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Briefing
Sustainability for Corporates: Letting the Green Light Shine

INSTITUTE OF DIRECTORS IN IRELAND

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On 21 April 2021, the European Commission adopted a proposal for a Corporate Sustainability Reporting Directive (the "**CSRD**"), with the aim of amending the existing reporting requirements under the Non-Financial Reporting Directive 2014/95 (the "**NFRD**"). The proposal is the latest in a series of measures following on from the European Commission's Action Plan: Financing Sustainable Growth, (the "**Green Plan**") and is designed to foster corporate transparency on sustainability issues and more sustainable corporate governance. The European Commission is shortly expected to publish a further proposal for a directive on sustainable corporate governance.

The Green Plan

The Green Plan, which was published in March 2018, is part of broader EU efforts to connect finance with the specific needs of the European and global economy and aims to:

- reorient capital flows towards sustainable investment in order to achieve sustainable and inclusive growth;
- manage financial risks stemming from climate change, resource depletion, environmental degradation and social issues; and
- foster transparency and long-termism in financial and economic activity.

To achieve these aims, the Green Plan includes a number of actions designed to increase corporate transparency in order to ensure that:

(a) financial market actors can properly assess the long-term value creation of companies and their management of sustainability risks, and

(b) companies are not overly focused on short-term financial performance but also have regard to the opportunities and risks stemming from environmental and social sustainability considerations.

The NFRD

The NFRD amends the Accounting Directive 2013/34 in order to require an in-scope company (a "**Company**") to report certain non-financial information, including information on how sustainability issues affect the reporting Company's performance, position and development and how the Company itself impacts on people and the environment. This reporting requirement came into effect for the first time in 2018 (covering financial year 2017) and generally applies to large public-interest entities with an average number of employees in excess of 500.

In July 2020 the Taxonomy Regulation entered into force, which, among other things, imposes additional reporting requirements on Companies. Specifically, Article 8(1) of the Taxonomy Regulation requires a Company to include in its non-financial report information on how and to what extent its activities are associated with economic activities that qualify as environmentally sustainable under the Taxonomy Regulation. According to Article 8(2), a Company must also disclose against three key performance indicators related to environmentally sustainable activities: turnover, capital expenditure and operating expenditure.

These reporting requirements will partially apply from 1 January 2022 and the European Commission must, by 1 June 2021, adopt a delegated act specifying the content and presentation of the information to be disclosed under Article 8, including the methodology to be used.

The CFRD

The origins of the CFRD lie in concerns around the effectiveness of NFRD disclosures, including regarding the sufficiency, relevance and reliability of the information being reported. The European Commission consulted on high-level changes to the NFRD in January 2020, which was followed be a more detailed consultation in February 2020.

Compared to the NFRD sustainability reporting requirements, the principal novelties of the CFRD proposal are to:

- extend the scope of the reporting requirements to additional companies, including all large companies and listed companies (except listed micro-companies) - a company will be classified as a large company if it has 250 employees or more and either an annual turnover of at least €50 million or an annual balance sheet total of at least €43 million;
- introduce a general EU-wide audit (assurance) requirement for reported sustainability information;
- specify in more detail the information that companies should report, and require them to report in line with mandatory EU sustainability reporting standards; and
- ensure that all information is published as part of companies' management reports, and disclosed in a digital, machine-readable format.

Sustainable Corporate Governance

According to the European Commission, it expects to publish a proposal for a directive on sustainable corporate governance in Q2 2021 with a view to encouraging companies to take account of opportunities and risks stemming from medium and longer-term environmental and social considerations.

By way of background, in 2019, the EU's Directorate General for Justice and Consumers commissioned a report on directors' duties and sustainable corporate governance, the objective of which was to assess the root causes of "short termism" in corporate governance. The report, which was published in July 2020, identifies a number of key drivers for short termism and state that "an EU policy intervention is required to lengthen the time horizon in corporate decision-making and promote a corporate governance that is more conducive to sustainability."

Following on from the report, in October 2020, the European Commission issued a public consultation on sustainable corporate governance which included a number of questions on directors' duties and sustainable corporate governance. It also sets out questions on due diligence requirements through the supply chain, including regarding the introduction of adequate processes to prevent, mitigate and account for human rights and environmental impacts in companies' operations and supply chains.

Conclusion

In recent years, the quantity of sustainability-related legislative developments can at times appear overwhelming. In attempting to come to grips with the various proposals it can sometimes be helpful to step back and look at the woods rather than the individual trees.

Specifically, a number of the recent legislative developments have been designed to improve the quality and quantity of information publicly available on sustainable investments. These include:

- the Sustainable Finance Disclosure Regulation, which imposes both entity and product level sustainability related disclosure requirements on financial market actors; and
- the Taxonomy Regulation, which provides for a classification system for environmentally sustainable activities, as well as additional disclosure requirements.

However, for these developments to be effective, actors in the financial markets must have access to sufficient information about their investments. The proposed amendments to the NFRD will help ensure the accessibility of this information by significantly increasing the number of companies required to report non-financial information, as well as improving the content of those reports. In turn, this will advance the EU's goal of making finance sustainable, and ultimately, the EU's transition to a low-carbon, more resource-efficient and circular economy.

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