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THE RAPIDLY EVOLVING ESG REPORTING LANDSCAPE: EUROPEAN AND UK DEVELOPMENTS

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THE CORPORATE SUSTAINABILITY REPORTING DIRECTIVE AND THE EUROPEAN SUSTAINABILITY REPORTING STANDARDS

Background to CSRD. In the EU, one of the most notable stories in ESG[1] reporting legislation in 2021 and 2022 has been the development of the Corporate Sustainability Reporting Directive (CSRD).[2] The CSRD seeks to build on and strengthen the provisions and requirements of the Non-Financial Reporting Directive (NFRD).[3] Many investors and legislators believe the NFRD has not produced the quality (i.e., completeness, reliability and comparability) of ESG-related corporate information that could lead to a shift in capital to ESG-aligned investments.

The NFRD established requirements on certain entities (including EU-listed companies, insurance companies, and banks) to include a non-financial statement in their annual report. At a minimum, the non-financial information should cover environmental, social and employee matters, human rights, anti-corruption, and bribery issues. The NFRD is not a standalone directive, and in fact operates by a number of amendments to various EU directives, in particular the Accounting Directive.[4] The same will be true of the CSRD, which will introduce further amendments, including to the Accounting Directive, in order to facilitate the implementation of its requirements.

In January 2020, the European Commission (EC) published a consultation seeking opinions on whether it should revise the non-financial reporting framework, including the NFRD. In February 2020, the EC published a further consultation, and a majority of respondents supported extending

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the application of the NFRD to a broader range of companies and establishing a common reporting standard for such companies.

These consultations led to the EC issuing a proposal for the CSRD in April 2021,[5] which included substantive updates to the pre-existing reporting framework under the NFRD, including:

- Extending the scope to all large companies (including private companies) and all companies listed on regulated markets (except listed micro-enterprises);
- Requiring the audit (assurance) of reported information;
- Introducing more detailed and standardized ESG/sustainability reporting requirements, with a requirement to report according to mandatory EU ESG/sustainability reporting standards (ESRS); and
- Requiring companies to digitally "tag" the report with tagged information to be published in a dedicated section of company management reports (i.e., reports to be provided electronically/digitally in XHTML format in accordance with European Single Electronic Format regulation).

Following the EC's proposal in April 2021, the CSRD was debated and discussed between the other branches of the EU's law-making institutions, namely the European Parliament and the European Council. This negotiation process ended with an announcement of the Parliament and Council on June 21, 2022[6] that political agreement had been reached on the CSRD, and a draft of the agreed document was published on June 30, 2022.[7]

The agreed form draft was broadly aligned with the EC's initial proposal, although it contained some notable changes, such as the requirement for ESG information to be disclosed in relation to certain non-EU companies (see below for further information).

At the time of writing, this agreed form is yet to be published in the Official Journal of the EU, at which point it will be formally enacted. However, given that political agreement has now been reached, it is not anticipated that any substantive changes will be made to the final version. Therefore, the below consideration of CSRD is based on the provisions of the agreed form draft that has been published.

Structure of the CSRD and ESRS. As noted above, while the CSRD sets out broad requirements, including the scope of the provisions, the specific reporting requirements that companies will face under the CSRD are to be detailed through a set of ESRS. These ESRS themselves are yet to be completed, with the EU setting a target date of November 2022 for the first ESRS to be submitted to the EC.

The EC mandated the European Financial Reporting Advisory Group (EFRAG) to develop draft ESRS requirements, and this work was delegated to a specific Project Task Force on ESRS (PTF-ESRS), consisting of members from 13 Member States, with expertise from a variety of sectors including companies, NGOs, auditors, and financial institutions.

During the winter of 2021-2022, EFRAG made available a number of Working Papers to be considered as work-in-progress documents, which provided stakeholders with an initial understanding of the conceptual thinking of the PTF-ESRS as to the structure and context of the ESRS.

EFRAG followed up with a public consultation on exposure drafts of the ESRS, which ran between April and August 2022.[8] The exposure drafts were published to seek the views of stakeholders on the various aspects of the ESRS, including their interoperability and the specific requirements that companies would face when disclosing ESG information.

According to EFRAG, the exposure drafts' architecture was designed:

- To organize the reporting of relevant disclosures addressing ESG/sustainability subject matters as required by the CSRD proposal;
- To foster maximum comparability across sectors while ensuring appropriate room for and balance between sector agnostic, sector-specific, and entity-specific information; and
- To facilitate the navigation through the reported information.

To facilitate these objectives, the ESRS are organized by categories intended to interact with each other. There are three primary categories of ESRS, two of which were included in the public consultation (with sector-specific standards to be developed at a later date). These categories are:

- *Cross-Cutting standards*: These standards cover general provisions that apply to sustainability reporting under the CSRD, including principles that companies should follow when disclosing under the specific topical standards (both sector-agnostic and sector-specific). Such sustainability disclosure requirements also relate to how companies comply with the ESRS, the way sustainability is embedded into the companies' business models, and how sustainability risks are identified. Two cross-cutting standards were released as part of the public consultation: ESRS 1 and ESRS 2.
- *Sector-Agnostic Topical Standards*: These standards cover a specific sustainability topic or sub-topic from a sector agnostic perspective. They set disclosure requirements relating to sustainability impacts, risks, and opportunities that are deemed to be material for all

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companies, regardless of the sectors they operate in. Such disclosure requirements complement those prescribed by the cross-cutting standards and cover information to be reported on the policies, targets, actions and action plans, resources adopted by the undertaking on a given sustainability topic or subtopic, as well as corresponding performance measurement metrics for each sustainability topic or subtopics. Eleven sector-agnostic topical standards were released as part of the public consultation, five of which covered environmental issues (ESRS E1-E5),[9] four for social issues (ESRS S1-S4),[10] and two for governance disclosures (ESRS G1 and ESRS G2).[11]

- *Sector-Specific Topical Standards*: The ESRS architecture foresees the preparation of sector-specific standards, not included in the public consultation. Such standards will prescribe disclosure requirements designed to provide for the preparation of information relating to sustainability risks, impacts, and opportunities that are deemed to be material for all undertakings operating in a given sector.

