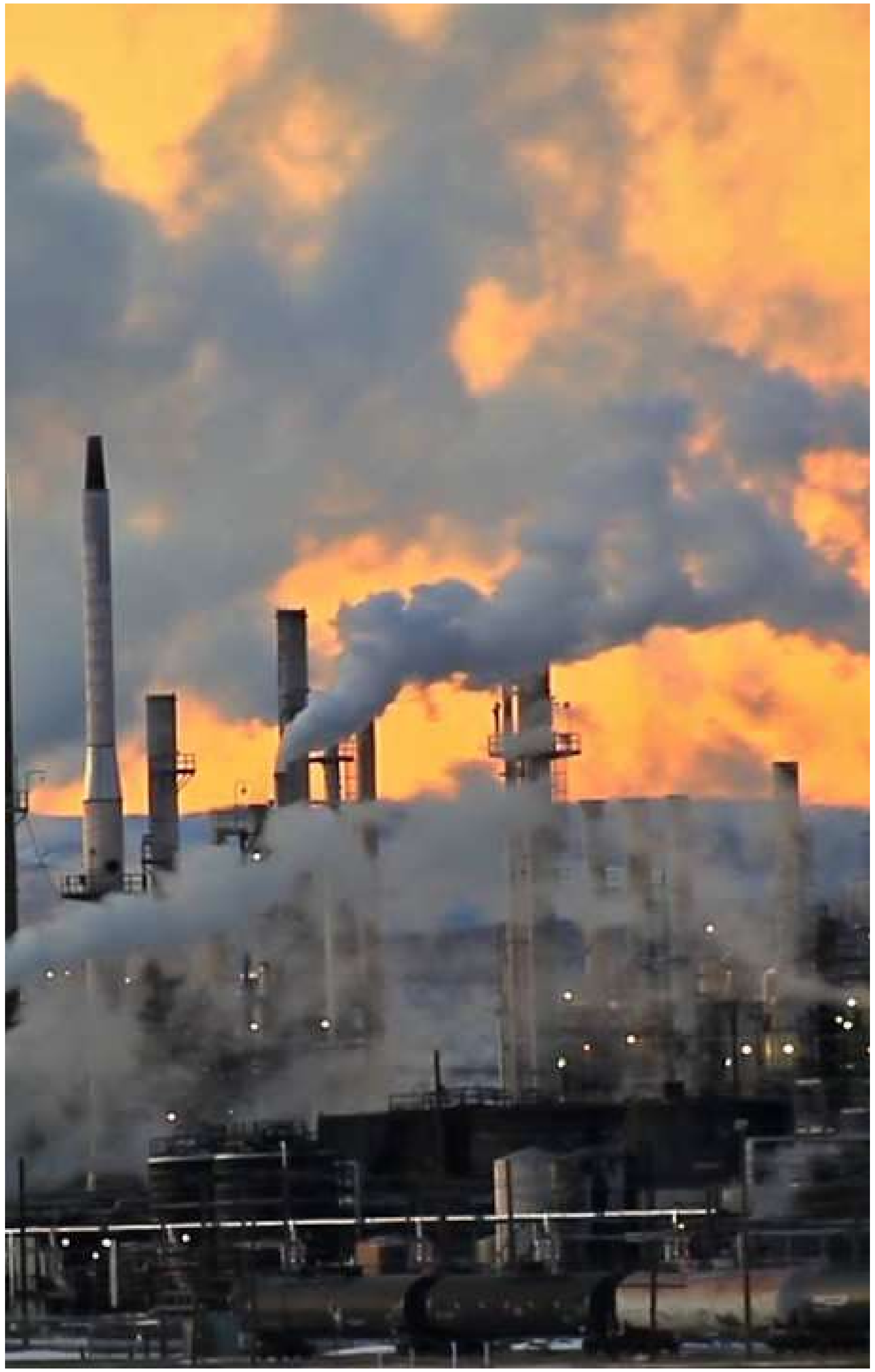
The text of the Ordinance can be found here (6). The ordinance builds on a series of measures published by the confederation in the past several years and accompanies several laws that were submitted to national votes with varying degrees of success in the past several years. These initiatives combine to position the country on the path to meeting its international climate commitments and reduction targets (Paris agreement). As the government failed to gain traction on some of its recent energy conservation and transition initiatives, one should expect that it will turn its attention to other levers to stay on track with its commitments, and therefore a scope expansion of the ordinance soon beyond the largest Swiss companies in not out of question.

