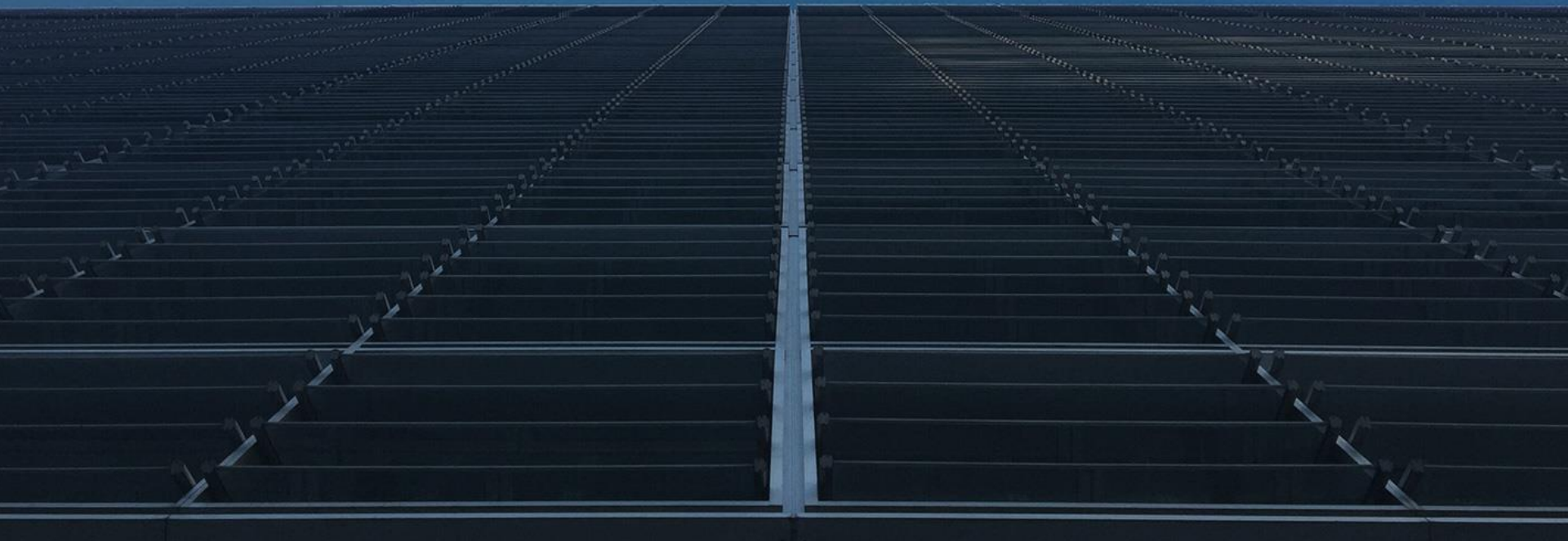


N O V E

# EU POLICY DEVELOPMENTS: CORPORATE REPORTING & DUE DILIGENCE

MARCH 2022



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EU Sustainable Finance Strategy

Taxonomy Regulation

Corporate Sustainability Reporting Directive (CSRD)

Corporate Sustainability Due Diligence Directive (CSDDD)

An aerial photograph showing a large flock of birds, likely terns, flying in a V-formation against a clear blue sky. The birds are small, white, and appear to be in flight, with their wings spread. The formation is dense and extends across the upper two-thirds of the frame. The background is a uniform, light blue color, suggesting a clear day.

# EU SUSTAINABLE FINANCE AGENDA

# EU SUSTAINABLE FINANCE STRATEGY



- **Non-legislative** initiative building on the 2018 sustainable finance action plan, aiming at **supporting the transition to a sustainable economy** with a set of actions, to avoid greenwashing, and make it easier for public authorities to raise sustainable capital.
- A revised strategy was published in **July 2021** alongside a proposal for a **regulation setting out a standard for European Green Bonds (EUGBS)**.



