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Sustainable Corporate Accountability in the EU: What is the legislative state of play?

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Sustainable Corporate Accountability in the EU

Corporate accountability, referring to a publicly listed company's performance in non-financial areas such as sustainability and social responsibility, is falling under the EU legislative spotlight. Now that the energy transition in the EU is gaining momentum, companies will have to do their part to become climate neutral, while avoiding so-called 'greenwashing'. In this context, the European Commission has been working to:

- Clarify what 'sustainable' is in the world of business
- Require companies to become more transparent about the environmental footprint that business operations have.

In a broader context, the EU is also striving to take a leadership role in what is increasingly a global trend. The meeting of the G7 finance ministers in London on 4-5 June led to a historic agreement, under which G7 nations will mandate climate reporting in line with the recommendations of the global Task Force on Climate-Related Financial Disclosures (TCFD). This is likely to encourage further national initiatives across the world, with the EU looking to be a trailblazer.

Below, we highlight how the scope of corporate accountability is being broadened in the EU and how this will result in more reporting, monitoring and transparency obligations:

1. Corporate Sustainability Reporting Directive (CSRD)

On 21 April, the European Commission published a proposal to replace the EU's Non-Financial Reporting Directive (NFRD) with the Corporate Sustainability Reporting Directive (CSRD). Under the existing NFRD, 11,700 large companies with more than 500 employees currently have to publish information on environmental, social, and human rights matters, as well as on anti-corruption and diversity on company boards. If the new CSRD enters into force, **this reporting obligation will apply to all large companies (approx. 50,000) listed on regulated markets**, and the reporting scope will be broadened by requiring more detailed information in line with mandatory EU sustainability reporting standards. Moreover, the CSRD proposal aims to improve coherence with existing pieces of legislation such as the Sustainable Finance Disclosure Regulation (SFRD), by ensuring that investee companies report on the information financial market participants need to fulfil their own SFDR reporting requirements. Early discussions on the CSRD proposal are beginning in the European Parliament and the Council of the EU, with further developments expected in Q3 and Q4 of 2021.

2. Reporting on Sustainable Finance

In June 2020, the European Commission introduced a system facilitating sustainable investment by formulating four main conditions for economic activities to be considered 'sustainable'. This 'Sustainable Finance' or 'EU Taxonomy' framework sets objective criteria reassuring investors their investments do not have a negative environmental impact. In line with article 8 of the EU Taxonomy Regulation, **the Commission will this summer further specify the way in which information about sustainability performance need to be disclosed by non-financial and financial undertakings**. The Commission will clarify the content and methodology to be used by companies under the new reporting obligations to be able to translate the technical screening criteria from the Sustainable Finance Regulation into quantitative economic performance indicators that will be publicly disclosed (e.g. percentage of environmentally sustainable economic activities in a company's turnover). These obligations will come on top of existing reporting and transparency obligations under the SFDR, the NFRD, and future obligations under the CSRD.

3. Sustainable Corporate Governance

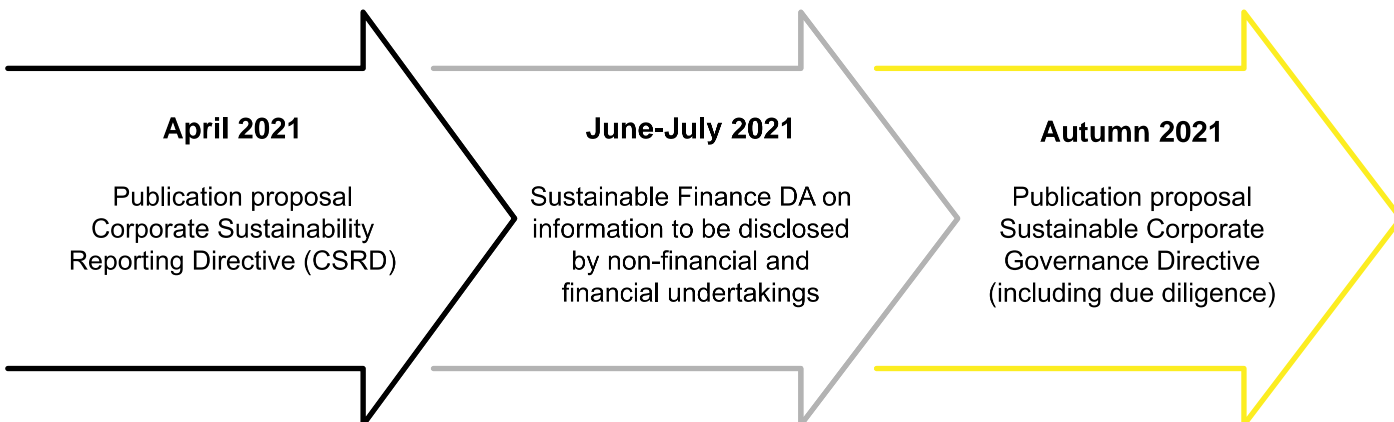
Where the CSRD, article 8 of the EU Taxonomy on Sustainable Finance and the SFDR oblige companies to report on the environmental impact of their economic activities, **the proposal for a Sustainable Corporate Governance Directive**, expected to be published by the end of the year, **will effectively require companies to undertake due diligence**. Due diligence means European companies will have to identify social, human rights and environmental abuses in their entire supply chain and mitigate the negative effects. The proposal will also entail corporate governance rules on the duties of board directors. With the Commission still in the process of translating the current voluntary due diligence requirements at OECD-level into clear targets and benchmarks that should apply nationally via the implementation of the future Directive, the upcoming rules will expectedly lead to an additional organisational and administrative burden for companies to set up internal process including reporting and transparency. The proposal is expected to be published in autumn 2021.

How will this impact companies in the EU?

Where large undertakings' non-financial reporting obligations are broadened and extended to cover due diligence, many more of these undertakings and SMEs will fall within the scope of EU reporting and due diligence monitoring obligations. Companies will have to reform board and accounting structures, while SMEs could face a greater administrative burden when reporting on due diligence. While it is clear that sustainability reporting is here to stay, timely awareness and preparation can ease the transition towards a more 'sustainable' non-financial disclosure regime.

With several initiatives in the pipeline at EU level, engagement with EU policymakers could be a useful way in shaping the regulatory framework as to facilitate a feasible non-financial reporting and due diligence framework.

Timeline EU initiatives



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