Scope of the CSRD. As noted above, the CSRD will apply to considerably more entities than are currently subject to the requirements of the NFRD. First, the CSRD will apply to all companies listed on EU-regulated markets, except for listed micro companies. Second, it will apply to a "large undertaking" that is an EU company (including any relevant EU subsidiary of a non-EU parent). A large undertaking is a defined term in the Accounting Directive and means an entity that exceeds at least two of the following criteria:

- A net turnover of €40 million;
- A balance sheet total of €20 million; and
- 250 employees on average over a financial year.

In addition, EU parent companies of "large groups" (i.e., corporate groups consisting of parent and subsidiary companies to be included in consolidated accounts and which, on a consolidated basis, exceed at least two of the three criteria noted above with respect to a large undertaking) will be required to report on a consolidated basis on behalf of the entire group.

The CSRD will also apply to insurance undertakings and credit institutions regardless of their legal form.

There are exemptions to the application of the CSRD. Most notably, a subsidiary will be exempt if its parent company includes reporting on the subsidiary in the parent's CSRD-compliant non-financial report. This will include those parent undertakings that are located outside the EU but report in accordance with standards deemed "equivalent" by the EC in separate regulations (which have not yet been published). As mentioned above, listed micro companies and non-listed small and medium-sized enterprises, or SMEs (and micro companies) are not subject to the CSRD's requirements, but can (and may be encouraged by investors or other stakeholders to report in line with the CSRD on a voluntary basis.

Notably, one of the key differences between the EC's original proposal for a CSRD and the politically agreed version was the inclusion of reporting requirements in relation to non-EU companies. Non-EU companies that would face these requirements are those that generate a net turnover of more than €150 million in the EU (for two consecutive years) and which have either:

- A large subsidiary (see thresholds above—notably, this would not include EU subsidiaries that were not large in their own right but were the parent companies of a large group); or
- A branch in the EU with net turnover of over €40 million.

Reporting requirements under the CSRD would not fall directly on those non-EU companies, but instead would be obligations of the EU-based branch or subsidiary, which would be required to procure the relevant information from its non-EU parent and include it in reports.

To the extent that the EU subsidiary or branch is unable to procure all of the required information to report in accordance with the CSRD, it would be required to issue a public statement stating that the non-EU entity did not make the necessary information available, and the EC shall publish a list of those third-country undertakings that have not provided the required information on its public website.

Notably, separate reporting requirements will be published by the end of June 2024 for the non-EU companies that will have obligations under the CSRD. These are unlikely to be as granular or detailed as the ESRS (see below), but will likely contain many of the same requirements.

Specific disclosure requirements under the CSRD/ESRS. While the ESRS are still to be finalized, and the drafts that have been made public as part of the consultation may well be subject to significant revision before entering into effect (in particular, given that the drafts were based on the EC's proposed CSRD as opposed to the politically agreed draft), it is still possible to draw some high-level conclusions about the specific requirements that companies will likely face under the CSRD from the text of the CSRD and the exposure drafts of the ESRS.

While going into each of the reporting requirements is not feasible within the scope of this Chapter, some of the key highlights/most notable reporting requirements are:

- The requirement to disclose a transition plan, demonstrating how the company's business model and strategy are compatible with the transition to a net zero economy and with limiting global warming to 1.5 °C;
- Reporting on absolute greenhouse gas emissions, including Scope 3 emissions;
- The use of scenario analysis as part of climate change mitigation and adaptation planning and the identification of key climate risks for the company;
- Discussion of how the company mitigates its impacts on workers in its supply chain and on the communities in which it and its value chain operates;
- The alignment of the company's business operations with the EU Taxonomy (see below for further information in relation to the EU Taxonomy), including in relation to the Taxonomy's "minimum safeguards" in relation to human rights; and
- Details of the company's strategy and approach, processes, and procedures as well as performance with respect to business conduct. Business conduct in this context includes issues such as corporate

culture, avoiding corruption and bribery, and transparency about anti-competitive behavior.

Notably, companies reporting under the CSRD will be required to ensure their reports are certified by an accredited independent auditor or certifier. This independent auditor or certifier must ensure that the sustainability information complies with the certification standards that are to be adopted by the EU. The reporting of non-EU companies that is subject to the CSRD must also be certified, which can be done by an auditor that is certified either in the EU or in their home country.

Timing and implementation. As noted above, the Parliament and Council must formally approve the political agreement before it is published in the Official Journal of the EU. It will enter into force 20 days after publication and its provisions must be integrated into Member States' national laws within 18 months from that date.

EFRAG intends to finalize the first ESRS and present it to the EC by November 2022, ahead of its adoption shortly after. The intended phase-in dates for the obligations of companies under the CSRD are staggered based on the type of company as follows:

- January 1, 2024, for companies already subject to the NFRD;
- January 1, 2025, for large companies and parent companies of large groups that are not presently subject to the NFRD;
- January 1, 2026, for listed SMEs, small and non-complex credit institutions, and captive insurance undertakings; and
- January 1, 2028, for non-EU entities required to report under CSRD.

The CSRD would not have direct effect, and so would have to be implemented by national legislation in each of the EU Member States.

Summary. While the exact details of the ESRS are yet to be finalized, the CSRD represents one of the most detailed, broad ranging, and challenging ESG/sustainability reporting requirements that companies will face globally in the short to medium term. The extension of the requirements to certain non-EU companies will also bring into scope entities that may not expect to be subject to EU requirements, and that largely operate in jurisdictions that have considerably less stringent or slower developing ESG reporting frameworks and requirements in place.

CORPORATE SUSTAINABILITY DUE DILIGENCE DIRECTIVE

Background. On February 23, 2022, the EC adopted a proposal for the corporate sustainability due diligence directive (CSDDD).[12] The EU's regulatory scrutiny board had twice rejected earlier proposals for CSDDD, and therefore the proposal finally adopted was an amended version of these earlier attempts. The CSDDD aims to better protect environmental and human rights, including labour rights throughout the supply chains of European companies and also companies operating in the EU.

