

THE EFFECTIVE DATE OF THE EU CORPORATE SUSTAINABILITY REPORTING DIRECTIVE IS IMMINENT – WHAT NON-EU COMPANIES NEED TO KNOW

On November 10, the European Parliament [adopted](#) a near-final [version](#) of the Corporate Sustainability Reporting Directive (CSRD), representing the most recent iteration of mandatory ESG reporting requirements advanced by the European Union, or by any other regulator for that matter. The CSRD is one of the cornerstones of the [European Green Deal](#) and the European [sustainable finance agenda](#), and forms part of a broader [EU policy](#) to commit companies to respect human rights and the environment in their global value chains.

Political agreement had been reached on the CSRD in June 2022 (see my previous briefing note, available [here](#)). The Council likely will adopt the CSRD at its meeting November 28. It will enter into force 20 days after publication in the *Official Journal*.

Background and Context

Action by the European Commission very much reflects the perceived need to impose harmonized disclosure standards on companies to meet growing demand by investors and other market participants for comparable, consistent and decision-useful information on sustainability. This is not just about climate, but extends as well to other environmental issues, biodiversity loss, and social and health issues. The benefit for companies also extends to enhanced access to capital from investors seeking returns based on sustainable business models and strategies. The European Commission notes that in the absence of policy intervention, the gap between what investors now demand and what companies provide will only grow wider. The gap has consequences not only for investors seeking to factor sustainability risks and opportunities into investment decisions but also increases the systemic risk affecting the financial and credit markets.

The CSRD is an update of the [Non-Financial Reporting Directive](#) (NFRD) that addresses perceived shortcomings of the NFRD by, among other things, broadening the scope of the companies subject to mandatory ESG reporting requirements (from 11,600 to 49,000) as well as broadening the scope of the disclosure.¹ To address reliability, and reduce the likelihood of greenwashing, the CSRD introduces independent audit and certification requirements.

The specific disclosure requirements applicable under the CSRD are to be set out in the European Sustainability Reporting Standards (ESRS), which are under development by the European Financial Reporting Advisory Group (EFRAG) and are to be adopted on a rolling basis as delegated acts of the European Commission (*see* [EFRAG Drafts](#)).² The first draft

¹ The CSRD amends the NFRD (2104/95/EU) as well as the [Audit Directive](#) (2006/43/EC), the [Transparency Directive](#) (2004/109/EC) and the [Accounting Directive](#) (2013/34/EU).

² It is contemplated that there will be a series of ESRSs, one covering general principles of sustainability reporting, one on general disclosure principles and the balanced focused on specific topics, including climate change, pollution, water and marine resources, biodiversity and ecosystems, resource use and circular economy, business conduct, workers in the value chain, affected communities and consumer end users.

ESRS is to be delivered shortly and the European Commission is expected to adopt the first ESRS by June 30, 2023.

The CSRD introduces more detailed reporting requirements, and a requirement to report in accordance with mandatory EU sustainability reporting standards (namely the [Sustainable Finance Disclosure Regulation](#) (SFDR) and the EU Taxonomy).

The CSRD as well as the Directive on Corporate Sustainability Due Diligence (*see* my previous briefing note, available [here](#)) have extra-territorial effect based on the level of business in the European Union or a listing on an EU regulated market. In brief, the CSRD requirements will be relevant to the following non-EU companies: non-EU companies with securities listed on an EU regulated market; potentially non-EU parents of EU subsidiaries and potentially non-EU subsidiaries of EU parent companies.

The following overview is based on the near final version of the CSRD approved by the European Parliament.

Disclosure Items

Unlike the climate-related disclosure requirements currently proposed by the SEC,³ the NFRD covers a broader range of disclosable information:

- environmental matters
- social matters and treatment of employees
- respect for human rights
- anti-corruption and bribery
- diversity on company boards (in terms of age, gender, educational and professional background)

Reporting covers the impact on business model, policies (including diligence processes), the outcome of those policies, risks and risk management, and relevant key performance indicators.

The CSRD picks up all of the foregoing requirements of the NFRD, plus it introduces new requirements noted below. The CSRD reflects a move away from “non-financial” perspectives embedded in the NFRD (as the distinction between financial and nonfinancial never made sense), in favor of information on “sustainability.” CSRD disclosure will be keyed off of two concepts:

- “sustainability matters,” which encompasses environmental, social and human rights, and governance factors, including the factors set out in the SFDR, which would pick up anti-corruption and anti-bribery matters; and

³ The proposed SEC rulemaking (in its current form):

- would cover climate only;
- would apply only to SEC registrants (and not to private companies or companies with substantial business in the United States that are not otherwise subject to SEC reporting requirements (including Level I ADR issuers));
- would not impose *per se* a double materiality standard; and
- would impose a certification requirement, but only in respect of Scope 1 and Scope 2 GHG emissions.

