CSRD: AN INTEGRAL ELEMENT OF THE EU SUSTAINABLE FINANCE FRAMEWORK

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On 21 April 2021, the European Commission adopted a comprehensive package of measures to reorient the flow of funds towards more sustainable investments. An integral element of this sustainable finance package is the Corporate Sustainability Reporting Directive (CSRD) proposal.[1]

The proposal builds on and revises the sustainability reporting requirements of the Non-Financial Reporting Directive (NFRD) to better align sustainability reporting with the broader regulatory framework for sustainable finance.[2] The objective of CSRD is to ensure that financial market participants and financial advisors possess the information necessary to meet the disclosure requirements set forth in the Sustainable Finance Disclosure Regulation (SFDR).[3]

The need to make sustainability-related information available to the financial industry has been highlighted in our previous article – **SFDR: Is the financial industry ready for disclosure?** Commenting on challenges around implementing the principal SFDR requirements, we stated that:

"*How difficult the implementation will be for financial products that take sustainability aspects into account, and for financial market participants or financial advisors, depends largely on the availability of the relevant ESG data. ESG data is required by the Regulatory Technical Standards (RTS) as Level 2 measures to complement the SFDR requirements. Furthermore, the obligation of investee companies to make this ESG data publicly available plays an important role.*"

In this article, we describe how the CSRD proposals fit into the EU Sustainable Finance Framework and summarize its key features in terms of in-scope definitions, reporting standards and usability of the reported data, as well as the audit requirements of the reported sustainability information.

HOW DOES CSRD FIT INTO THE EU SUSTAINABLE FINANCE FRAMEWORK?

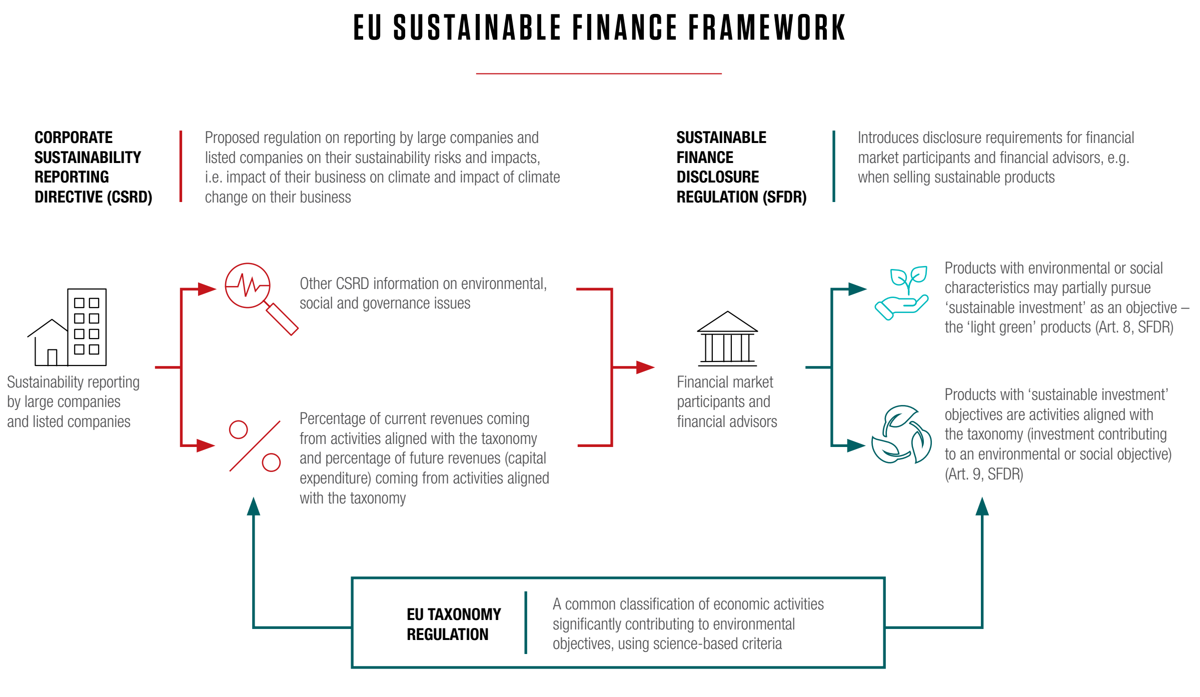
According to the EU Taxonomy Regulation, any undertaking which is subject to an obligation to publish non-financial information must include within its non-financial statement information relating to the proportion of revenues, capital expenditure and operating expenditure derived from activities that qualify as environmentally sustainable.[4]

1. Proposal for a DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL amending Directive 2013/34/EU, Directive 2004/109/EC, Directive 2006/43/EC and Regulation (EU) No 537/2014, as regards corporate sustainability reporting
2. DIRECTIVE 2014/95/EU OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groupsw
3. REGULATION (EU) 2019/2088 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 27 November 2019 on sustainability- related disclosures in the financial services sector
4. REGULATION (EU) 2020/852 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088

CSRD expands these reporting requirements so that further information on environmental, social and governance aspects must also be published to show the company's impact on sustainability matters, and the impact of sustainability matters on the company's development, performance, and position. This includes, but is not limited to, a description of the business model, strategy, resilience to sustainability risks, objectives related to sustainability matters, and the policy on sustainability issues.

