THE CORPORATE SUSTAINABILITY REPORTING DIRECTIVE

An overview from
a funds and asset
manager perspective

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What is the Corporate Sustainability Reporting Directive?

The Corporate Sustainability Reporting Directive[1] (CSRD) will create a new EU framework for sustainability reporting by companies. CSRD aims to provide greater transparency and more comparable and standardised information on how companies perform from a sustainability perspective. This information is essential for funds and asset managers seeking to integrate ESG considerations into their investment decisions and to comply with their obligations under the EU sustainable finance regime. CSRD is therefore foundational to the EU sustainable finance regime and the European Green Deal. CSRD will replace the existing Non-Financial Reporting Directive (NFRD), significantly extending the scope of companies required to report and expanding the range of reporting requirements. Under the proposal, the changes will impact on the 2023 reporting period and companies in scope will be required to provide the broad range of new reporting requirements by 1 January 2024. Companies will be subject to an annual reporting requirement under the CSRD thereafter.

Scope

CSRD represents a significant extension of scope to existing sustainability reporting.

All large companies and all companies (including SMEs) listed on EU regulated markets (with the exception of micro-enterprises) will be required to apply the reporting standards as prescribed by CSRD.

While large banks and insurance companies will continue to be subject to the reporting obligations, the current definition of a 'large company' under NFRD has been extended. This now includes EU companies or EU subsidiaries of non-EU companies which, on their balance sheet date, meet two of the following three criteria:

- A net turnover in excess of €40 million
- A balance sheet total in excess of €20 million
- More than 250 employees on average during the financial year

It is estimated that the number of entities affected by this extension of scope will increase roughly fivefold from the current NFRD requirements to 50,000 companies in the EU[2].

[1] See COM(2021) 189 final, 21 April 2021.

[2] See European Commission press release dated 21 April 2021.

Impact on Asset Managers and Funds

Supporting compliance with SFDR and Taxonomy obligations

CSRD seeks to ensure alignment with other EU regulatory initiatives on sustainable finance, in particular the Sustainable Finance Disclosure Regulation[3] (SFDR) and the EU Taxonomy Regulation[4] (Taxonomy). Funds and asset managers have been subject to SFDR since 10 March 2021 while the Taxonomy will begin to apply from 1 January 2022. The reporting standards to be developed under CSRD will specifically include the ESG reporting metrics in respect of SFDR and the Taxonomy and will therefore assist funds and asset managers in meeting their compliance obligations under the detailed SFDR Level 2 reporting requirements of these regulations.

In respect of SFDR, CSRD will mandate reporting standards in respect of the principal adverse impact (PAI) indicators to be provided under the Principal Adverse Impacts Statement contained in the draft Regulatory Technical Standards relating to SFDR[5].

Article 8 of the Taxonomy requires companies falling within the scope of the existing NRD (to be extended to those falling under CSRD) to report on the extent to which their activities qualify as sustainable under the Taxonomy. The requirements pertain to both financial and non-financial undertakings falling under the scope of the NFRD/expanded CSRD. Asset managers that fall under the scope of NFRD/expanded scope of CSRD will therefore be subject to these Taxonomy reporting obligations as a business in their own right, in addition to any financial products they manage that are required to disclose on Taxonomy alignment. The Commission Delegated Act published in July 2021[6] (Taxonomy Article 8 Delegated Act) specifies the content, methodology, and presentation of the information to be disclosed by both non-financial and financial undertakings. The reporting standards to be developed under CSRD will fully take into account these indicators and build on the 'substantial contribution' and 'do-no-significant-harm' criteria of the Taxonomy.

Scoping challenges for funds and asset managers and preventing duplication

Under the proposed legislation, the extension of the scope of CSRD would impact large asset managers and funds structured as companies which meet two of the three criteria mentioned above, or those funds listed on EU regulated markets such as ETFs. Being captured under CSRD reporting will be a significant undertaking in light of the key requirements imposed by CSRD. However, a stated aim of CSRD is to reduce complexity and the potential for duplicative reporting requirements. With that in mind it is important to consider that funds and asset managers are already subject to the extensive disclosure and reporting requirements under SFDR. SFDR is a dedicated disclosure regime for investors such as funds and asset managers while CSRD is intended to enable such investors to access the information they need in relation to the sustainability impact of their investee companies. Therefore, as the co-legislators consider the CSRD proposal, the scoping between SFDR and CSRD needs to be considered further with a view to preventing overlap and unintended consequences.