- “key intangible resources,” which encompasses resources without physical substance on which the business model fundamental depends that are a source of value creation.

The key disclosure topics to be included in a dedicated section of a CSRD-compliant management report (based on amendments to the Accounting Directive: Section 19a for large undertakings and SMEs, and Section 29a for parent undertakings of consolidated groups) are:

- ***business model and strategy***, including:
 - resilience of the model/strategy in relation to risks related to sustainability matters [Section 19a/29a(a)(i)];
 - sustainability-related opportunities [Section 19a/29a(a)(ii)];
 - implementing actions and related financial and investment plans to ensure that the model/strategy are compatible with the Paris Agreement thresholds [Section 19a/29a(a)(iii)];
 - how the model/strategy take account of the interests of stakeholders and the impact of the business on sustainability matters [Section 19a/29a(a)(iv)]; and
 - how the strategy has been implemented in respect of sustainability matters [Section 19a/29a(a)(v)];
- ***time-bound targets related to sustainability***, including, where appropriate, absolute GHG emission reduction targets for at least 2030 and 2050, progress to date and whether the targets related to environmental factors are based on conclusive scientific evidence [Section 19a/29a(b)];
- ***the role of the board and management*** regarding sustainability matters, including expertise and skills of the board/management, or access to such expertise and skills [Section 19a/29a(c)];
- ***policies*** relating to sustainability [Section 19a/29a(d)];
- ***incentive arrangements*** linked to sustainability [Section 19a/29a(e)];
- ***the due diligence process*** in respect of sustainability matters, and, where applicable, in line with EU due diligence requirement [Section 19a/29a(f)(i)];
- ***the principal adverse effects*** connected to the reporting company and its value chain [Section 19a/29a(f)(ii)];
- ***the principal risks*** related to sustainability matters, including principal dependencies on these matters, and how the risks are managed [Section 19a/29a(g)];
- ***actions taken to prevent, mitigate, remediate or bring to an end actual or potential adverse impacts*** [Section 19a/29a(f)(iii)]; and
- ***indicators*** relevant to the foregoing disclosures [Section 29a(g)].

There are derogations (permitting scaled disclosure) available in respect of the foregoing for, among others, SMEs, and captive insurance and reinsurance undertakings.

Required disclosure will need to cover qualitative and quantitative information, retrospective and forward-looking information, and information that covers short-, medium- and long-term horizons.

The CSRD also:

- requires companies to digitally “tag” reported information [Section 29d];
- confirms the applicability of the concept of “double materiality,” by clarifying that reporting should cover information needed to understand how “sustainability matters affect [the reporting company’s] development, performance and position” and the impact of the activities of the reporting company “on people and the environment”;
- precludes the ability of member states to allow reporting outside a management report; and
- requires third-party audit (assurance) of reported sustainability information.

Large undertakings and SMEs (except micro-undertakings) that are listed on EU regulated markets also will be required to address key intangibles resources (including social, human and intellectual capital), how the business model depends on such resources and how such resources are a source of value creation [Section 19(1)];

Applicability

The CSRD extends the scope of ESG disclosure beyond the scope of the NFRD, which covers, based on the Accounting Directive, large undertakings that are public-interest entities with listed securities and an average number of employees in excess of 500, EU credit institutions and EU insurance companies, as well as public-interest entities that are parent undertakings of a large group with an average number of employees in excess of 500 on a consolidated basis. CSRD disclosure requirements will apply to:

- all “large undertakings” or “large groups” (whether or not listed on an EU regulated market), which encompasses EU companies (either an EU company or an EU subsidiary of a non-EU parent company) or EU groups on a consolidated basis, in all cases meeting *any two of the following three* criteria: as of the most recent balance sheet date (i) more than €40 million of annual net turnover, (ii) more than €20 million of total assets, and (iii) average numbers of employees in excess of 250⁴
 - Note: this could include a large EU subsidiary of a non-EU parent company; and
 - Note: an EU parent undertaking of a large group that on a consolidated basis satisfies at least two of the three EU nexus criteria is also covered. All undertakings that are parent undertakings of large groups should report at the group level;
- companies (wherever organized) listed on an EU regulated market⁵, including SMEs that are not micro-enterprises⁶;
- EU credit institutions;

⁴ Based on definitions in the Accounting Directive (Articles 1-3).