The rules proposed in the CSDDD are wide ranging and include a number of notable developments that have not been publicized to the same extent as the core obligation of companies to perform diligence on their value chains. The CSDDD is considered part of the EU's Green Deal and is a further example of the global trend toward regulatory oversight of supply chains. It follows related legislation such as the UK's Modern Slavery Act[13] and the French Duty of Vigilance Act,[14] which has gained further momentum through the U.S. Uyghur Forced Labor Prevention Act[15] and Germany's mandatory human rights due diligence law,[16] both passed in 2021.

Scope of the CSDDD. The CSDDD would extend to certain large companies operating or based in the EU. The thresholds are based on a combination of employee numbers, turnover, and industry type. Lower thresholds are set for both EU and non-EU companies that are viewed as operating in "high-impact" sectors, meaning that they generate over 50 percent of their revenue in sectors that the EU has determined to have higher-risk supply chains, including clothing, extraction of mineral resources, agriculture, and metals manufacturing.

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Type of Company	Revenue Threshold	Employee Threshold
EU based *Non-high-impact company*	Global revenue of over €150 million	500+
EU based *High-impact company*	Global revenue of over €40 million	250+
Non-EU based *Non-high-impact company*	EU-wide revenue of over €150 million	No threshold
Non-EU based *High-impact company*	EU-wide revenue of between €40 million and €150 million	No threshold

The thresholds for each type of company are:

Requirements of the CSDDD. Pursuant to the CSDDD, in-scope companies would have to publicly identify "actual and potential" adverse impacts on the environment and/or human rights of the operations of not only the company itself and its subsidiaries, but also "value chain operations carried out by entities with which the company has an established business relationship." Such adverse impacts include forced labor, inadequate worker health and safety, exploitation of workers, greenhouse gas emissions, pollution, and ecosystem degradation.

The CSDDD does not define the concept of "established business relationship," but notes that the "establishment" of such relationships should be reviewed at least every 12 months. Companies would then have to implement measures to prevent and mitigate potential adverse environmental and/or human rights impacts, and bring to an end or minimize the extent of any such actualized adverse impacts. The CSDDD includes a list of actions that companies in this context would be required to take, if relevant (e.g., seeking contractual assurances, making necessary investments, and providing targeted and proportionate support for SME suppliers).

In-scope companies would also be required to integrate due diligence into their corporate policies and implement a specific due diligence policy, which would need to be updated annually and the effectiveness of which must be regularly monitored.

Notably, the CSDDD would also introduce a requirement for certain companies (EU companies with global revenue over €150 million and over 500 employees and non-EU companies with EU revenue of over €150 million) to design a plan to ensure that their business models and strategies are compatible with the transition to a sustainable economy and with "the limiting of global warming to 1.5 degrees Celsius in line with the Paris Agreement." This plan would need to include details of the extent to which climate change is a risk for, or an impact of, the company's operations.

For those companies that identify climate change as a principal risk for, or principal impact of, their operations, the plan must also include emissions reduction objectives. The CSDDD also states that any director who has variable remuneration that is linked to their contribution to the company's business strategy and long-term interests and sustainability, should have the fulfillment of the plan factored into such variable remuneration.

Like the CSRD, the CSDDD would not have direct effect, and so would have to be implemented by national legislation in each of the EU Member States. The Member States would have two years from the enactment of the CSDDD to complete this process.

The CSDDD also introduces specific duties for the directors of in scope EU companies. These duties include the requirement that, when fulfilling their duty to act in the best interest of the company, directors take into account the consequences of their decisions for sustainability matters. Such matters include, if applicable, human rights, climate change, and environmental consequences in the short, medium, and long term. In addition, directors would have a specific duty to put in place and oversee the due diligence actions required by the CSDDD, with due consideration for relevant input from stakeholders and civil society organizations.

The CSDDD contains enforcement provisions in both public and private litigation. Public enforcement (by way of fines) would be left to Member States, with the EC noting that no new authorities would necessarily need to be created, and Member States could use existing national authorities that may be well-positioned to implement enforcement measures. However, the EC has proposed to establish a European Network of Supervisory Authorities to help implement the CSDDD, in order to facilitate bloc-wide coordination and convergence of regulatory, investigative, sanctioning, and supervisory practices.

The CSDDD would also create a separate civil liability regime under which private parties could sue and be sued in EU courts for damages incurred as a result of breaches. Persons negatively impacted by an EU company's operation could sue if the company did not sufficiently act to prevent, minimize, end, or mitigate the adverse impacts of its business activity. However, the proposed civil liability regime is somewhat limited in scope—if companies secure contractual assurances from business partners in relation to compliance with their supplier code of conduct (and undertake appropriate verification measures accordingly), then they may have defenses in respect of such civil claims.

Timing. The CSDDD, at this stage, remains a proposal of the EC, and therefore will be debated and discussed with the other relevant institutions (the Parliament and Council) through the EU's trilogue process before a final version is enacted.

This negotiation process may lead to significant revisions to the provisions of the CSDDD, and therefore the progress of the proposal should be carefully monitored through the coming months. Once adopted, the CSDDD will need to be transposed by each EU Member State into national law, as directives do not have direct effect in the EU. The CSDDD proposal states that Member States would have to apply the CSDDD provisions

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within two years from the entry into force of the CSDDD for the larger in scope companies,[17] and within four years for the other companies that are in scope.

SUSTAINABLE FINANCE DISCLOSURE REGULATION

Background. The Sustainable Finance Disclosure Regulation (SFDR) imposes mandatory ESG disclosure obligations for asset managers and other financial undertakings.

The SFDR was introduced by the EC alongside the Taxonomy as part of a package of legislative measures arising from the EC's Sustainable Finance Action Plan. The EC's aim in developing the SFDR was to improve transparency, prevent greenwashing, and direct capital towards more sustainable investments/products and businesses, in response to the calls of investors, consumers, and other stakeholders for more accurate, comparable, and transparent ESG-related information from financial market participants.

Requirements of the SFDR. The SFDR was adopted by the EU in 2019 and entered into force in March 2021. The SFDR lays down certain sustainability disclosure obligations at both product level and entity level for financial advisers and financial market participants entities in relation to financial products, with the intention that these additional disclosures will lead to the redirection of capital toward more sustainable investment and mitigate greenwashing risks through improved transparency.