The implementation of CSRD will result in an increase in the number of firms required to disclose sustainability matters and enhance both the quality and usability of the reported data. Once in force, CSRD will therefore tackle one of the main concerns regarding the disclosures of financial market participants and financial advisors. When it comes to adequately reflecting sustainability risks – especially for financial products promoting environmental or social characteristics (so-called 'light green' products, as per Article 8 of SFDR) or products that have sustainable investment as their objective (so called 'dark green' products, as per Article 9 of SFDR) – the greater availability of information will be key to fulfilling the disclosure obligations laid down by SFDR.

The following chart illustrates how CSRD fits into the EU Sustainable Finance Framework:



Source: European Commission

WHICH FIRMS FALL WITHIN THE SCOPE OF THE PROPOSED CSRD?

Currently, under NFRD only public interest firms with more than 500 employees are required to disclose non-financial matters in their management reports. CSRD extends the group of companies obliged to report on sustainability matters to all large private companies, as well as all companies listed on regulated EU markets.

While for these listed entities the threshold of 500 employees no longer applies, micro-enterprises are excluded and therefore not obliged to report in accordance with CSRD. Micro-enterprises are those entities which have fewer than 10 employees and whose annual turnover and annual balance sheet does not exceed two million euros.

Large companies will be required to report their sustainability matters according to CSRD from the financial year 2023 onwards. To ease the burden on listed SMEs, CSRD will come into force from 2026 for them.

As a result of these changes, the number of companies that are required to include sustainability matters in their management reports will increase from approximately 11,600 to 49,000, which will significantly improve the availability of ESG data needed for financial market participants and financial advisors to fulfil their obligations resulting from SFDR.

WHAT REPORTING STANDARDS WILL BE APPLICABLE POST CSRD IMPLEMENTATION?

CSRD requires companies to report in accordance with mandatory EU sustainability reporting standards which are set to be developed by the European Financial Reporting Advisory Group (EFRAG) in collaboration with relevant international initiatives.

The first set of standards is scheduled to be adopted as delegated acts by 31 October 2022, specifying the information that firms must disclose regarding their impact on sustainability matters and the effect sustainability matters have on their firms. A second set of standards, specifying complimentary information that companies need to include in their disclosures, should be adopted by 31 October 2023. Importantly, the disclosure obligations laid down in SFDR will also be taken into account when drafting these delegated acts.

WHAT MEASURES ARE PROPOSED TO ENHANCE THE USABILITY OF REPORTED DATA?

Digitization of reporting creates opportunities for more efficient use of information and offers the potential for significant cost savings for both users and companies, notably when using artificial intelligence or machine learning solutions. Therefore, companies will be required to prepare their financial statements and management reports in XHTML format and to tag sustainability information. Digitally marked data is machine-readable and can flow as structured data into the European Single Access Point for public information envisaged in the Capital Markets Union action plan.

HOW MUCH IS THE AUDITING OF THE REPORTED SUSTAINABILITY INFORMATION GOING TO CHANGE?

CSRD introduces a general, EU-wide audit requirement for sustainability information as part of the management report. The absence of such an audit requirement would reduce the credibility of the disclosed information. The statutory auditor or audit firm should examine the compliance of the sustainability disclosures with the EU reporting standards, the process carried out by the company to determine the reported information and the previously explained requirements for digitally tagging the sustainability information.

CONCLUSION

CSRD is an important step towards aligning the framework for sustainability reporting within the European Union as it ensures comparability of sustainability-related data across the European Union. Financial market participants and financial advisors facing SFDR requirements will also benefit from these additional disclosures in terms of fulfilling their reporting obligations. Finally, the usability of reported data through digital tagging of sustainability-related information paves the way for digitization as an innovation lever in the transformation to a more sustainable economy.

Contact us to learn more about how we can leverage the sustainability-related disclosures for your institution and how to set up the necessary environment for data management and analysis. Take advantage of the opportunities that the ESG regulations and the shift towards sustainable growth offer your organization.

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