

Corporate Sustainability Reporting Directive— a New Sustainability Standard for EU Companies

November 2, 2022

The European Commission proposed the Corporate Sustainability Reporting Directive (the “[CSRD](#)”) in April 2021 as a new framework for companies to include sustainability information in their financial reporting. Following review and discussion, the European Parliament is expected formally to adopt the CSRD at its plenary session on 9 November 2022. Once implemented into the national law of EU member states, the CSRD’s requirements will be phased in from January 2024. The CSRD achieves its aims by amending the EU Non-Financial Reporting Directive (the “NFRD”), which is the existing basis for EU sustainability reporting in financial statements; the EU Audit Directive and Regulation, to cover the audit of sustainability information; and the EU Transparency Directive, to extend sustainability reporting requirements to companies with securities listed on regulated markets.

The CSRD substantially widens the scope of companies subject to sustainability-related reporting obligations and expands and standardises, in considerable detail, the type and form of information to be reported. It also introduces a new external audit requirement for such reports.

Current Position with Sustainability Reporting by EU Companies

A limited number of EU companies (principally EU credit institutions, insurance undertakings and those listed on an EU-regulated market, in each case with more than 500 employees) are currently subject to the NFRD. According to the Commission, this covers approximately 11,700 large companies and groups across the European Union. The NFRD requires companies in scope to include a non-financial statement as part of their annual public reporting obligations, covering information about four sustainability issues (environment, social and employee issues, human rights and bribery and corruption) and how the company addresses those issues through its business model, policies (including implemented due diligence processes), outcomes, risks and risk management and key performance indicators (“KPIs”) relevant to the business. According to the guidelines on non-financial reporting issued by the Commission, climate-related information should reflect the recommendations of the Task Force on

Climate-related Financial Disclosures. In addition, one aspect of the EU Taxonomy Regulation is that companies in scope of the NFRD must report the degree of alignment of their activities (generally measured as a proportion of turnover) with the EU Taxonomy. Otherwise, the NFRD does not introduce or require the use of a non-financial reporting standard or framework, nor does it impose detailed disclosure requirements, such as lists of indicators per sector. As a consequence, information currently disclosed takes different forms, with issues of limited comparability between disclosures.

Extension of the Reporting Obligations to More Companies under the CSRD (Including Subsidiaries of Non-EU Companies)

The CSRD will apply to all “large” EU companies which are EU companies (including EU subsidiaries of non-EU parent companies) exceeding at least two of the following criteria:

- more than 250 employees;
- net turnover of more than €40 million; or
- balance sheet total of €20 million.

The CSRD will also apply to companies with securities listed on an EU “regulated market” (broadly, the main EU stock exchanges), irrespective of whether the issuer is established in the European Union or a non-EU country. This includes small and medium-size enterprises (“SMEs”) listed on an EU-regulated market, except for certain listed micro-enterprises and SMEs listed on SME growth markets or multilateral trading facilities.

EU subsidiaries or branches of non-EU parent companies are in scope of the CSRD to the extent that the third-country company generates turnover of more than €150 million in the European Union, and the subsidiary is a large or listed company or a significant EU branch (generating more than €40 million in turnover). The EU subsidiary or branch will be responsible for publishing sustainability reports under the CSRD at the consolidated level of the non-EU parent from 2028 onwards.

The CSRD acknowledges that an EU subsidiary (or branch) may not be able to obtain the necessary information from its non-EU parent company to complete the sustainability reporting given that a non-EU parent undertaking will usually publish financial statements on a consolidated basis. As a consequence, the CSRD allows a non-

EU parent company to report on a consolidated basis for their EU subsidiaries, or branches, provided that the consolidated sustainability reporting of the non-EU parent undertaking is prepared in a manner equivalent to the EU standards. It is presently unclear whether this form of “substituted compliance” will be available to U.S. or UK companies and their EU subsidiaries, given the divergence between local disclosure standards. Where substituted compliance is not available, the CSRD requires the EU subsidiary to request its non-EU parent company to provide all the necessary information for the report. If this is not provided, the EU subsidiary must publish the sustainability report, containing such information that it possesses, with a statement indicating that the non-EU parent company did not make the necessary information available.

Mandatory Audit and Assurance Regime Regarding the Data Reported

As above, the CSRD will significantly extend the sustainability-related information that companies are required to include in their annual reports. The CSRD will also introduce a mandatory audit and assurance regime in relation to the data reported, which will either be carried out by the company’s existing auditor or an independent assurance services provider—in either case, a significant extension to the current scope of an audit.

PAI and Taxonomy Reporting Linked to Reporting Obligations of Fund Sponsors under the Sustainable Finance Disclosure Regulation (the “SFDR”)

Information reported under the CSRD will also link to information, such as information on “principal adverse impacts” (“PAI”) and alignment of activities to the environmental standards in the Taxonomy Regulation, that many fund sponsors are reporting in relation to their investee companies under the SFDR.

Under the CSRD, since Article 8 of the EU Taxonomy Regulation refers to undertakings within the scope of the NFRD, which will be expanded under the CSRD, a broader range of companies will also be required to disclose the degree of alignment of their activities with the EU Taxonomy.