In addition, the SFDR includes disclosure obligations in relation to adverse impacts on sustainability matters at entity level and for specific financial products. These obligations require financial market participants and financial advisers to disclose whether they consider negative externalities on ESG issues of the investment decisions/advice and, to the extent applicable, how this is reflected at the product level.

In July 2022, Regulatory Technical Standards for the SFDR were published in the Official Journal, which include prescribed form templates that entities will be required to disclose against when offering certain sustainability-related financial products and a statement for presenting key performance indicators in relation to any adverse impacts that are identified. These Regulatory Technical Standards will enter into effect from 1 January 2023.

EU TAXONOMY

Background. An important component of the EU's Sustainable Finance Action Plan from 2018 is the EU Taxonomy Regulation, which came into effect in July 2020.[18] The Taxonomy Regulation tasks the EC with establishing a list of environmentally sustainable activities, and defining technical screening criteria for each of six environmental objectives.[19] The aim of the Taxonomy Regulation is to develop a set of criteria that determine whether a specific economic activity (as opposed to a company or economic operator as a whole) is "sustainable."

These criteria for the climate change adaptation and mitigation objectives were formally adopted for the consideration of the Parliament and Council by the EC in June 2021, after a challenging set of negotiations was published in the Official Journal of the EU in December 2021. Criteria for the remaining objectives will be established through further delegated acts, which the EC is due to adopt before the end of 2022. See below for further information in relation to these delegated acts.

The operative provisions of the Taxonomy have applied since January 1, 2022, with respect to climate change mitigation and climate change adaptation environmental objectives, and will apply from January 1, 2023, when they relate to the other environmental objectives.

The Taxonomy Regulation applies at both a product level, which is relevant for those financial market participants making available financial products in the EU, and at an entity level, to those entities that are subject to the NFRD, or which will be subject to the CSRD (once the CSRD is in effect).

Structure of the taxonomy regulation. In order to be considered a "sustainable" economic activity (otherwise known as being "Taxonomy-aligned"), an economic activity must:

- Contribute substantially to one or more of the environmental objectives set out in the Taxonomy;
- Not significantly harm any of the other environmental objectives;
- Be carried out in compliance with the minimum safeguards; and
- Comply with the technical screening criteria that are established pursuant to delegated acts introduced by the EC.

In turn, the six environmental objectives that an activity may contribute to are listed in the Taxonomy Regulation. The Regulation itself contains high level information about how an activity may substantially contribute to each environmental objective, with more specific and granular requirements included (in the case of climate change mitigation and climate change adaptation) or to be included (in the case of the other four environmental objectives) in Technical Screening Criteria. The environmental objectives are:

- Climate change mitigation;
- Climate change adaptation;
- Sustainable use and protection of water and marine resources;
- Transition to a circular economy;
- Pollution prevention and control; and
- Protection and restoration of biodiversity and ecosystems.

Economic activities can also be considered Taxonomy-aligned if they are determined to be "enabling activities," or activities that directly enable other activities to make a substantial contribution to one or more of the environmental objectives, have a substantial positive environmental impact on the basis of life cycle considerations, and do not lead to a lock-in of assets that undermine long-term environmental goals.

The Taxonomy Regulation also sets out what may be considered "significant harm" in the context of each environmental objective. This can range from having significant GHG emissions (in the context of climate change mitigation), to significant inefficiencies in the use of materials and the direct or indirect use of natural resources (in the context of circular

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economy). The EC issued technical guidance on the application of the do-no-significant-harm principle in February 2021.[20]

The minimum safeguards that an activity must meet to be considered Taxonomy-aligned are based on international frameworks in relation to corporate conduct and human rights. These frameworks include:

- The OECD Guidelines for Multinational Enterprises;[21]
- The UN Guiding Principles on Business and Human Rights;[22]
- The International Labour Organization's Declaration on Fundamental Principles and Rights at Work;[23] and
- The International Bill of Rights.[24]

The technical screening criteria are a set of more granular and specific requirements (over and above the high-level requirements of the Taxonomy Regulation itself) that economic activities are required to meet, in order for those activities to be Taxonomy-aligned. These requirements are set out in delegated acts that have been, and will continue to be, adopted by the EC, and will be regularly reviewed given the developing nature of science in this area. The technical screening criteria have a number of roles, including identifying the most relevant potential contributions to the given environmental objective, specify minimum requirements that are required to be met, and set quantitative and qualitative thresholds in relation to performance. Please see below in relation to the technical screening criteria that have already been developed and published as delegated acts.

Transparency requirements. Article 8 of the Taxonomy Regulation requires certain companies (namely financial market participants and those subject to CSRD) to provide information to investors about the environmental performance of their assets and economic activities. In this regard, the EC adopted the Article 8 delegated act (discussed below), which specifies the content, methodology, and presentation of information to be disclosed by large companies on their activities' alignments with the Taxonomy.

Financial products with objectives relating to sustainable investment or carbon emission reduction may also need to make additional pre-contractual and periodic reporting disclosures under Article 5 of the Taxonomy Regulation.

Delegated acts. Given the highly technical nature of many of the topics included in the Taxonomy, the Taxonomy Regulation gives the EC the ability to adopt delegated acts relating to certain matters. Delegated acts are measures adopted by the EC under a specific mandate, which are used to supplement elements of framework primary legislation in the EU.

The EC published the first such delegated act in the Official Journal of the EU on December 10, 2021, and concerned disclosure obligations for companies under Article 8 of the Taxonomy Regulation (the Article 8 Delegated Act).

Article 8 of the Taxonomy Regulation contains the provision that requires corporates that are subject to the NFRD (soon to be extended to those subject to the CSRD) to disclose the proportion of their turnover, capital, and operational expenditure that is Taxonomy-aligned. It also sets out common rules relating to key performance indicators. The Article 8 Delegated Act sets out certain application dates for companies to disclose this information, which in the case of the requirements to disclose Taxonomy-aligned activities was during 2022.

Another delegated act that entered into force in December 2021 was what has come to be known as the Taxonomy Climate Delegated Act. This delegated act specifies the technical screening criteria for the first two environmental objectives in the Taxonomy Regulation, namely climate change mitigation and climate change adaptation, including determination thresholds as to whether an activity aimed at climate change mitigation or climate change adaptation would in fact do significant harm to another one of the environmental objectives. The Taxonomy Climate Delegated Act has been in force since January 1, 2022, and the EC intends to supplement it with similar delegated acts with respect to the remaining four environmental objectives during 2022.