It is essential that CSRD does not introduce duplicative reporting requirements on the same or similar ESG issues which are already reported under SFDR. Such an overlap would not only be very burdensome but also detrimental to a clear and consistent understanding for investors, who could receive the same or similar information presented in different templates and formats (for instance in the periodic report template under SFDR as an appendix to the annual report versus disclosure in the management report of the annual report under CSRD).

Accordingly, Irish Funds supports the position of the European Fund and Asset Management Association (EFAMA) which calls for the exclusion of funds from the scope of CSRD, as these are financial products already subject to SFDR. We also support EFAMA's proposal to introduce a waiver or cross-reference possibility under asset managers' CSRD disclosures to the extent that they already submit such information under SFDR at the entity level.

[3] See Regulation (EU) 2019/2088.
[4] See Regulation (EU) 2020/852.
[5] See Final Report on draft Regulatory Technical Standards, Joint Committee of the European Supervisory Authorities, 2 February 2021.
[6] See Commission Delegated Regulation, 6 July 2021.

Interaction between CSRD, the EU Taxonomy and SFDR

The 6 environmental objectives (detailed Technical Screening Criteria apply under each)

1. Climate change mitigation
2. Climate change adaptation
3. Sustainable use and protection of water and marine sources
4. Transition to a circular economy
5. Pollution prevention and control
6. Protection and restoration of biodiversity and ecosystems

Standards set by EFRAG

EU TAXONOMY

The EU Taxonomy creates a harmonised classification system for economic activities that qualify as "environmentally sustainable" for investment purposes. In order to be considered Taxonomy aligned a financial product must invest in economic activities that contribute substantially to one or more of 6 environmental objectives and 'do no significant harm' against any of these objectives.

Regulation

Companies in scope of CSRD report on their Taxonomy aligned activities

CSRD

The Corporate Sustainability Reporting Directive, replacing NFRD, provides that all listed companies or large companies must report sustainability-related information in respect of their business activities with an audit (assurance) of the reported information.

Reporting

Asset managers use Taxonomy reporting for disclosures under SFDR

ESG Data

Company disclosures & third party data vendors

SFDR

The Sustainable Finance Disclosure Regulation (SFDR) provides a new set of disclosure requirements applicable to financial market participants, financial advisors, and financial products, in order to increase transparency on sustainability. All asset managers and financial products in scope are required to comply with certain disclosure obligations. Additional disclosure and reporting requirements apply in respect of financial products that fall under Article 8 or Article 9 of SFDR, as these are ESG products. Reporting on PAI or harmful activities from a sustainability perspective at both product and entity level is a key requirement.

PAI indicators under the level 2 template

9 Environmental indicators
5 Social indicators
2 indicators from a list of 64 optional indicators

Principal Adverse Impact Statement reporting

Proposed CSRD Reporting Requirements

In addition to the existing requirements, and in accordance with the sustainability reporting standards being developed by the European Financial Reporting Advisory Group (EFRAG), companies will be expected to report on:

- **Governance:** A description of the role of the administrative, management and supervisory bodies regarding sustainability matters and a description of the company policies underpinning its sustainability strategy.
- **Strategy:** Explanation of how the company's business model and strategy is compatible with the transition to a sustainable economy and with limiting global warming to 1.5 °C degrees. This will require entities in scope to perform assessments on a scientific basis on the impact of climate risk on their business and portfolio of assets.
- **Risk:** The principal actual or potential adverse impacts connected with the company's value chain and a description of the principal risks to the company related to sustainability matters and how the company manages those risks.
- **Metrics:** A description of the targets related to sustainability matters set by the company and of the progress it has made towards achieving those targets. It is expected that the metrics will be fully aligned with the 14 mandatory PAI indicators required by SFDR. CSRD will be applicable to the listed companies that the funds invest into and therefore, in order for there to be harmonisation in reporting, these metrics will have to be included at CSRD level. If an entity is required to report under CSRD, then it will have to consider the Taxonomy reporting requirements under the Taxonomy Article 8 Delegated Act. This Delegated Act requires entities to categorise their business activities into Taxonomy aligned and non-Taxonomy aligned activities and specifically detail how the business activity is contributing to at least one environmentally sustainable objective while complying with the 'do no significant harm' principle in relation to the other environmental objectives as defined in the Taxonomy.