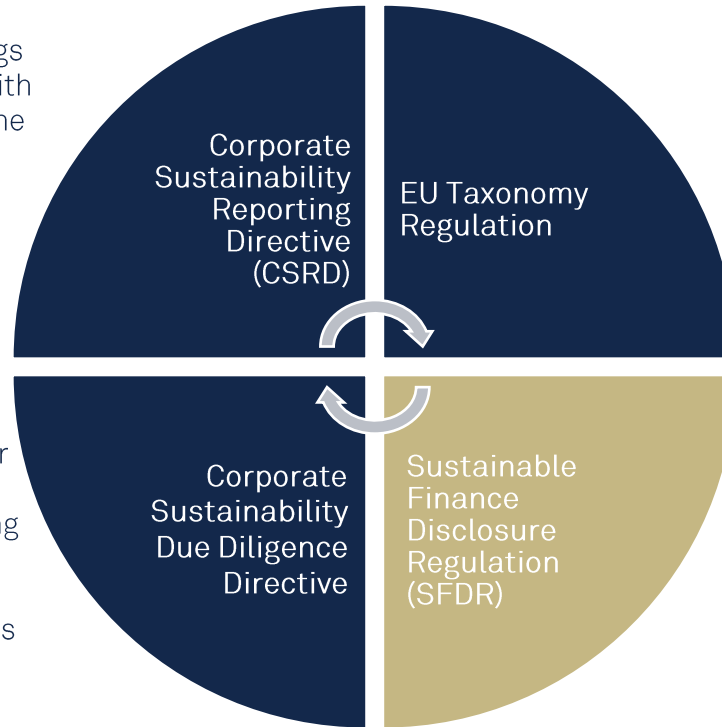
- The overall goal of the strategy is to **channel financial flows** into economic activities deemed 'sustainable' (defined by the EU Taxonomy Regulation), and to put in place **mandatory disclosure regimes for both non-financial and financial companies** to provide investors with the information they need to make informed sustainable investment decisions.

# OVERVIEW OF EU SUSTAINABLE FINANCE POLICY

Creation of a set of rules that brings **sustainability reporting** on par with financial reporting, and requires the audit of reported information.

Facilitates accurate disclosure of information in accordance with The **SFDR** and the **Taxonomy**.

New **due diligence obligations** for companies operating in the EU; complements the CSRD in outlining details about information to be reported on **environmental and human rights risks** in value chains