Finally, the EC, after much consideration and controversy, published on March 9, 2022, a complementary delegated act in relation to nuclear and natural gas energy activities (the Complementary Delegated Act). The Complementary Delegated Act applies from January 1, 2023, and sets out certain conditions under which nuclear and natural gas energy activities can be included in the list of taxonomy-aligned economic activities.

These conditions include:

- That the activities contribute to the transition to climate neutrality;
- In relation to natural gas, that the activities contribute to the transition from coal to renewables; and
- In relation to nuclear, that the activities fulfill nuclear and environmental safety requirements.

Future development in relation to taxonomy. Under Article 26(1) of the Taxonomy Regulation, the EC was due to publish a report on the Taxonomy Regulation and its implementation by July 2022, and the report is to be refreshed every three years. However, as of the date of writing, this first report has not yet been published. Given the continuing development of science in this area, the Taxonomy, and in particular the technical screening criteria, is intended to be continually refined over the years. Therefore, accurately disclosing to it over a period of time will likely require a level of expertise at disclosing companies and investors.

Social taxonomy. In addition to the Taxonomy, which focuses primarily on environmental sustainability, EU institutions have also been interested in the development of a Social Taxonomy. On February 28, 2022, the EU Platform on Sustainable Finance (PSF) published a final report[25] on a Social Taxonomy, which set out a proposed structure within the current EU legislative framework on sustainable finance.

The PSF report utilized many of the structural aspects of the environmental Taxonomy, such as the development of "social objectives," types of substantial contributions, the do-no-significant-harm principle, and minimum safeguards.

A key difference was that the three social objectives identified in the report (which were (i) decent work, including for value chain workers; (ii) adequate living standard and wellbeing for end-users; and (iii) inclusive and sustainable communities and societies) were then divided into "sub-objectives." The sub-objectives focus on health and safety, healthcare, housing, wages, non-discrimination, consumer health, and communities' livelihoods.

The EC website states that the PSF report will be analyzed in due course, but specific timeframes for follow-up action have not been outlined to date.

EU GREEN BOND STANDARD

Background. A further aspect of the EU's Action Plan was the proposed creation of an EU-wide standard for green bonds. This suggestion was brought into legislative form via a proposal for a regulation from the EC published on July 6, 2021, which followed an earlier consultation on the subject.

The EU Green Bond Standard (GBS) is intended to set out uniform requirements for issuers of bonds that wish to use the label "green" or market their bonds as environmentally sustainable in the EU. One key feature of the GBS is that it is proposed to be a wholly voluntary standard. Therefore, no (new) legal requirements would be imposed in relation to marketing bonds that were not GBS-aligned (in fact, the EU's own 2022 green bond issuance would not have been GBS-aligned). The GBS is therefore anticipated to form more of a "gold standard" or best practice outline, leaning on the principles of existing respected international frameworks such as the International Capital Market Association's Green Bond Principles.

To be considered GBS-aligned, an issuer must comply with the requirements of the GBS until the maturity of the bond. The GBS also relies heavily on the EU Taxonomy in determining whether or not activities underlying the issuance can be determined to be sustainable. The main requirement under the GBS is that all proceeds of the issue are fully allocated, before maturity, to economic activities that are Taxonomy-aligned (see above for further detail in relation to the Taxonomy).

The GBS expressly notes that it does not limit an issuer's ability to use the proceeds of a GBS-aligned issuance to cover losses from other activities, and a GBS-aligned bond may be refinanced by the issuance of a new GBS-aligned bond.

Requirements under the GBS. In order for a bond issuance to be considered GB-aligned, before the bond is offered to the public, a fact sheet must be prepared in a form prescribed by the GBS Regulation. This factsheet should then be approved by a third-party reviewer, and published on the issuer's website, alongside with external reviewer's review.

After being issued, annual allocation reports should be prepared each year, again in a form prescribed by the GBS Regulation, until the full allocation of the net proceeds of the bond has been made. Once the proceeds have been fully allocated, the issuer must draw up a final allocation report and provide it to a third-party reviewer for the purpose of obtaining a post-issuance review, and publish that post-issuance review.

In addition, after proceeds have been fully allocated, in order to be GB-aligned, the issuer is required to produce a report on the impact of the use of proceeds - once again in a form prescribed by the GBS Regulation.

The GBS Regulation also establishes criteria for registration with the European Securities and Markets Authority (ESMA) as an approved external reviewer for European green bonds. An external reviewer has to apply for registration from ESMA and is required to notify ESMA in case of material changes to the conditions for its registration before any such changes are implemented.

Next steps. The GBS Regulation will now be required to pass through the EU's ordinary legislative procedure, meaning that it will require a negotiated final position to be agreed between the Parliament and Council.

UK MANDATORY ESG DISCLOSURES

In the UK, different pieces of legislation govern ESG matters. In July 2019, the UK adopted a Green Finance Strategy,[26] following closely on the heels of legislation committing the UK to achieve net zero greenhouse gas (GHG) emissions by 2050.[27] The Green Finance Strategy's objectives are "to align private sector financial flows with clean, environmentally sustainable and resilient growth, supported by [UK] government action to strengthen the competitiveness of the UK financial sector."[28]

The strategies employed to meet these objectives include three pillars: Greening Finance, Financing Green, and Capturing the Opportunity.

Greening Finance involves ensuring that climate and environmental factors are integrated into mainstream financial decision-making, including the evaluation and incorporation of current and future financial risks and opportunities associated with climate change and other environmental factors. Greening Finance also involves ensuring a robust market for green financial products. To meet these Greening Finance objectives, the UK government stated its expectation that all listed companies and large asset owners disclose in line with the Task Force on Climate-related Financial Disclosures (TCFD) by 2022. The second pillar, Financing Green, encourages the flow of capital into projects and solutions that will help the UK meet its long-term carbon-reduction goals. The third pillar, Capturing the Opportunity, aims to capture the economic opportunities associated with the growth of the green financial markets and commercial innovations that arise through the transition to a greener economy.