The information required under CSRD should contain forward-looking and retrospective information, and qualitative and quantitative information, while also covering short, medium and long-term horizons. Companies will have to disclose how they identify the information they report.

The extensive obligations under CSRD mean companies in scope will need to begin preparing for its implementation immediately.

CSRD and the Concept of 'Double Materiality'

Both NFRD and SFDR apply a double materiality perspective, a concept which is central to the proposed CSRD. Double materiality requires companies to consider both the impact of sustainability factors on the company's value (financial materiality) as well as the company's impact on the economy, the environment, and people (impact materiality). Importantly, the concept also implies the need to assess the interconnectivity of the two.

However, research has identified several issues in applying double materiality. These include: poor disclosure of the process of determining material sustainability issues; variation in the approach used by organisations to apply the concept; organisations often lack skills to apply materiality to sustainability issues; assessment of materiality favours short-term financial interests; and, the materiality assessment process often falls outside the scope of sustainability assurance engagements.[7]

The proposed CSRD is seeking to clarify the legal requirements of double materiality, with the aim of addressing these issues. With a clearer approach to the double materiality concept, companies would be given less discretion to judge what information is in fact necessary for an understanding of their development, performance, position and impacts.

Asset managers and funds need to transform their materiality assessment process to sufficiently adhere to the concept of double materiality. Doing so will enhance financial performance, investment decision making, engagement with stakeholders and the overall credibility of their sustainability reporting.

[7] See "The double-materiality concept, Application and issues", GRI, May 2021.

EFRAG – The New European Sustainability Reporting Standard Setter

EFRAG provides advice to the European Commission on the adoption of financial reporting standards and its role is now evolving to advise on sustainability reporting standards. Ahead of the publication of the CSRD proposal, EFRAG was requested by the European Commission to carry out preparatory work on possible EU non-financial reporting standards and on potential governance arrangements for European sustainability reporting standard-setting. In March 2021, EFRAG's European Reporting Lab issued two final reports – one proposing a road map for the development of a comprehensive set of EU sustainability reporting standards[8] and the other on potential governance and funding changes to EFRAG[9] in preparation for EFRAG to become the European sustainability reporting standard setter.

Under the proposed CSRD, the European Commission is empowered to adopt delegated acts to provide for sustainability reporting standards, taking into consideration the technical advice provided by EFRAG. EFRAG will develop draft sustainability reporting standards for the European Commission to adopt under a due process, subject to public oversight and transparency and with the input of expert stakeholders. In May 2021, the European Commission endorsed the proposals for the reform of EFRAG's governance[10], which included a proposal for the establishment of a new Non-Financial Reporting Board within the EFRAG structure.
The European Commission also requested EFRAG to put in place interim working methods to start the technical work immediately to develop draft sustainability reporting standards.

EFRAG's newly named Project Task Force on European sustainability reporting standards (PTF-ESRS) is currently working on the development of the sustainability reporting standards, building on the technical work already undertaken by EFRAG. Ultimately, the goal of EFRAG's roadmap is to have harmonisation across the standards and enhance the quality of sustainability reporting for those who fall into scope. It is expected that EFRAG will focus heavily on cooperating with established institutions and organisations that are committed to advancing sustainability reporting on the basis of their respective mandates and areas of expertise. To this effect, standard-setting should not only align with EU standards, but should build on standardisation initiatives to foster global convergence over time. Requirements relating to the EU Taxonomy, Task Force on Climate-related Financial Disclosures (TCFD) and SFDR will be aligned in the first set of draft standards to be issued in mid-2022, followed by a more advanced second set of standards for other priority risks. However, even after these are implemented, EFRAG will be further enhancing the reporting landscape as they progress in this leadership role.