⁵ Listed securities include equity as well as debt securities, and depositary receipts in respect of equity or debt (*see* [MiFID](#) (2004/39/EC)). EU regulated markets would not include multilateral trading facilities in the European Union.

⁶ Micro-enterprises have 10 or fewer employees, €700,000 or less of net annual turnover or total assets of €350,000 or less.

- EU insurance undertakings; and
- other companies designated as public-interest entities by national authorities.⁷

Finally, groups with non-EU parent companies will be required to comply with certain requirements (with reporting based on the entire group, from the perspective of the parent) if:

- the group, on a consolidated basis, generated net turnover of more than €150 million in the European Union in each of the last two consecutive financial years; *and*
- the group has:
 - at least one EU subsidiary that meets the requirements for an EU public-interest entity (*i.e.*, a “large undertaking,” or EU regulated market listing (other than a micro-enterprise)); or
 - a branch that generated more than €40 million in turnover in the preceding financial year.

Overall, there are only limited additional exemptions to these reporting requirements, such as if an otherwise covered company is a subsidiary of a parent entity that is already reporting under the CSRD on a consolidated basis, then a separate report is not required, unless that subsidiary is a large public interest entity (*i.e.*, listed on an EU regulated market). If an EU subsidiary within a non-EU consolidated group otherwise meets the thresholds, it would be subject to the full disclosure requirements.

Note that since Article 8 of the [Regulation to establish a framework to facilitate sustainable investing](#) (2020/852/EU) refers to Articles 19a and 29a of the Accounting Directive, the undertakings added to the scope of the CSRD will need to comply with Article 8, which calls for disclosure of:

- the proportion of turnover derived from products or services associated with economic activities that qualify as environmentally sustainable under Articles 3 (environmentally sustainable economic activities) and 9 (environmental objectives); and
- the proportion of capital expenditure and the proportion of operating expenditure related to assets or processes associated with economic activities that qualify as environmentally sustainable under Articles 3 and 9.

Timing

The CSRD’s disclosure requirements will apply as follows:

- From 1 January 2024: for EU undertakings already subject to the NFRD (including EU subsidiaries of non-EU companies), with reports first due in 2025;
- From 1 January 2025: for EU undertakings (including subsidiaries of non-EU groups) that are not presently subject to the NFRD, meeting two of the following three

⁷ The public-interest entity is defined in the Accounting Directive, Article 2(1), and includes undertakings with securities listed in on EU regulated markets, credit institutions, insurance undertakings and those designated as such by national authorities. Large undertakings are defined in the Accounting Directive, Article 3(4). Large consolidated groups are defined in Article 3(7).

thresholds - more than 250 employees, €40 million in annual net turnover and/or €20 million in total assets, with reports first due in 2026;

- From 1 January 2026: SMEs that are listed on an EU regulated market, with reports first due in 2027 (subject to a two-year opt-out, provided disclosure is provided they disclose in their management report why the sustainability information has not been provided); and
- From 1 January 2028: non-EU groups, including US and other companies incorporated outside the European Union, on a consolidated basis that have a subsidiary or branch in the European Union and meet the EU substantial business test. Reports would first be due in 2029.

Note that as a Directive, the CSRD will need to be transposed into national law. Note too that the Commission might exempt companies on a reciprocal basis, but that may be unlikely in the near-term given the breadth of the coverage of the Directive and lack of comparable third-party regimes.

Concluding Thoughts

As I have continued to observe during the pendency of SEC rulemaking on climate-related disclosures, the European Union is setting the bar not only for EU companies but also for non-EU companies that trigger the disclosure thresholds of EU disclosure regimes. The sooner global companies can move to a common template the better for all.

In the meantime, understanding the ever-changing and often inter-related disclosure requirements across multiple jurisdictions will be the price of global operations. Once again, EU standards have global implications, in the first instance for non-EU subsidiaries of EU companies and EU subsidiaries of non-EU global enterprises, and ultimately for non-EU companies with listings or substantial operations in the European Union. The web will grow as those otherwise beyond the scope of the CSRD are nonetheless asked to provide verified/audited reports on ESG matters at the request of those up the value chain that are within the scope of the CSRD.

While there are transition periods for these new disclosure requirements, their breadth and complexity warrant attention across value chains sooner than later.

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