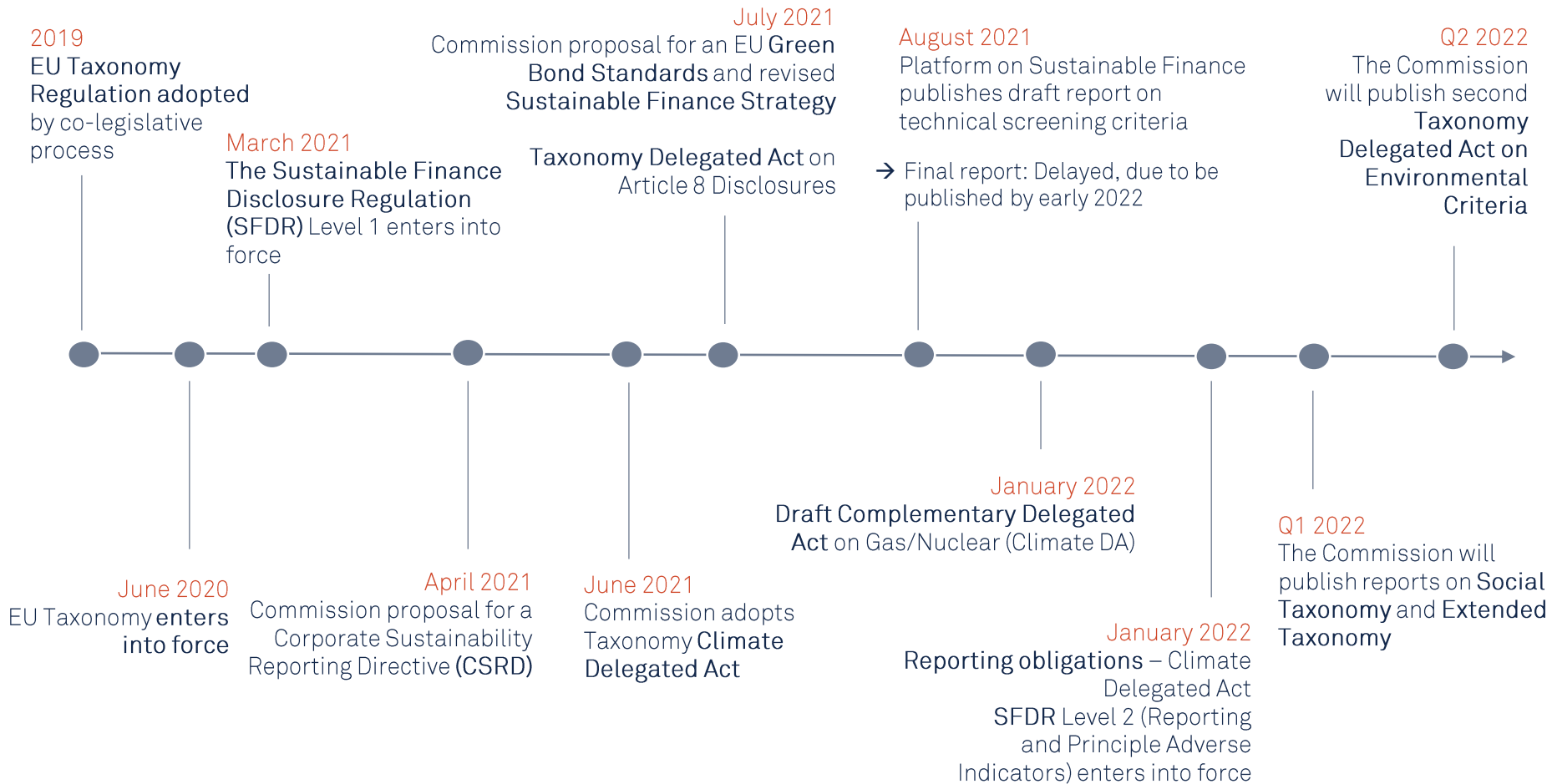


EU-wide classification system for sustainable economic activities; provides the “**common language**” for both the CSRD and the SFDR, in addition to a range of other EU policy (such as funding programmes)

Based on CSRD data, financial market participants and financial advisers are mandated to **conduct sustainability-related disclosures** of their financial products (i.e., ESG and Taxonomy related analysis)

- Non-financial actors (i.e., companies)
- Financial actors (i.e., asset managers, financial advisers, insurance providers)

# TIMELINE



A low-angle photograph of a blue sky with wispy clouds. A bird is in flight in the center. In the bottom left corner, there are silhouettes of trees and streetlights. The text 'EU TAXONOMY REGULATION' is overlaid in white in the lower right quadrant.

# EU TAXONOMY REGULATION

# EU TAXONOMY REGULATION



- Eu-wide **classification system** for **sustainable economic activities** – providing common language for investors, companies, policymakers and financial institutions; Based on **6 environmental objectives**.
- Under article 8 of the Taxonomy, companies are required to disclose the proportion of their turnover aligned with the taxonomy (**reporting obligations are set out in the CSRD**).



- Aim is to **steer green investments** to ‘sustainable’ activities by creating an operational list based on technical screening criteria.
- The Taxonomy provides the **basis for further policy work** in sustainable finance, including standards, labels and potential other new rules.



- The **Climate Delegated Act**, outlining technical screening criteria for the two first environmental objectives, was officially adopted and approved by the two co-legislators on 8 December 2021 and applies as of **1 January 2022**.
- A **second Delegated Act**, outlining technical screening criteria for the remaining four environmental objectives, is foreseen for adoption in **Q2 2022**.



# SIX ENVIRONMENTAL OBJECTIVES

- In practice, the Taxonomy is an **operational list of economic activities**, which is established with the help of **technical screening criteria**, based on the 6 environmental objectives set out in the Regulation

1) Climate change **mitigation**

2) Climate change **adaptation**

3) Sustainable use and protection of **water** and marine resources

4) Transition to a **circular economy**

5) **Pollution** prevention and control

6) Protection and restoration of **biodiversity** and ecosystems

Covered by the first  
Delegated Act on Climate

Will be covered in an  
upcoming Delegated Act

# CLASSIFICATION OF A SUSTAINABLE ACTIVITY

1. The activity must **make a substantial contribution** to at least one environmental objective;
2. The activity **must 'do no significant harm'** (DNSH) to any other environmental objective;
3. The activity must comply with the **minimum social safeguards** set out in Article 18;
4. The activity must **comply with the technical screening criteria**, published as Delegated Acts for companies to determine the extent to which their activities align with the Taxonomy.