The Ordinance came into force on January 1st, 2024. However, because of the transition provision, enforcement should be expected to start a year out, early 2025. Any company meeting the size criteria that has not yet started to report therefore still has a few months to act. It is a complex exercise to complete however, so for those still looking to start or have yet to aggregate their work into a formal report, we recommend initiating the work as soon as possible. Emission assessments can take as long as 6-12 months to complete, for instance, depending on the availability and completeness of the business and operational data needed to support the process. Fortunately, different aspects of the TCFD framework can be addressed in parallel. We describe the framework in greater detail below.

The TCFD framework

The Task Force on Climate-Related Financial Disclosures is an initiative that was established in 2015 by the Financial Stability Board (FSB). FSB (7) was created in 2009, after the global financial crisis, to promote stability of the international financial system. After convening for over a year, the Task Force published its framework in 2017. The framework aims to standardize the way the financial risks connected to climate change are being reported. The framework was originally used by the financial industry but has since been adopted across all economic sectors, including by public entities.

Climate-related risks are generally organized into three classes. The first class comprises acute and chronic physical risks, such as the risk of flooding faced by production facility or the compounding effect of temperature changes on the recurrence of illnesses. The second class accounts for risks related to the transition to a clean energy economy, including the timing of the transition and considerations of supply and demand related to transition scenarios. The third class encompasses litigation risks, which for a company can come from customers, activists' groups, investors, or any other stakeholder group. Litigation types include, but are not limited to, cases where a company is identified as a polluter, cases where statements made by a company are thought to be intentionally misleading (greenwashing or misleading reporting) and cases where a company is viewed as not doing enough (and therefore failing its obligations). Today, a large majority of climate-related litigation still takes place in U.S. courts. However, activities are increasing elsewhere, including in Europe (8).



The TCFD framework is articulated around four pillars, each bringing additional levels of complexity to the forefront (including technical difficulties). Companies should not shy away from tackling issues in parallel, yet creating a reduction strategy without a clear understanding of the current baseline is nearly impossible. The four pillars are:

Governance – The structural processes, assigned levels of responsibility and accountability for the management of climate change-related risks and opportunities. The key difficulty is to put teeth to this process, such as connecting executive rewards to the implementation of environmental strategies. However, there are precedents related to social issues that can be used to guide the implementation, such as approaches to address a lack of diversity or to tackle workplace gender inequalities. In the spirit of the framework, it is critical that top leaders in the organization be involved in the strategy, including the Board of Directors. Approvals at various levels of a large organization might take time and therefore ample lead needs to be allocated to properly achieve the objectives of this pillar.

Strategy – The actual and potential impacts of climate-related risks and opportunities on the business, including the multi-year strategy and financial planning. Things become a bit more complex when it comes to quantifying the impact of climate change-related risks on the business and its strategy. This analysis benefits from an understanding of transition scenarios and how they may affect the core business, both positively and negatively. For instance, changes in the costs of production of primary materials may shift production to new areas, which might then affect a company's supply chain. Likewise, the speed of the climate transition might open opportunities for new products and shift a company's list of priorities. Modeling of macroeconomic and sectorial conditions is needed to fully quantify the impacts on strategy.

Risk management – The processes used to identify, assess, and manage climate change-related risks. The process starts with the team. Does your company have an executive responsible for understanding and monitoring exposures? Is this person surrounded by resources capable of developing or maintaining the information necessary to perform risk assessments and compare them over time. Climate change-related risk assessments follow processes similar to those used to assess other risks, with the notable difference that projections generally need to reach father out into the future. It is common to look ahead a decade or more when evaluating climate change-related risks, which usually means beyond the range of standard financial projections. It is important though to use longer timelines, as today's decisions are likely to have compounding effects in the future. Any delay in acting will make the problem exponentially more difficult to address. For instance, the cost of carbon offsets has been gradually increasing in recent years (9). Investing in direct reductions today (i.e., streamlining operations and making them less carbon intensive) is likely to be cost effective over time in comparison to investing in offsets at any point down the road. Moreover, offsets need to be purchased every year while the cost of investing in permanent reductions generally decreases over time.