[8] See "Final Report - Proposals for a relevant and dynamic EU sustainability reporting standard-setting", European Reporting Lab @ EFRAG, February 2021.
[9] See "Final Report - Potential need for changes to the governance and funding of EFRAG", Jean-Paul Gauzès, EFRAG Board President, March 2021.
[10] See letter from Commission Mairead McGuinness, DG FISMA to Jean-Paul Gauzès, President of the Board of EFRAG, dated 12 May 2021.

Process for the adoption of European sustainability reporting standards

CSRD

Provides the EU Framework for Sustainability Reporting.

DELEGATED ACTS

Adopted by the European Commission, based on technical advice from EFRAG, that provide for European Sustainability Reporting Standards.

TECHNICAL ADVICE

EFRAG develops European Sustainability Reporting Standards with stakeholder input and provides these as technical advice for the European Commission to adopt.

CONSULTATION WITH ESMA

The European Commission is required to request the opinion of ESMA on the technical advice provided by EFRAG. ESMA must provide its opinion within two months from the date of receipt of the request from the European Commission.

CONSULTATION WITH OTHER BODIES

The European Commission is required to consult with a number of additional bodies prior to adopting standards including:

- The Member State Expert Group on Sustainable Finance
- The European Banking Authority (EBA)
- The European Insurance and Occupational Pensions Authority (EIOPA)
- The European Environment Agency (EEA)
- The European Union Agency for Fundamental Rights (FRA)
- The European Central Bank
- The Committee of European Auditing Oversight Bodies
- The Platform on Sustainable Finance

Role of ESMA and Supervisory Considerations

Given ESMA's role in developing Regulatory Technical Standards (RTS) under SFDR and the need for coherence between these RTS and the new European sustainability reporting standards, ESMA will be required to give an opinion on EFRAG's technical advice. This is also in recognition of ESMA's role in promoting supervisory convergence in the enforcement of corporate reporting by issuers whose securities are listed on EU regulated markets and who will be required to use these sustainability reporting standards.

Furthermore, ESMA is mandated under the CSRD proposal to issue guidelines for national competent authorities in order to promote supervisory convergence of sustainability reporting. ESMA is to issue such guidelines following consultation with the European Environment Agency and the European Union Agency for Fundamental Rights.

The proposed text of CSRD specifies the minimum types of sanctions and administrative measures that EU Member States should provide for in the case of infringements of sustainability reporting requirements. This is with a view to improving sustainability reporting and to contribute to the transition towards a fully sustainable and inclusive economic financial system. Such penalties are required to be effective, proportionate and dissuasive.

Consolidated/Group Reporting

From a group reporting perspective, a subsidiary would be exempted from the obligations set out under the CSRD proposal if its sustainability information is included in the consolidated management report of a parent undertaking. However, subsidiary companies that are exempted will still be required to publish a consolidated management report of the parent company reporting at group level and to include a reference in their legal-entity management report to note the fact that the subsidiary is exempted from the requirements of the Directive. The purpose of this is to ensure sustainability information is easily accessible for users and to provide transparency in relation to which entity is the parent undertaking of the exempted subsidiary undertaking that is reporting at the consolidated level. The exemption also applies where the parent undertaking reporting at the consolidated level is a third country undertaking reporting sustainability information in accordance with the requirements of CSRD. The details of these exemptions are yet to be finalised.

Timeframe

There is an ambitious implementation timeframe for CSRD. The Commission and EFRAG aim to implement the new European sustainability reporting standards on a phased basis, with the first draft set due from EFRAG on 15 June 2022, with the Commission intending to adopt them by October 2022. Member States will be expected to transpose CSRD into national law by 1 December 2022. However, the final transposition deadline will depend on how the European Parliament and Council progress in their negotiations. If they reach agreement in the first half of 2022, then the Commission should be able to adopt the first set of reporting standards under the new legislation by the end of 2022. The CSRD reporting requirements would then come into effect from 1 January 2023 with the Commission planning to adopt the second set of European sustainability reporting standards at the end of October 2023.