# TRANSITIONAL AND ENABLING ACTIVITIES

In addition to ‘sustainable activities’, the Taxonomy also recognises:

- **‘Transitional activities’** for which low-carbon alternatives are not yet available, and that have greenhouse gas emission levels which match to the best performance in the sector or industry. They must also not prevent the development and deployment of low-carbon alternatives, and not lead to a lock-in of carbon-intensive assets (e.g., manufacture of steel).
- **‘Enabling activities’** that allow other activities to make a substantial contribution to an environmental objective may also be considered Taxonomy-aligned (e.g., the manufacturing of renewable energy technologies).

# ARTICLE 8 DELEGATED ACT

- On 6 July 2021, the Delegated Act supplementing **Article 8 of the Taxonomy Regulation** was adopted by the Commission, outlining the content, methodology and presentation of information to be disclosed by financial and non-financial undertakings.
- It also requires **companies falling within the scope of the existing Non-Financial Reporting Directive** – and the additional companies brought under the scope of the proposed CSRD – to report on how and to what extent their activities are aligned with the Taxonomy and can be deemed environmentally sustainable (turnover, CapEx and OpEx).
- Non-financial undertakings will need to **disclose**:
  - *Taxonomy-eligibility* from 1 January 2022
  - *Taxonomy-alignment* from 1 January 2023

# IMPLICATIONS FOR NON-FINANCIAL UNDERTAKINGS

- **Mandatory use (disclosure):**
  - Article 8 of the Taxonomy Regulation
  - Corporate Sustainability Reporting Directive (CSRD)
  
- **Voluntary use (guide for investments):**
  - There are **many possible voluntary uses of the EU Taxonomy** by market participants, which are not defined in policy instruments. For example, companies can use the criteria of the EU Taxonomy as an input to their environmental and sustainability transition strategies and plans.
  
- **Taxonomy as a reference point for other EU policies:**
  - In addition, the **Taxonomy framework also provides the basis for further policy work in sustainable finance** (e.g., it has been used as a basis for the proposal for a European Green Bond Standard) and it is becoming a **point of reference for other EU policies especially related to the public spending** (e.g., The use of the 'do no significant harm' principle of the Taxonomy Regulation is translated into the Recovery and Resilience Facility).



CORPORATE SUSTAINABILITY REPORTING  
DIRECTIVE (CSRD)

# CORPORATE SUSTAINABILITY REPORTING DIRECTIVE (



- April 2021 proposal for a **Directive** as part of the **Sustainable Finance Package** (published alongside the Taxonomy Climate Delegated Act).
- Combined revision of four existing pieces of legislation (including the **Non-Financial Reporting Directive**).
- Extend EU's sustainability reporting requirements to all large companies and all listed companies.



- Create a set of rules that brings sustainability reporting on a par with financial reporting, and requires the audit of reported information.
- Ensure companies report reliable, **comparable sustainability information** to investors and stakeholders.
- Simplify the reporting process for companies (EU standards as “one-stop-shop”).



- 31 October 2022: Adoption of a **set of standards** specifying the reporting obligations
- 31 October 2023: Complementary information about **sector-specific reporting requirements**
- 1 January 2023: Reporting requirements must be **included in management reports**, accompanied by **annual mandatory CSR audits**

# DISCLOSURE OBLIGATIONS

- **Article 8 of the Taxonomy Regulation** sets out the content, methodology and presentation of information to be disclosed by financial and non-financial undertakings (in the scope of the new CSRD).
- The **Taxonomy-disclosures by companies should be made as part of the non-financial statement** that is required under the current Non-Financial Reporting Directive (NFRD).
- The CSRD proposal also **requires the audit (assurance) of reported information**, in addition to introducing **more detailed reporting requirements** (see next slides), and a requirement to **report according to mandatory EU sustainability reporting standards**. In addition, the CSRD requires companies to digitally ‘tag’ the reported information.



