Cooley

EU's New Mandatory ESG Reporting Rules: Don't Miss Your Chance to Comment

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In January 2023, the European Union adopted the Corporate Sustainability Reporting Directive (CSRD), which requires EU and non-EU companies with activities in Europe to file annual sustainability reports. These reports need to be prepared in accordance with European Sustainability Reporting Standards (ESRS).

On June 9, 2023, the European Commission published a **draft of the first set of ESRS**. The draft runs 247 pages long and includes 12 standards in total: 10 topical standards (summarised below) and two cross-cutting standards that provide more detail on how to prepare the sustainability report.

The draft standards

The table below summarises the 10 topical environmental, social and governance (ESG) standards, each of which sets out the data points to be reported and explains when reporting is mandatory and when it is voluntary.

Environmental	
E1 Climate change	Disclosures on climate change mitigation, climate change adaptation and energy consumption. Disclosures on climate change mitigation relate to the entity's endeavors to limit global warming to 1.5°C in line with the Paris Agreement and disclosures on Scopes 1, 2 and 3 greenhouse gas emissions and transition risks.
E2 Pollution	Disclosures on pollution of the air, water, soil, living organisms and food resources, as well as the use of substances of concern and microplastics. This standard covers pollutants generated or used during production processes and that leave facilities as emissions, products, or as part of products or services.
E3 Water and marine resources	Disclosures on consumption, withdrawal and discharge from and into water (including ground and surface water) and marine resources. It also requires consideration of the extraction and use of marine resources.

E4 Biodiversity and ecosystems	Disclosures covering areas such as the drivers of biodiversity loss, impact on species, and impacts and dependencies on ecosystems.
E5 Circular economy	Disclosures on resource inflows, outflows, waste, resource optimization and risks of the transition to a circular economy. A circular economy is one in which the value of products, materials and other resources in the economy are maintained for as long as possible, enhancing their efficient use in production and consumption, and thereby reducing the environmental impact of their use, minimising waste and the release of hazardous substances at all stages of their life cycle.
Social	
S1 Own workforce	Disclosures on the company's own workforce – including freedom of association, working conditions, access to equal opportunities and other work-related rights.
S2 Workers in the value chain	This standard is similar to ESRS S1 in content but requires consideration of the workers in the company's value chain(s).
S3 Affected communities	Disclosures on the impact of a company's own operations and value chain – including its products and services, impact on indigenous rights, civil rights, and social and economic rights, including water and sanitation, among others.
S4 Consumers and end-users	Disclosures on the impacts of a company's products and/or services on consumers and end-users. This includes access to quality information, privacy and the protection of children. Companies are not required to consider the unlawful use or misuse of products or services.
Governance	
G1 Business conduct	Disclosures on anti-corruption and anti-bribery practices, the protection of whistleblowers, political lobbying and the management of relationships with suppliers (including payment practices).

Value chain reporting

The CSRD and reporting standards require EU reporting entities to consider and – where necessary – report on the impacts of their business, and their upstream and downstream value chain, on each of these topics. This is broader than other reporting frameworks.

Materiality

The materiality assessment is the starting point for reporting under the ESRS. Companies are required to assess and report on "material" sustainability-related impacts, risks and opportunities (IROs) in their value chain under each of the 10 topical standards outlined above. If, following the materiality assessment, a given sustainability matter is assessed to be material, the company must disclose against the relevant topical ESRS.

The CSRD follows the "double materiality" principle, meaning that businesses need to consider what is material from both:

1. The **investor perspective**, which means reporting on ESG matters material to the company's value creation.
2. The **wider stakeholder perspective**, which means reporting on ESG matters material to the company's impact on the economy, environment, nature and people.

A sustainability matter is "material" for CSRD reporting if either of the two is satisfied. Compared to previous drafts of the ESRS, there is a move away from mandatory disclosures and more of a focus on materiality (e.g., it is only mandatory to disclose climate IROs if material for the business or its value chain). The European Financial Reporting Advisory Group is currently working on guidance to provide more explanations on how companies should conduct their materiality assessments.

Reporting risks

Outside of the mandatory disclosures, the draft ESRS do not require businesses to disclose any information that is nonmaterial to the business. The draft ESRS explain that nonmaterial information is only permitted in narrow circumstances to avoid obscuring material information with puffery. Businesses should be aware of this when drafting their sustainability reports to avoid risks of greenwashing allegations.

Mandatory disclosures

Irrespective of a company's materiality assessment, the company will always be required to report in full against the disclosure requirements and data points, which are set out in the ESRS on 'general disclosures'. Mandatory disclosures include the role of management on sustainability matters, the integration of sustainability-related performance incentive schemes and an explanation of the processes used to identify the company's IROs, how materiality was assessed, and how those IROs deemed material interact with the company's strategy and business model.

Permitted exclusions

Companies are not required to disclose specific information on intellectual property, know-how or results of innovation, even if such information is material. In addition, certain EU member states may, at national law, also permit companies to omit information on impending developments or matters under negotiation. In each case where a company relies on an exemption, it must disclose this to be the case.

Next steps

Following the public consultation, which closes on July 7, 2023, the European Commission may amend the draft ESRS. The updated draft will then be formally approved and adopted into EU law, which we anticipate before the end of 2023. The law will take the form of an EU regulation that will apply directly in all 27 EU member states. Other sets of standards will be adopted in the coming years for businesses operating in high-risk sectors, small- and medium-sized enterprises, and non-EU parent companies.

This is the last time the standards will be open for comment, so **stakeholders are encouraged to provide input**. If you have any questions or would like support with submitting comments, please contact a member of Cooley's international ESG team.

For further detail on the companies covered by the CSRD, see **Cooley's related October 2022 client alert**.

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