The first corporate reporting under the CSRD would issue in January 2024 in respect of the financial year of 2023 and reporting would follow every year thereafter. The implementation of CSRD will take place against a backdrop of other pending EU sustainable finance requirements, in particular relating to SFDR and the EU Taxonomy as well as Commission Delegated Acts pertaining to UCITS, AIFMD and MiFID. However, the reporting provided by investee companies under CSRD will assist funds and managers (in an EU context) in meeting their obligations under these other regulatory requirements. Discussions will continue on the convergence of sustainability reporting internationally during this period.

EU sustainable finance timelines of key developments

Note: Elements of the below are subject to change or further clarification at the EU level.

Jan 2022

EU Taxonomy:
Mandatory annual report disclosures on Taxonomy eligibility for Climate Change Mitigation and Climate Change Adaption for non-financial companies (covers the FY 2021).

Level 1 Taxonomy alignment prospectus disclosure for financial products (potentially qualitative only). Inclusion of disclaimers where the product is not Taxonomy aligned (and potentially where Taxonomy alignment cannot yet be calculated).

SFDR:
Level 1 periodic disclosure for financial products starts for reports issued from 1 January 2022.

June 2022

SFDR:
Update or issue PAI Statement by 30 June 2022 (qualitative only) for Level 2 template and publish on website (where complying).

CSRD:
EFRAG aims to have the first set of draft standards ready for the Commission to adopt.

Jul 2022

SFDR:
SRDR Level 2 Regulatory Technical Standards apply. Update prospectus to include new pre-contractual disclosure template.
Periodic reporting template begins to apply (industry seeking clarification on the phasing in of this L2 template in respect of reference periods).

Aug 2022

UCITS / AIFMD / MiFID / IDD
Application of entity level requirements to integrate sustainability duties organisationally and into investment advice. Focus on sustainability risk management processes and related reporting to the Board/Senior Management.

Oct 2022

CSRD:
Commission plans to adopt the first set of reporting standards by the end of October 2022.

EU sustainable finance timelines of key developments

Note: Elements of the below are subject to change or further clarification at the EU level.

Dec 2022

CSRD:
Member States will be expected to transpose the new Directive into law by 1 December 2022* (dependent on the timing of the legislative process).

SFDR:
Disclosure of PAI at product level by 30 December 2022. Update to pre-contractual disclosure templates required to facilitate this.

Jan 2023

EU Taxonomy:
Mandatory Annual Report disclosures for all 6 Taxonomy objectives (covers FY 2022).
Non-financial companies to report on Taxonomy alignment.
Financial undertakings to report on Taxonomy eligibility.

CSRD:
Reporting requirements come into effect from 1 January 2023.

SFDR:
Updates required to the pre-contractual disclosure templates in respect of the 4 remaining environmental objectives under the Taxonomy.

June 2023

SFDR:
Annual PAI Statement due by 30 June 2023 for managers complying. (Industry is requesting clarification on the phasing in of the reporting relating to reference periods).

Oct 2023

CSRD:
Commission plans to adopt the second set of reporting standards by the end of October 2023.

Jan 2024

CSRD:
Companies apply the standards for the first time to reports published in 2024 (covers FY 2023). Mandatory assurance required.

Taxonomy:
Financial undertakings begin reporting on Taxonomy alignment alongside non-financial companies.

Assurance

CSRD introduces a requirement for 'assurance' to be provided on the reported sustainability information. The proposal is to start with 'limited' assurance with the objective being to ultimately move towards 'reasonable' assurance so that there is a similar level of assurance provided for both financial and sustainability reporting.

The proposal also introduces the potential for EU Member States to allow the assurance services for sustainability information to be provided by firms other than the traditionally engaged auditors of financial information.

ESG Data Vendors

CSRD should bring positive developments to the ESG data vendor landscape. The market for ESG ratings and data products has grown exponentially over the past few years. As asset managers and funds have placed increasing reliance on these services to meet NFRD, SFDR and Taxonomy requirements, there are concerns about the potential risks they pose to investor protection, the transparency and efficiency of markets, risk pricing, and capital allocation.