# EXPANSION OF REPORTING REQUIREMENTS

- **Parent undertakings** must include the **sustainability report in the consolidated management report**, in which case **subsidiaries** are exempted from the obligation.
  - If the parent undertaking is established in a **third country**, the subsidiary is exempted only if the EU recognises equivalence of the reporting standard in the third country. The definition of 'equivalent' is, however, **yet to be defined** by the co-legislators and the Commission.
  
- The proposed directive clarifies the principle of **double materiality**, meaning that companies have to report on how sustainability issues affect their business, and about their own impact on people and the environment.
  
- Companies are required to seek **limited assurance** (a level of assurance that is less than that provided in an audit) over their reported information – option is included to move towards a reasonable assurance requirement at a later stage.

# REPORTING REQUIREMENTS

Environmental Factors	Resilience to sustainability   Business plans to comply with the Paris Agreement
Administrative, Management & Supervisory Bodies	Implemented due diligence processes   Principal actual and potential adverse impacts in value chain
Strategy Implementation	Implementation of a company's strategy with regard to sustainability matters   Opportunities for the company related to sustainability
Stakeholders	Information on how stakeholders' interests are incorporated
Sustainability Targets	With the inclusion of the progress made on these
Risks	Reporting on principal risks connected to the company
Governance Factors	e.g., Role and composition of administrative, management and supervisory bodies

Retrospective and forward-looking information	Report on qualitative and quantitative information, forward-looking, and retrospective information.
Information about "Intangibles"	Information about intellectual, human, social, and relationship capital
Environmental Factors	Extent to which an activity is environmentally sustainable according to the Taxonomy, the technical screening criteria and do-no-significant-harm thresholds of the Taxonomy.
Social Factors	e.g., Gender equality   Working conditions   Respect for human rights

# CSRD: STATE OF PLAY

## European Parliament

- The JURI committee is examining compromise amendments ahead of the **vote scheduled on 15 March**. The final vote will take place in Parliament's part-session (plenary) in March or April.
- Several committees have provided an opinion, including ECON, DEVE, ENVI, EMPL and ITRE. In these Committees, the “progressive coalition” consisting of Renew, S&D, Greens/EFA and the Left are getting majority for their amendments (e.g., expansion of scope, no exemptions)

## Council of the EU

- On 24 February, the Competitiveness Council (internal market and industry), **unanimously adopted a general approach** on the CSRD. Importantly, the Council is asking for a longer timeframe for the Directive to enter into force – to allow companies to prepare.
- The Council is expected to start negotiations shortly after the vote in plenary – the French Presidency is eager to reach an agreement **before the summer**.

A large container ship is shown from a low angle, moving through the ocean. The ship's hull is dark blue and red, with several red and blue shipping containers visible on the deck. The water is dark with white foam from the ship's wake. The sky is overcast with grey clouds.

CORPORATE  
SUSTAINABILITY  
DUE DILIGENCE DIRECTIVE

# CORPORATE SUSTAINABILITY DUE DILIGENCE DIRECTIVE



- **Legislative proposal** presented by the EU Commission on 23 February 2022.
- The Directive is centred around **new legally binding due diligence obligations** for companies operating in the EU.




- Improve corporate governance practices to **better integrate human rights and environmental adverse impacts**;
- **Avoid fragmentation** of due diligence requirements in the single market;
- Increase **corporate accountability** for adverse impacts;
- Improve **access to remedy** for those affected by adverse impacts;
- Complement other measures addressing specific sustainability challenges.






- Inter-institutional scrutiny and **negotiations**: As of March 2022
- **Entry into force** (final adoption): Likely end of 2023
- **Application** (full obligations): 2 years after entry into force [circa 2025]
- **Application** (limited obligations): 4 years after entry into force [circa 2027]

# SCOPE

	<p><b>Full obligations:</b> &gt;500 employees &amp; &gt;150 million EUR net turnover worldwide</p> <p><b>Limited obligations:</b> &gt;250 employees, net turnover of &gt; 40 million EUR worldwide &amp; 50% generated in high-impact sectors</p>
<p>EU companies</p>	