Metrics & targets – The Key Performance Indicators that are used to measure risks and monitor them over time. This pillar is likely the most difficult to address for most companies because it requires the quantification of a company's emissions baseline, modeling of forward-looking emission scenarios, the establishment of targets in line with carbon neutral trajectories and the selection of metrics that are relevant to the business. The process also needs to be quantitative and backed by data that is available on a regular and consistent basis. Companies will generally progress towards completing the requirements of this pillar over time. We recommend starting with simple metrics and building more detailed views over time, while remaining fully transparent on any known limitations during the reporting process.

Across all pillars, the expectation is that companies work towards a full integration of climate considerations across their business processes and business interactions (upstream and downstream). It is expected that executive level employees will be involved and that the Board is briefed regularly on ongoing activities. Collaborators are kept aware of climate issues and of any policies established by the company (such as limitations on short business flights for instance). Risks are quantified and strategies are deployed to mitigate them. The company is using its market position to influence others, such as policymakers, business partners and customers. The company reports on all aspects mentioned above and maintains a transition plan, which clearly outlines its emission levels, sources, reduction targets, and its multi-year strategy to achieve them. To fully comply with the requirements is a significant effort that requires specialized expertise.

Where to start if you are new to the framework?

Download the Task Force methodology white paper and the checklist, both provided on the TCFD website (10). The framework refers to the four pillars discussed in the previous section (governance, strategy, risk management and metrics & targets). We recommend organizing the work around those pillars. We also recommend that a cross-functional working group be formed to facilitate the gathering of data across the organization and to ensure that everyone is included. At a minimum, we recommend having representatives from the executive team, product development, supply chain management, operations, finance, marketing, human resources, and business development.

With the team formed, companies should start by surveying what has already been done across the four pillars. For instance, the topic of sustainability might come up on a regular basis at the Board meeting, even if informally. Staff events related to climate awareness, such as a mobility challenge, might already take place on an annual basis. Employees might have written an internal position paper on activities they would like to take place. Third-party partners might have provided summaries of their own strategies. Policies on topics such as waste management and recycling may already be in place. Once the information is gathered, it can be summarized in a baseline assessment that aims to position all past and ongoing initiatives within the context of the four pillars.

On that basis a gap analysis can be performed, benchmarking against the detailed recommendations of the TCFD framework as they apply to the relevant industry or industries. If this is a new initiative, it is likely that large gaps in data will be identified and therefore also in the quantitative verticals of the framework. Risk management considerations and metrics & targets are invariably some of the most difficult aspects to address in the TCFD framework.