As part of efforts to achieve the first pillar of the Green Finance Strategy, the UK introduced a new Listing Rule LR 9.8.6(8)[29] in December 2020, which requires companies with a premium listing in the UK to include in their annual report, for financial years beginning on or after January 1, 2021, information to comply with the TCFD's recommendations. In the alternative, companies can elect to explain in the annual report why they have not complied with the TCFD recommendations. Notably, LR 9.8.6(8) does not presently require third-party verification of ESG disclosures, although the FCA has identified that it considers third-party verification to be of value, and will continue to work towards coordinating a policy response in this regard.

In December 2021, the FCA announced that it was extending the TCFD reporting requirements to a wider scope of listed issuers, by including issuers of standard listed shares. The FCA also released an updated version of its handbook, including specific guidance for UK issuers as to how to report in line with the TCFD recommendations.

In a poll conducted by the members of the GC100 (the General Counsel of the FTSE100 group of companies) in June 2021, 73 percent of respondents indicated that they will include a statement of full compliance with the TCFD recommendations, with the remainder indicating partial compliance. Seventy-five percent of respondents also indicated that they will be seeking independent assurance of their TCFD-aligned disclosures, to be carried out by environmental consultants, sustainability ratings providers, or large accounting firms.

To further this aim, the UK government issued an additional consultation paper in March 2021 in relation to extending TCFD-based reporting requirements to all UK companies that are currently required to produce a non-financial information statement under the Companies Act 2006.

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Broadly, this includes UK companies and LLPs that have more than 500 employees and are listed or have an annual turnover of more than £500 million. This policy was implemented through the Companies (Strategic Report) (Climate-related Financial Disclosure) Regulations 2022 and the Limited Liability Partnerships (Climate-related Financial Disclosure) Regulations 2022 (together, the UK MCD Regulations), which were made on January 17, 2022.

The UK MCD Regulations do not directly incorporate a requirement for in-scope companies and LLPs to report in line with the TCFD recommendations. Instead, and different from the requirements under the Listing Rules, the UK MCD Regulations introduce specific additional reporting requirements for companies' directors to include in their annual strategic report. Such reporting requirements are aligned with, but not identical to, the TCFD recommendations.

In addition to the above, such strategic reports are already required to contain, alongside the general risks and uncertainties facing the company, information about environmental matters (including the impact of the company's operations on the environment), the company's employees, and social, community, and human rights issues. The strategic report also must contain (in the case of certain large companies)[30] a non-financial statement providing information relating to environmental matters (including the impact of the company's operations on the environment), the company's employees, social matters, respect for human rights, and anti-corruption and anti-bribery matters.

In addition to the UK MCD Regulations, the UK government has also indicated that the forthcoming Sustainability Disclosure Requirements (SDR) will introduce requirements for companies in the UK to report on ESG matters on the basis of double materiality. The SDR proposals are discussed later in this chapter.

The UK has also adopted regulations requiring certain companies to conduct energy efficiency audits and to disclose their energy consumption and GHG emissions. The Companies (Directors' Report) and Limited Liability Partnerships (Energy and Carbon Report) Regulation requires the disclosure of GHG emissions by quoted companies, large unquoted companies, and large limited liability partnerships (known as Streamlined Energy and Carbon Reporting (SECR)).[31] The Energy Savings Opportunity Scheme (ESOS) requires companies in the UK to carry out mandatory energy savings assessments by calculating their total energy consumption, carrying out energy audits and identifying where energy savings can be made.[32]

The UK Corporate Governance Code (the Code), issued by the Financial Reporting Council (the FRC), forms another piece of the ESG framework.[33] The Code consists of a set of principles of good governance in the areas of board leadership and company purpose, division of responsibilities between the board and the company's executive leadership, board composition, succession and evaluation, audit, risk and internal control, and executive and board remuneration. The Code does not impose rigid rules but rather provides flexibility through a set of principles for boards to use. It operates on the basis of "comply or explain" and applies to all companies with a premium listing, whether incorporated in the UK or elsewhere. Finally, the Code requires companies to include in their annual corporate reports and accounts a disclosure statement setting out how they have applied the principles.

The Companies Act imposes on directors a similar, but more general, duty to promote the success of a company.[34] In doing so, company directors must have regard to the impact of the company's operations on the community and the environment, and the likely consequences of any decision in the long term.

The UK has also been proactive in addressing the "S" element of ESG in its disclosure regulations. The Equality Act 2010 mandates gender pay gap reporting in the UK for large employers (more than 250 relevant employees), and voluntary for smaller companies.[35] In addition, the voluntary "Think, Act, Report" framework prompts companies to collect data, take action to address gender pay gaps, and publish information on their progress.[36] The Modern Slavery Act of 2015 requires large commercial organizations to publicly state each year what actions they have taken to ensure their business and supply chains are slavery free.[37]

SUSTAINABILITY DISCLOSURE REQUIREMENTS

Background. In addition to the EU, the UK government has indicated that it is looking to introduce legislative and regulatory changes that will provide more information to investors and consumers in relation to ESG issues. The key initiative in this regard to date has been the Sustainability Disclosure Requirements (SDR), which then UK Chancellor, Rishi Sunak, first mentioned in July 2021. It was then formally proposed in the UK government's Greening Finance: A Roadmap to Sustainable Investing[38] report that was published in October 2021 as an update to the UK's 2019 Green Finance Strategy.

The SDR is intended to provide an integrated framework for ESG reporting in the UK, and would introduce requirements both in relation to corporate ESG disclosures and ESG disclosures in relation to financial products. In doing so it therefore appears to be taking on both the roles that the EU has split out between the SFDR (with respect to financial companies) and CSRD (with respect to non-financial companies).

The development of SDR remains at an early stage (and, to a certain extent, has stalled—see below), and therefore understanding of its possible content is limited at this point. However, the UK government has indicated certain key aspects of the SDR will be its focus on double materiality, and the fact that it will extend past climate-related reporting to other aspects of ESG. In both of these ways, it is therefore an extension of the scope of the corporate ESG reporting requirements introduced by the mandatory climate disclosures regulations that took effect from April 2022.