	<p><b>Full obligations:</b> &gt;150 million EUR turnover generated in the EU</p> <p><b>Limited obligations:</b> &gt;40 million EUR turnover generated in the EU, at least 50% of global turnover generated in high-impact sectors</p>
<p>Non-EU companies</p>	

## High-impact sectors

			<ul style="list-style-type: none"> <li>• Will apply to value chains beyond Conflict Minerals, regardless where extracted</li> <li>• Will apply for fabricated metal products (except machinery &amp; equipment)</li> </ul>	<ul style="list-style-type: none"> <li>• To be reviewed every seven years</li> <li>• Addition of new sectors planned</li> </ul>
<p>Agriculture</p>	<p>Textiles</p>	<p>Extraction &amp; wholesale of Mineral Products</p>		

# DUE DILIGENCE OBLIGATIONS

- Due Diligence Policy (Updated annually)
- Description of approach
  - Code of conduct
  - Description of processes

- Identification of adverse impacts\*
- Appropriate measures to identify actual or potential adverse impact (own operations, subsidiaries and value chain)

- Prevention of adverse impacts\*
- Development and implementation of prevention action plan
  - Contractual assurance, investments & targeted support for SMEs

- Addressing adverse impacts\*
- Neutralise impact
  - Corrective action plan
  - Contractual assurance, investments & targeted support for SMEs

Last resort:  
Temporarily **suspend**, and eventually **terminate** the business relationship

- Establish complaints procedure
- For persons affected
  - Trade Unions and worker's representatives
  - Civil Society Organisations

- Monitoring
- Periodic assessments of Due Diligence Policy (at least every 12 months)
  - Qualitative and quantitative assessment

- Communication to the wider public
- No new reporting obligations – these are set out in the CSRD
  - If not in scope of the CSRD: Annual statement on website

\* Companies that are only in the scope of limited obligations will only be required to address adverse impacts that are relevant to their specific 'high risk impact sector'



# VALUE CHAIN CONSIDERATIONS

- Obligations should apply with respect to **the company's own operation, the operations of its subsidiaries and the value chain operations** carried out by entities with whom the company has “an established business relationship”
- Companies in the scope should **reassess their list** of ‘established business relationships’ every 12 months.

## Definition of ‘established business relationship’:

Any direct or indirect business relationship which are lasting in view of their intensity and duration, and which do not represent a “negligible or ancillary part of the value chain”.

# DIRECTORS' DUTIES

- Only applies to **EU companies** in the scope of this Directive.
- Directors are responsible for **overseeing the due diligence obligations** and adapting the corporate strategy to take sustainability matters into account.
  - Currently, the obligations are only related to environmental and human rights adverse impacts, but the Commission should also look at expanding obligations to include climate impacts.
- Companies will need to adopt a **climate plan to** ensure that the business model and strategy is aligned with sustainability matters and with the Paris Agreement.
  - The fulfilment of the climate plan should be linked to the **variable remuneration of a director**.

# SANCTIONS & LIABILITY

<b>Sanctions</b>	<p>Will be laid out by Member States in their respective national laws when transposing the Directive (to be enforced by national supervisory authorities).</p> <p>If financial by nature, the sanctions shall be based on the turnover of the company.</p>
<b>Civil liability</b>	<p>Companies will be liable for damages if they fail to comply with their due diligence obligations (including failing to mitigate adverse impacts), and if because of the failure, an adverse impact occurred and led to damage.</p> <p>→ “Safeguard” for liability in value chains beyond tier 1</p> <p>The burden of proof will be set out by Member States in their respective national laws.</p>

# OTHER POINTS TO NOTE

- The Due Diligence Directive also includes an **amendment to the Whistle-blower Directive** to ensure that breaches of the Due Diligence Directive qualifies for the protection of the persons reporting such breaches.
- Companies shall provide **targeted support for SMEs** in their value chains (direct financing, low-interest loans, etc), and the company shall bear the costs of third-party verification when contractual assurance is demanded from SMEs.
- Member States shall encourage **existing industry schemes** for companies to use to support the implementation of their due diligence obligations.
- The civil liability rules set out in the Directive shall be **without prejudice to existing stricter rules** in EU Member States (Germany and France currently have due diligence laws in place)



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