Due to the lack of consistency, comparability and verification of this ESG data, there have been calls for regulation of ESG data vendors. In December 2020, the French securities regulator, the Autorité des Marchés Financiers (AMF), and its Dutch counterpart, the Autoriteit Financiële Markten (AFM), issued a joint position paper[11] calling for new legislation that would grant ESMA supervisory powers over ESG data providers. In January 2021, ESMA sent a letter to the Commission[12] calling for legislative action on ESG ratings and assessment tools, and most recently, the Board of the International Organization of Securities Commissions (IOSCO) published a consultation report[13] in July 2021 that proposes a set of recommendations to mitigate risks flowing from activities of ESG ratings and data products providers and to address some of the challenges faced by users of ESG ratings and data products, as well as the companies that are the subject of these ratings or data products.

With the expected standardisation of frameworks, the increased scope and the introduction of mandatory reporting, the CSRD sustainability standards will help to overcome the challenges relating to the consistency and reliability of ESG data. Furthermore, the CSRD requirements to report ESG data in the management report and in digital format will allow for more efficient, structured, and comparable data collection by data vendors.

Digitalisation and ESAP

The European Commission plans to make publicly reported data under various EU regulations and directives more accessible via a common data platform, the European Single Access Point (ESAP). It is proposed that CSRD would require companies to digitally tag the reported information, so it is machine readable and feeds into the ESAP. All information included in the ESAP will be expected to be comparable in terms of content and rendered in a structured, machine-readable and AI-compatible format.

It is expected that the ESAP will provide standardised sustainability data reported by investee companies which is essential to delivering on sustainable finance. Given the international nature of investment portfolios and the need to address sustainability reporting at a global level, the replication of such initiatives internationally would greatly contribute to the availability of ESG data and consequently the ability to make informed investment decisions and enhanced disclosures relating to sustainability.

Interaction with Existing Sustainability Standards and International Context

The landscape for sustainability reporting has rapidly evolved in recent years. This evolution is occurring in response to demands from a wide range of stakeholders, including investors, governments, supranational organisations and regulators, as well as non-governmental organisations. A range of different standards, frameworks, principles and guidelines have proliferated. While there is much alignment in terms of what these various initiatives seek to achieve, the landscape of standards remains fragmented.[14] Like all efforts on sustainability, complete success will only come through global actions and international convergence.

[11] See "Position Paper: Call for a European Regulation for the provision of ESG data, ratings, and related services", AMF and AFM, 15 December 2020.
[12] See letter from Steven Maijoor, Chair of ESMA to Commission Mairead McGuinness, DG FISMA, 28 January 2021.
[13] See "Consultation Report, Environmental, Social and Governance (ESG) Ratings and Data Products Providers", IOSCO, July 2021.
[14] See "Comparing international sustainability reporting frameworks", Irish Funds, 13 July 2020.

EFRAG have engaged with numerous other reporting bodies internationally to exchange experience, expertise, tools and content in order to ensure consistency and coherence between EU and global sustainability reporting. CSRD will reflect the principles of TCFD, but there is also potential for convergence with other international frameworks.

The IFRS Foundation has recently announced the establishment of a new International Sustainability Standards Board (ISSB)[15] to develop, in the public interest, a comprehensive global baseline of high-quality sustainability reporting standards to meet investors' information needs. This development is to be welcomed, as a global set of internationally recognised sustainability reporting standards is essential to allow for consistency, comparability and transparency of reporting for all stakeholders and for the success of sustainable finance.

A reporting baseline will allow investors access to sufficient information regarding sustainability matters so that they can make informed decisions and comply with their own obligations arising from regulation, not just in relation to EU-based companies. In its consultation paper on sustainability reporting[16], the IFRS Foundation noted its relationships with other institutions and initiatives such as the SASB, GRI, CDSB and CDP as well as with bodies such as EFRAG. EFRAG intends to engage further in these international developments with a view to developing the global baseline on sustainability reporting.

[15] See IFRS Foundation press release, 3 November, 2021.

[16] See "Consultation Paper on Sustainability Reporting", IFRS Foundation, September 2020.

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