EU Corporate Sustainability Reporting Directive: regulating beyond borders.

In brief

The EU has politically agreed on the adoption of the Corporate Sustainability Reporting Directive ("CSRD"), and will likely adopt it before the end of 2022. The CSRD will overhaul the current sustainability reporting landscape for all multinational companies with significant activities in the EU, including those headquartered outside the EU. The reporting obligations of the CSRD will progressively come into force between 2024 and 2028.

Key takeaways

Although the reporting obligations of the CSRD will not be immediately applicable, given the breadth of the reporting requirements all multinational companies with significant activities in the EU should start planning now as companies will be required to report qualitative and quantitative information across a range of environmental, social, and governance (ESG) issues. As a first step, companies should determine to what extent they will be subject to the requirements of the CSRD. This will then enable them to prepare an optimal reporting strategy, ensuring compliance with these new obligations. Other considerations include ensuring that companies have clear baseline data against which they can monitor progress, that they have adequate systems put in place to measure the necessary data and that there are appropriate resources and a robust governance framework in place to enable meaningful reporting across the areas and geographies that may be required. since the CSRD is part of a wave of new EU legislative initiatives transforming the ESG sphere from a mainly voluntary framework to compulsory requirements, companies should strive to adopt a holistic approach to compliance with EU ESG legislation, including but not limited to the CSRD, as this will be significantly more efficient and impactful, helping them achieve greater business sustainability and lowering compliance risks in a cost-effective way.

In more detail

In the context of its flagship European "Green Deal" policy, the EU is on the verge of formally adopting new legislation that will overhaul the current sustainability reporting landscape for all multinational companies with significant activities in the EU. This will also include those headquartered outside the EU, such as in the UK, US, or China.

The CSRD was initially tabled by the European Commission in April 2021 and was informally agreed last June at the political level between the EU's co-legislators[1]. To become enforceable, the agreement still needs to be formally adopted at EU level and transposed into national laws. The formal adoption will likely happen before the end of 2022, and the transposition into national laws would then have to take place over the following 18 months.

In practice, the CSRD will extend the scope of sustainability reporting obligations to a wider pool of companies and significantly reinforce existing reporting requirements. Most notably, companies will be expected to report – not only qualitative but also quantitative – information on cross-cutting sustainability issues. These will include ESG issues and will also notably cover

[1] See the Provisional Agreement of the Parliament and the Council here.

lobbying activities, specific targets, and climate neutrality plans. All reports will be subject to detailed and mandatory EU sustainability reporting standards.

The CSRD is part of a series of steps taken by the EU to transform the ESG sphere from a mainly voluntary framework to compulsory requirements. Together with, most notably, the Taxonomy Regulation and the upcoming Corporate Sustainability Due Diligence Directive, these new laws will change how companies gather, synthesize and report information on sustainability matters and manage their reputation as companies with environmentally sustainable activities and plans. In addition, this will also impact how companies monitor, control, mitigate and communicate on human rights and environmental issues arising not just within their core activities but throughout their global value chain.

A closer look at the CSRD

Who is covered by the new sustainability reporting obligations?

Under the CSRD, the obligation to report sustainability-related information falls upon specific corporate entities (namely, subsidiaries or parents) rather than corporate groups.

The following **EU companies** will be required to prepare and publish a sustainability report:

- All EU-based companies that are themselves "large" or that are parents of a group that is "large" on a consolidated basis, i.e., who meet two of the following criteria:
  - (i) Turnover above EUR 40 million
  - (ii) Balance sheet total above EUR 20 million
  - (iii) Average yearly number of employees above 250
- Small- and medium-sized (but not micro) EU-based companies whose transferable securities (e.g., shares) are admitted to trading on any regulated market in the EU.

When companies caught by this scope are part of a company group, the CSRD allows the sustainability information to be reported on a consolidated basis at a group level (instead of at the subsidiary level) by another company of the group, but only under certain conditions.

For **non-EU companies**, (partial) sustainability reporting is required at the group level if a non-EU company, at a consolidated level (or, if consolidation is not applicable, at the individual level) generated a "net turnover" of more than EUR 150 million in the EU for each of the last two consecutive financial years, and has either one or more:

(i) Branch(es) with a "net turnover" of more than EUR 40 million in the EU

(ii) EU subsidiary(ies) that is either "large" (as defined above), or has listed securities and is not a micro-enterprise

Formally speaking, the branch or subsidiary itself is responsible for publishing the information (on its website) free of charge and in at least one of the official languages of the EU.

When will the reporting obligations start?

The reporting obligations of the CSRD will progressively enter into force between 2024 and 2028.