In November 2021, the FCA issued a discussion paper[39] seeking industry participants' views on the proposed SDR and an accompanying sustainability labeling system. The discussion paper was focused exclusively on the aspects of the SDR that are aimed at asset managers and regulated asset owners—i.e., companies involved in investment management and decision-making processes, and not on the disclosure requirements of other companies.

The discussion paper was meant to be followed up by an FCA consultation during Q2 2022. However, in July 2022, the FCA announced that this consultation was to be delayed until Q3 to "take account of other international policy initiatives and ensure stakeholders have time to consider these issues." This delay may be due to the ongoing development of the ISSB Standards, which the UK government has announced will be a key element

of the SDR. However, in what may be seen as a related development, the UK government announced in May 2022 that it had scrapped the inclusion of the SDR in its proposed financial services bill. The government indicated that it believes the SDR is still very much moving forward, but the status of the proposals remain somewhat uncertain, especially given the change in Prime Minister in the UK in September 2022.

Potential requirements of the SDR. As noted above, given the nascent state of the SDR, the publicly available information as to its requirements is somewhat limited. However, it is possible to ascertain some aspects of what may be included in the SDR based on public statements of the UK government between July 2021 and the time of writing (assuming that SDR continues to go ahead).

The UK government has indicated that the SDR will focus on double materiality, and therefore require companies to disclose not only ESG impacts that may have a direct impact on their bottom line, but also ways in which those companies may impact the environment, societies, or other stakeholders. In addition, the UK government has indicated that, at least in the longer term, the SDR will require disclosures in relation to ESG issues covering broader topics than just the climate. Finally, the UK government has announced that it is monitoring the progress of the ESG standard being developed by the International Sustainability Standards Board (ISSB). The government's October 2021 roadmap indicated that the ISSB standards will "form a core component of the SDR framework, and the backbone of its corporate reporting element."

The appeal of the UK leveraging the ISSB standards is clear, given the resulting benefits in relation to consistent and comparable reporting internationally and that the ISSB standards will also cover ESG reporting topics beyond climate. However, it is, at this stage, unclear how the UK government will reconcile the fact that the ISSB standards are to be developed on the basis of financial materiality, and yet the SDR is intended to focus on double materiality.

In relation to the financial undertaking aspects of SDR, and also the related proposal in relation to sustainable product labels, we may garner some indication as to the content of the SDR from the FCA discussion paper, although we would note that this is subject to consultation and considerable revision before any eventual implementation.

The discussion paper introduces a system of disclosures for asset managers and asset owners and product labels as follows:

- Standardized disclosures containing product-level information, aimed at consumers;
- Detailed disclosures at product and entity level on ESG issues, aimed at professional investors; and
- Product categorization and labels.

The base level consumer-facing disclosures would be provided in a standardized format, describing the product's key ESG-related characteristics in a manner that would seek to improve comparability and accountability for any ESG-related claims made. These disclosures are likely to constitute a subset of the more detailed, investor-focused disclosures.

The proposed investor-facing disclosures would be designed to provide more granular and nuanced information for sophisticated investors in their decision-making process. These disclosures would be provided at both entity level and product level.

The proposed standardized product classification and labeling system would help consumers understand the sustainability attributes of different products. The FCA will develop and implement the labels, building on other international initiatives by regulators and the private sector.

The discussion paper proposes three "Sustainable" categories:

- Transitioning—Products with sustainable characteristics, themes, or objectives; low allocation to UK Taxonomy-aligned sustainable activities;
- Aligned—Products with sustainable characteristics, themes, or objectives; high allocation to UK Taxonomy-aligned sustainable activities; and
- Impact—Products with the objective of delivering positive environmental or social impacts.

The discussion paper considers that these three categories can be mapped against the categories of sustainable investment in the SFDR. Transitioning products would be seen as comparable to Article 8 products, while Aligned products would be comparable to Article 9 products, and Impact products would be limited to a small subset of Article 9 products.

Mandatory transition plans. The SDR may be complemented by the requirement, announced by the UK government at COP 26 in November 2021, that asset managers, regulated asset owners, and listed companies in the UK will be required to publish, by 2023, net zero transition plans that set out how they will decarbonize their business to transition to a lower carbon economy, in particular with respect to the UK's net zero 2050 target.

However, despite introducing that rule, the UK government acknowledged that a "gold standard" is yet to be established as to what a good or appropriate transition plan looks like for companies. It therefore announced that it would set up a Transition Plan Taskforce, bringing together industry, academia, and regulators to develop such a standard and relevant associated metrics.

The Transition Plan Taskforce was formally launched on April 25, 2022, with a two-year mandate and an aim to "drive decarbonization by ensuring that financial institutions and companies prepare rigorous plans to achieve net zero and support efforts to tackle greenwashing."

The taskforce is working with international frameworks that are preparing guidance on transition plan disclosures, including the Glasgow Financial Alliance for Net Zero and ISSB. It intends to build upon the work already carried out to develop detailed templates suitable for incorporation into regulation.

The taskforce will develop:

- A sector-neutral framework for private sector transition plans;
- Sector-specific guidance for finance and real economy sectors; and
- Recommendations for listed companies and stakeholders on preparing and using transition plans.

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UK TAXONOMY

A further key aspect of the UK's Green Finance Strategy is the proposed development of a UK Green Taxonomy, also known as the UK Taxonomy. The UK has been able to see the development of the framework of the EU Taxonomy, and subsequently has affirmed its commitment to developing a complementary regime.

In June 2021, the UK government established the Green Technical Advisory Group (GTAG) to oversee the development of the UK Taxonomy, and to provide independent, non-binding advice to the UK government on developing and implementing a classification system in the UK regulatory context. GTAG is chaired by the Green Finance Institute, and is composed of members from businesses, taxonomy and data experts, and subject-matter experts from academia, NGOs, the UK Environment Agency, and the Committee on Climate Change.

The UK Taxonomy is expected to play a key underpinning role in the context of the SDR by determining whether economic activities can be considered sustainable—similar to the considerable interplay between the EU Taxonomy and both the CSRD and SFDR in an EU context. The UK government has indicated that it is aware of the importance of consistency between international standards such as Taxonomies. In that regard the UK Taxonomy will likely resemble closely its EU equivalent (and that is reflected in the information released to date in relation to the UK Taxonomy—see below). However, some amendments that make it specific to the UK market are also expected.

