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EU'S SUSTAINABLE FINANCE ACTION PLAN TAKES SHAPE: NEW PROPOSALS FOR CLIMATE REPORTING AND GREEN INVESTMENTS

11 May 2021 | Insight
Legal Briefings – By **Rebecca Perlman and Stéphanie Regalia**

We assess EU proposals for corporate sustainability reporting and vetting green economic activity.

On 21 April 2021 the European Commission took another step towards implementing the Green Deal and the Sustainable Finance Action Plan by adopting a package of measures, including a proposal for a Corporate Sustainability Reporting Directive (CSRD) and the first Climate Delegated Act under the Taxonomy Regulation. This was followed by the release on 7 May 2021 of the draft EU Taxonomy article 8 Delegated Act which outlines mandatory company disclosures under the Taxonomy Regulation and is open for consultation until 2 June 2021.

SNAPSHOT:

• The proposed Corporate Sustainability Reporting Directive (CSRD) aims to improve the quality, comparability and accessibility of corporate reporting on sustainability issues and applies to a greater number of companies than the current Non-Financial Reporting Directive (NFRD).
• The EU Taxonomy Climate Delegated Act provides technical screening criteria to determine activities aligned with the Taxonomy's climate mitigation and climate adaptation objectives, while the draft Taxonomy article 8 Delegated Act provides a methodology for companies required to report on the extent of their activities which qualify as environmentally sustainable.
• The package of measures further includes six Amending Delegated Acts to ensure financial advisers, asset managers and insurers include sustainability considerations in their procedures and their advice to clients.

THE PROPOSAL FOR A CORPORATE SUSTAINABILITY REPORTING DIRECTIVE

A promised action point under the Sustainable Finance Action Plan, the CSRD aims to address the reporting gaps identified in its predecessor, the Non-Financial Reporting Directive (NFRD). Feedback from consultations on the implementation of the NFRD found that companies reported insufficient information or omitted information that investors and other stakeholders thought important, with an overall lack of trust in data that is difficult to compare between companies.

The CSRD addresses these shortcomings by both extending the scope of companies covered and establishing a set of sustainability standards that will ensure higher quality reporting, better comparability between companies as well as improved accessibility through digitalisation.

On the scope:

The CSRD drops the number of employees threshold and extends the scope to listed small and medium-sized enterprises (SMEs). Below is a table comparing the scope of each directive:

Directive	NFRD	CSRD
Companies required to report	Large undertakings which are public-interest entities (i.e. listed companies, banks, and insurance companies), exceeding 500 employees during the financial year reported	**All large companies**, whether listed or not and without reference to any employee-threshold, and **all listed SMEs** (with the exception of listed micro-enterprises)
Estimated total number of companies covered	11,000	50,000

On the sustainability standards:

The proposed CSRD provides for the adoption of delegated acts defining the sustainability standards that companies are required to report against. The proposal anticipates the need for coherence between the various sustainability disclosure regulations, as it explicitly provides that the information reported must correspond to the needs of financial market participants subject to the Sustainable Finance Disclosures Regulation (SFDR). As the proposal currently stands, these standards should be adopted by the Commission by 31 October 2022. This leaves a two-year period (between 2021 and 2023) during which financial market participants will have to rely on information reported under the NFRD and other frameworks before better-aligned standards have been adopted to facilitate this process.

The European Financial Reporting Advisory Group (EFRAG) will be responsible for developing the draft reporting standards. In February 2021 the EFRAG published its final report on EU sustainability reporting standard-setting, which includes a roadmap for the development of a comprehensive set of standards.

The CSRD proposal innovates by introducing a general EU-wide audit requirement for reported sustainability information. While the objective is to provide a similar level of assurance for sustainability reporting as is applied to financial reporting, the Commission recognises that the current market for audit services is not yet able to meet this objective. The proposal therefore sets out a progressive approach, with a 'limited" assurance requirement in the absence of sustainability assurance standards. Should the Commission adopt sustainability assurance standards in the future, the level of assurance required would automatically increase to that of reasonable assurance. The proposal also allows Member States to open up the market for sustainability assurance to firms other than the usual auditors for financial information.

Finally, the Commission's proposal requires companies to digitise their reporting so that it can be fed into the European Single Access Point, as envisaged in the Capital Markets Union Action Plan. Corporate sustainability reporting should therefore be easier for investors and other stakeholders to access when carrying out market analysis and comparative research.

THE EU TAXONOMY DELEGATED ACTS

The Climate Delegated Act:

The Commission released the first EU Taxonomy Climate Delegated Act on 21 April 2021. The Delegated Act establishes the technical screening criteria to determine activities in specific sectors that make a substantial contribution to two of the six environmental objectives set out in the Taxonomy Regulation (article 9): climate change mitigation and climate change adaptation.

Sectors covered include energy, forestry, waste collection and treatment, manufacturing, transport, and buildings. Agriculture and natural gas will be covered in future delegated acts, whereas nuclear energy is still undergoing a separate review process. In March, the Joint Research Centre, the Commission's in-house science and knowledge service, released a technical assessment of nuclear energy in respect of the "do no significant harm' principle of the Taxonomy Regulation, finding that nuclear energy was compatible with the principle. The report will undergo further review by independent experts before the Commission makes a decision.

Further delegated acts are expected to determine technical screening criteria for activities that substantially contribute to the other four environmental objectives under article 9 of the Taxonomy Regulation: the sustainable use and protection of water and marine resources, the transition to a circular economy, pollution prevention and control, and the protection and restoration of biodiversity and ecosystems.

The draft article 8 Delegated Act:

On 7 May, the Commission released the draft EU Taxonomy article 8 Delegated Act, which outlines how companies that fall under the scope of the current NFRD (or potentially the CSRD, if adopted) are required to report the extent of their activities that qualify as environmentally sustainable under the Taxonomy Regulation. This draft Delegated Act complements the NFRD (and by extension the CSRD) by providing a common reference point for reporting that falls both under the scope of article 8 of the Taxonomy Regulation and the NFRD (or CSRD).

The draft article 8 Delegated Act sets out distinct KPIs for financial and non-financial companies (banks, investment firms, asset managers, and insurers/reinsurers). The Commission is accepting feedback on the draft text until 2 June 2021.

THE AMENDING DELEGATED ACTS ON SUSTAINABILITY PREFERENCES, FIDUCIARY DUTIES AND PRODUCT GOVERNANCE

The Commission also released six amendments to existing Delegated Acts relating to fiduciary duties, investment and insurance advice, product oversight and governance. These amendments are meant to ensure financial firms (advisers, asset managers or insurers) build sustainability considerations into their procedures and investment advice to clients.

The amendments require that advisers obtain information about their clients' sustainability preferences, while also clarifying the obligations that financial firms are under to assess their own sustainability risks (for example the impact of physical climate risks, such as floods, on the value of investments). Amendments to investment and insurance product oversight and governance seek to further ensure that sustainability factors are considered in designing those products.

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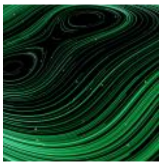

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If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.

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