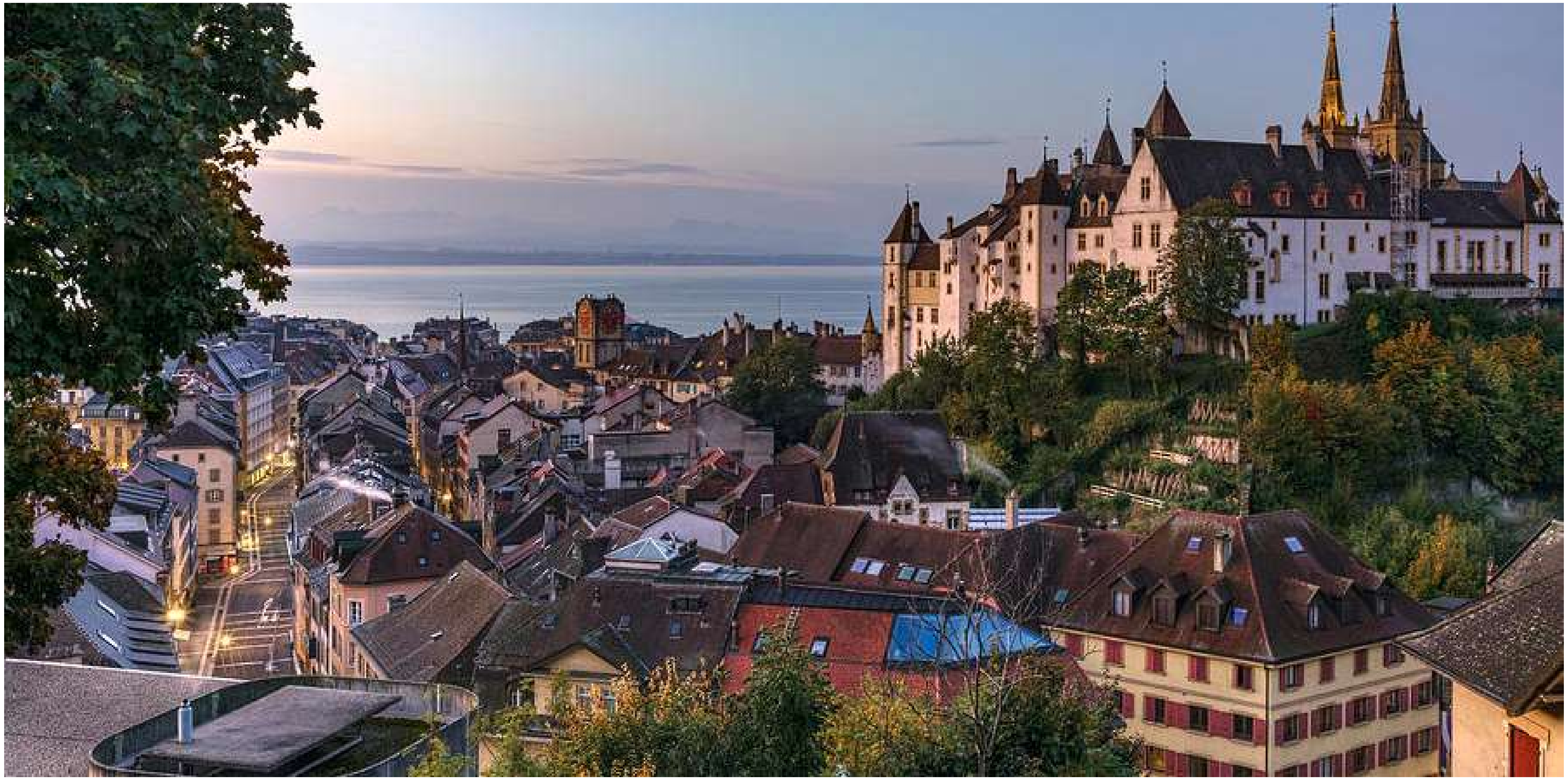
Equipped with the gap analysis, companies should then estimate the greatest opportunities and risks they face and prioritize resources and efforts to address those first. It is important to try to budget sustainability as soon as possible during the project. Executing a sustainability strategy comes at a cost, and too often we see companies initiating work without a full understanding of costs vs benefits and therefore without optimizing resources and priorities. Because companies know their own business and markets better than anyone else, the qualitative risk assessment suggested above will likely yield a priority ranking that accurately reflects the greatest risks (which resolution can then be budgeted).

The next step consists in gathering the data necessary to measure risks. As a first step, companies will need to determine their emissions. It is not possible to set reduction targets without a clear understanding of the starting point. An emission assessment will also help identify sources that contribute the most to the company's balance sheet. Companies might need to look outward to fill the gaps for incomplete data sources.

From there on and using sectorial guidance, companies can define reduction targets that align with the Paris agreement. This work is best done by analyzing climate scenarios, downscaled to the business segments and regions of operations. The quantitative risk assessment then is about understanding what is likely to happen based on various future temperature scenarios and the associated severity and frequency of the various potential outcomes.

Finally, equipped with this information, the company can plan out the work needed to reach its objectives. If the analysis was done at the right level of granularity (in particular by relying on the GHG accounting protocol (11) Scope 1, 2 and 3 segmentation), it should have insights on the proportion of emissions that can be directly reduced and the proportion that is not reducible at the present time. It should therefore be able to plan out concrete reduction actions and budget offset needs over time.

Once there, the company should proceed to report its findings, the formal governance structure it has established and its strategies forward. This work is best presented alongside other financial reports as well as in a separate transition plan, meant to specifically outline targets and annual expected reductions.



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