Timing of Application—for “NFRD Companies” First Report Due in 2025, for Others in 2026

For financial years starting on or after 1 January 2024, the CSRD will apply to companies that are already subject to the NFRD, with the first report to be produced in 2025. Companies that are not presently subject to the NFRD will have to apply the CSRD from financial years starting on or after 1 January 2025 and report in 2026 on 2025 data. For financial years starting on or after 1 January 2026, the CSRD will apply to listed SMEs, albeit subject to an opt-out until 2028, with the report in 2027 being based on 2026 data.

The New Reporting Standards in Detail

Reporting of Sustainability Matters—Reporting of ESG Matters on Company Itself and PAI Reporting on a Forward-Looking and Retrospective Basis

A primary obligation under the CSRD is to report on “sustainability matters”, which are environmental, social and human rights, and governance factors, including principal adverse impacts on sustainability factors under the SFDR. As a key principle, companies must report on both the impacts of their activities on people and the environment and on how various sustainability matters affect their business.

The CSRD requires reporting of how the business strategy relates to sustainability matters and reporting on the company’s relevant principal adverse indicators. Importantly, companies will report such information in accordance with a detailed set of sustainability reporting standards, which are under development—see below.

Companies will provide sustainability information on a forward-looking as well as retrospective basis, both in qualitative and quantitative terms and based on conclusive scientific evidence where appropriate.

The scope of reporting notably includes sustainability risks and adverse effects, such as work-force treatment and human rights risks, in the company’s “value chain”, which are broadly its supply and distribution arrangements, in and outside the European Union. The CSRD recognises the practical challenges here—for the first three years of the CSRD, if information regarding the value chain is not available, companies can explain why they cannot obtain such information and their plans to obtain the information. There is some overlap between the CSRD and the draft Corporate Sustainability Due Diligence Directive, which will require large EU companies to identify and, where

necessary, prevent, end or mitigate adverse effects of their activities on the environment and human rights.

Companies must also report on the alignment of their business model to the Paris Agreement and the European Union's objective for climate neutrality by 2050, including their greenhouse gas emissions targets and the company's exposure to coal, oil and gas related activities.

Companies will be required to report on their "key intangible resources," which are resources such as employees' skills and relationships with suppliers. These resources often relate to particular groups of "stakeholders", such as communities benefited by the activities of the undertaking. There is a close link here between the value generated by such resources and social and environmental sustainability considerations, such as the undertaking's relationship with its stakeholders.

Separate Reporting Obligations for SMEs

There will be separate delegated acts for SMEs, which will be subject to a more limited set of reporting requirements that reflects their size and complexity.

Standardisation of Reporting; the European Sustainability Reporting Standards (the "ESRS")

The European Financial Reporting Advisory Group (the "EFRAG") is currently developing detailed sustainability reporting standards (the European Sustainability Reporting Standards (the "[ESRS](#)")), which will specify in detail the CSRD's higher level requirements, allowing the information to be audited and presented in comparable format. Sustainability reporting standards will specify the information to be presented in relation to climate change mitigation and adaptation, other environmental matters, fair and equal treatment of employees and respect for human rights. The current drafts of the sustainability reporting standards require a very extensive of qualitative information and data. By way of example, the draft reporting standard for "Own workforce" comprises 65 pages of requirements (including guidance and definitions) relating to characteristics of the workforce, engagement with the workforce, training, health and safety management systems, remuneration, discrimination and human rights issues. As above, the CSRD envisages reporting on value chains, and a separate set of standards covers "Workers in the value chain", reflecting the different considerations that apply to value-chain workers.

The European Commission is required to adopt the first set of reporting standards by 30 June 2023, with a second set of reporting standards by 30 June 2024 that will specify complementary information requirements and sector-specific standards. The standards will take account of existing international standards, such as the Sustainability

Accounting Standards Board and the Task Force on Climate-related Financial Disclosure. Sector-specific standards, which have yet to be consulted on, will be developed independently of the sector-specific standards published by the Sustainability Accounting Standards Board (the “SASB”) but will be mapped to SASB standards in later versions of the ESRS.

Relation with Other Reporting Frameworks

The CSRD recognises the need for coherence of sustainability reporting standards at the global level. As above, the detailed sustainability reporting standards will take account of existing standards and frameworks to reduce complexity and the risk of inconsistent reporting requirements on global undertakings, and make express reference to the global baseline standards developed by the International Sustainability Standards Board (the “ISSB”).

Neither the United States nor the United Kingdom has proposed sustainability reporting at anything like the scale proposed by the European Union. The Securities and Exchange Commission’s March 2022 proposal to amend the “issuer rule” deals with reporting by public companies on climate matters only, focused on disclosing greenhouse gas emissions from the relevant company and its value chain. Similarly, current disclosure requirements for large UK companies and for London Stock Exchange-listed issuers are solely climate-focused. It is worth noting, however, that the CSRD is likely indirectly to impact U.S. and UK business with EU subsidiaries or branches, which will be asked to report on more data within their group.

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