Little information as to the specifics of the UK Taxonomy have been released to date, and GTAG continues its work in developing the Taxonomy. However, the UK government's roadmap indicates that the UK Taxonomy will adopt the same six environmental objectives in the EU Taxonomy. It will also deploy similar requirements for activities to meet in order to become Taxonomy-aligned, specifically that an activity must:

- Make a substantial contribution to one of the six environmental objectives;
- Do no significant harm to the other objectives; and
- Meet a set of minimum safeguards.

How the UK Taxonomy develops as GTAG and the UK government release further information will be interesting to note, particularly whether we will see differing treatment in relation to some of the more controversial aspects of the EU Taxonomy, such as the inclusion of certain nuclear and gas activities. At this stage however, it is too early to tell how these particular issues will be dealt with in the UK.

The UK Taxonomy is one of the subjects that may be revisited as part of the UK government's plan to update its Green Finance Strategy by the end of 2022. In May 2022, the UK government issued a call for evidence to support this proposed update, which is intended to take stock of progress toward the Green Finance Strategy to date and set out how the UK can better ensure the financial services industry supports the UK's energy security, climate, and environmental objectives. The call for evidence included a number of specific questions that stakeholders were invited to comment on, as well as a space for general comments, and closed on June 22, 2022. The UK government has indicated that it will respond by the end of 2022, but has not done so as of the date of writing.

ENDNOTES:

[1]EU legislators use the phrase "sustainability" when discussing reporting requirements that would otherwise fall in*to* the ambit of ESG. For the purposes of consistency with the original names of proposals, we therefore use the term "sustainability" in this section.

[2] https://finance.ec.europa.eu/capital-markets-union-and-financial-markets/company-reporting-and-auditing/company-reporting/corporate-sustainability-reporting_en.

[3] https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014L0095&from=EN.

[4] https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32013L0034&from=EN.

[5] https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52021PC0189&from=EN.

[6] https://www.consilium.europa.eu/en/press/press-releases/2022/06/21/new-rules-on-sustainability-disclosure-provisional-agreement-between-council-and-european-parliament/.

[7] https://www.consilium.europa.eu/media/57644/st10835-xx22.pdf.

[8] https://www.efrag.org/lab3.

[9]Climate change; pollution; water and marine resources; biodiversity and ecosystems; and resource use and circu*la*r economy.

[10]Own workforce; workers in the value chain; affected communities; and consumers and end-users.

[11]Governance, risk management and internal control; and business conduct.

[12] https://eur-lex.europa.eu/resource.html?uri=cellar:bc4dcea4-9584-11ec-b4e4-01aa75ed71a1.0001.02/DOC_1&format=PDF.

[13] https://www.legislation.gov.uk/ukpga/2015/30/contents/enacted.

[14] https://respect.international/wp-content/uploads/2017/10/ngo-translation-french-corporate-duty-of-vigilance-law.pdf.

[15] https://www.cbp.gov/trade/forced-labor/UFLPA.

[16] https://www.bundesregierung.de/breg-en/federal-government/supply-chain-act-1872076.

[17]I.e., those companies based in the EU with global revenue of over €150 million and over 500 employees, and those companies based outside of the EU with EU revenues of over €150 million.

[18]Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088 (June 18, 2020), available at https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32020R0852.

[19]For more details on the Regulation, including the legislative text: https://ec.europa.eu/info/business-economy-euro/banking-and-finance/sustainable-finance/eu-taxonomy-sustainable-activities_en.

[20] https://ec.europa.eu/info/sites/default/files/c2021_1054_en.pdf.

[21] https://www.oecd.org/daf/inv/mne/48004323.pdf.

[22] https://www.ohchr.org/sites/default/files/documents/publications/guidingprinciplesbusinesshr_en.pdf.

[23] https://www.ilo.org/wcmsp5/groups/public/—ed_norm/—declaration/documents/normativeinstrument/wcms_716594.pdf.

[24] https://www.ohchr.org/en/what-are-human-rights/international-bill-human-rights.

[25] https://ec.europa.eu/info/sites/default/files/business_economy_euro/banking_and_finance/documents/280222-sustainable-finance-platform-finance-report-social-taxonomy.pdf.

[26]HM Government, Green Finance Strategy: Transforming Finance for a Greener Future (July 2019).

[27]UK Department for Business, Energy & Industrial Strategy and Chris Skidmore MP, "UK Becomes First Major Economy to Pass Net Zero Emissions Law: New target will require the UK to bring all greenhouse gas emissions to net zero by 2050" (June 27, 2019).

[28]HM Government, Green Finance Strategy: Transforming Finance for a Greener Future (July 2019).

[29] https://www.handbook.fca.org.uk/handbook/LR/9/8.html.

[30](i) Large companies with over 500 employees and which are either (i) a traded company, (ii) a banking company, (iii) an authorised insurance company, or (iv) an insurance company.

[31]Companies (Directors' Report) and Limited Liability Partnerships (Energy and Carbon Report) Regulation, available at https://www.legislation.gov.uk/uksi/2018/1155/pdfs/uksi_20181155_en.pdf.

[32] https://www.gov.uk/guidance/energy-savings-opportunity-scheme-esos.

[33]UK Corporate Governance Code, available at https://www.frc.org.uk/directors/corporate-governance-and-stewardship/uk-corporate-governance-code.

[34]Companies Act 2006 s. 172, available at https://www.legislation.gov.uk/ukpga/2006/46/contents.

[35]Equality Act 2010, Ch.3 Equality of terms, Sec. 78 Gender pay gap information, available at https://www.legislation.gov.uk/ukpga/2010/15/contents.

[36] https://www.gov.uk/government/publications/think-act-report/think-act-report.

[37]Modern Slavery Act 2015, available at https://www.legislation.gov.uk/ukpga/2015/30/contents/enacted.

[38] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1031805/CCS0821102722-006_Green_Finance _Paper_2021_v6_Web_Accessible.pdf.

[39] https://www.fca.org.uk/publication/discussion/dp21-4.pdf.

https://legal.thomsonreuters.com/

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