What companies?	When do the reporting obligations start?
Companies subject to non-financial reporting under current EU law	For financial years starting on or after 1 January 2024
Large companies or parents of large groups	For financial years starting on or after 1 January 2025
Listed small- and medium-sized companies	For financial years starting on or after 1 January 2026
Non-EU companies/groups in the scope of the CSRD	For financial years starting on or after 1 January 2028

What will have to be covered by the sustainability report?

Companies covered by the CSRD will be required to report on a wide range of ESG-related factors, including at a minimum:

(i) Information on the company's business model, strategy, targets, and policies concerning ESG issues, as well as ESG-related risks

(ii) The roles, skills, and incentives of the company's leadership relating to ESG issues

(iii) Information relating to the company's value chain due diligence matters, including the principal actual (or potential) adverse impacts connected with the company's operations and value chain

The specific content of the sustainability report will be based on detailed, sector-specific, and mandatory sustainability reporting standards. Although these standards are still under development, they will at least cover the following topics:

Environmental	Social and human rights	Governance

• Climate change mitigation, including greenhouse gas emissions on scope 1, scope 2 and where relevant scope 3 greenhouse gas emissions
• Climate change adaptation
• water and marine resources
• Resource use and circular economy
• Pollution
• Biodiversity and ecosystems
	• Equal treatment and opportunities for all, including:
	  • Gender equality and equal pay for work of equal value
	  • Training and skills development
	  • The employment and inclusion of people with disabilities
	  • Measures against violence and harassment in the workplace, and diversity
	• Working conditions, including:
	  • Secure employment
	  • Working time
	  • Adequate wages
	  • Social dialogue
	  • Freedom of association
	  • Existence of work councils
	  • Collective bargaining, including the rate of workers covered by collective agreements
	  • The information, consultation, and participation rights of workers
	  • Work-life balance and health and safety
	• The respect for human rights, fundamental freedoms, democratic principles, and standards established in various international human rights treaties and instruments
		• The role of the company's administrative, management, and supervisory bodies concerning ESG issues, composition, expertise, and skills to fulfill this role or access to such expertise and skills
		• The main features of the company's internal control and risk management systems that relate to the sustainability reporting process
		• Business ethics and corporate culture, including anti-corruption and anti-bribery, the protection of whistleblowers, and animal welfare
		• The company's ability to exert political influence, including its lobbying activities
		• The management and quality of relationships with customers, suppliers, and communities that are affected by the company's activities, including payment practices, especially regarding late payments to SMEs
		• The main features of the company's internal control and risk management systems concerning the sustainability reporting and decision-making process

The sustainability report should cover qualitative, quantitative, forward-looking, and retrospective information covering short, medium, and long-term time horizons in all these categories.

The deadline for the first draft of these sustainability standards to be submitted to the European Commission is November 2022; they should be adopted a few months later, and no later than 30 June 2023. The consultation process for the second, sector-specific set of standards will likely commence in 2023, and their adoption should occur before 30 June 2024. Once adopted, both standards will be directly applicable and binding on EU Member States and EU companies. Non-EU companies required to report at group level will be subject to a different set of sustainability standards to be developed and adopted by the European Commission by to 30 June 2024.

How should companies respond?

Although the reporting obligations of the CSRD will not be immediately applicable, given the magnitude of the task, all multinational companies should start preparing now.

As a first step, companies should determine where, how, and to what extent they will be subject to the requirements of the CSRD. This will then enable them to prepare an optimal reporting strategy, ensuring compliance with these new obligations occurs in the smoothest way possible. This strategy should notably be developed in light of the developments of the general and sector-specific European sustainability reporting standards and the way the CSRD is implemented into the national law of the various European countries.

Other considerations include ensuring that companies have clear baseline data against which they can monitor progress, that they have adequate systems put in place to measure the necessary data and that there are appropriate resources and a robust governance framework in place to enable meaningful reporting across the areas and geographies that may be required

More broadly, companies should adopt a holistic approach to EU ESG legislation. Given the current levels of legislative activity in this sphere, implementing a new process to achieve compliance with each new legislative demand by the EU is likely to be inefficient. Instead, it will be significantly more efficient and impactful for companies to align themselves in a synergistic way to comply with the entire wave of EU legislation on sustainability issues, thereby achieving greater business sustainability and lowering compliance risks in a cost-effective way.

Contact Us

William-James Kettlewell
Associate
Brussels
william-james.kettlewell
@bakermckenzie.com

Fiona Carlin
Partner
Brussels
fiona.carlin
@bakermckenzie.com

Jo Hewitt
Partner
London
jo.hewitt
@bakermckenzie.com

Eva-Maria Segur Cabanac
Partner
Vienna
eva.segurcabanac
@bakermckenzie.com