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From:	General Secretariat of the Council
To:	Working Party on Company Law (Sustainability information)
Subject:	Non-paper of the Commission services on the CSRD proposal - Empowerment to the Commission for the adoption of sustainability reporting standards via Delegated Acts

Delegations will find attached a non-paper of the Commission on the above mentioned subject.

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Non-paper of the Commission services on the CSRD proposal - Empowerment to the Commission for the adoption of sustainability reporting standards via Delegated Acts

DISCLAIMER

This non-paper has not been adopted or endorsed by the Commission. Any views expressed in it may not in any circumstances be regarded as stating an official position of the Commission. The information contained therein is only intended for discussions with the Member State representatives at the Council Working Party.

1. Introduction

This non-paper aims at supporting the discussions on the proposal for a Corporate Sustainability Reporting Directive in the next Council WG meeting on 14 October 2021, by explaining the reasons for the choice of delegated acts for the adoption of sustainability reporting standards, and for the level of detail of the requirements included in the directive.

2. Framing the empowerment to the Commission

Level of detail of the level 1 requirements (balance L1/L2)

The Commission services are of the view that the framing of the empowerment to the Commission to adopt sustainability reporting standards in EU law needs to balance two different requirements.

On the one hand, for legal and political reasons the empowerment must be sufficiently clear and circumscribed. It should provide the necessary guarantees that the adopted standards would meet the objectives defined in the Directive by the co-legislators, and not extend beyond those objectives.

On the other hand, there must be a sufficient degree of flexibility in the way that the level 1 requirements of the CSRD proposal frame the content of the standards. There are a number of reasons why this flexibility is needed:

- a) It is not possible to list all disclosures and all sustainability topics and sub-topics in an exhaustive manner. Preparers and users generally accept that sustainability information can be divided into three topics (environment, social and governance, or ESG). While the Directive must adequately frame the list of sub-topics for environmental, social and governance matters, it is not feasible for the level 1 text to list all sustainability disclosures and sub-topics in an exhaustive manner: it must inevitably stop at a certain level and leave the detail to be filled in by the standards.¹

¹ Other Sustainable Finance legislation like the Taxonomy Regulation and the SFDR also empower the Commission to adopt Delegated Acts and RTS respectively, to specify the content, presentation and methodology of the information to be disclosed pursuant to their requirements. Both regulations contain general requirements in their level 1 texts.

- b) The needs of users regarding sustainability information are not static and will continue to evolve. New disclosures may be required on specific sustainability sub-topics as new priorities arise. To respond adequately to the evolving information needs of financial market participants and other stakeholders, the level 1 text must remain flexible enough to allow for the development of new sustainability reporting standards that cannot be clearly foreseen today.
- c) Related EU legislation will also evolve. EU legislation in the field of environment, social issues, sustainable finance and corporate governance, sectoral rules for preparers as well as rules in other fields, all influence the choice of sustainability information that companies should be required to disclose. The level 1 text must remain sufficiently flexible to allow standards to evolve in response to new EU legislation that is not decided or cannot be foreseen today.
- d) The situation regarding global sustainability reporting standards is highly dynamic. There is a recognised need to ensure as much consistency and interoperability as possible between European reporting standards and global standards. This is a particular challenge since some global reporting standards exist already (GRI, SASB) while others are under consideration and will be developed in coming years (ISSB/IFRSF). The more detail introduced in the level 1 Directive, the harder it becomes to ensure consistency with global initiatives when adopting sustainability reporting standards.

Overall, standards need to be able to remain up to date and incorporate relevant elements to the required disclosures, without going through the heavier procedure of amending the Accounting Directive through the ordinary legislative procedure on every occasion. A similar approach applies and is accepted in the field of financial reporting.

The Commission's proposal seeks to create the right balance between the need for precision in the level 1 text and the need for adequate flexibility in the following ways:

- Art 19a (and 29a) defines the reporting areas in detail and in an exhaustive manner. According to Article 19b(1), Delegated Acts adopted by the Commission would specify the information that undertakings should report in accordance with Articles 19a and 29a.
- Article 19b(2) specifies the three topics to be covered by sustainability reporting standards in an exhaustive manner: environmental factors, social factors, and governance factors. Therefore, only matters relevant to ESG can be included the standards. It also lists a minimum set of sub-topics for each of those three topics. By making the list of sub-topics a non-exhaustive list, the proposal provides certainty that those sub-topics will be covered, but also leaves a degree of flexibility for specific disclosures on other sub-topics, consistent with the need for flexibility outlined above. The list of environmental sub-topics is framed according to the environmental objectives of the taxonomy. The list of social sub-topics mainly follows the authoritative list of the two first chapters of the European Pillar of Social Rights, focussing on those issues that are relevant for businesses and not related to the role of the state, and includes the respect for the human rights, fundamental freedoms, democratic principles and standards established in the Charter of Fundamental Rights of the European Union and other international conventions. The list of governance sub-topics is mainly inspired by the authoritative list of the International Corporate Governance Network

(ICGN) and the proposals put forward by EFRAG in its report on preparatory work for sustainability reporting standards.²

- Article 19b(3) lists a number of pieces of EU legislation that the Commission should take account of when adopting the standards as Delegated Acts, and also requires the Commission to take account of “work of global standard-setting initiatives for sustainability reporting, and existing standards and frameworks for natural capital accounting, responsible business conduct, corporate social responsibility, and sustainable development.” This list is by definition non-exhaustive, since the Commission is in any case obliged to ensure the coherence of the EU legal framework when adopting level 2 measures.

Summarising, the CSRD proposal presents a balanced approach between providing for the needed flexibility in the adoption of standards and sufficiently framing the empowerment and the exercise of the delegation of powers by the Commission. This ensures that any disclosure element of the standards is relevant to sustainability reporting as framed in Articles 19a, 29a and 19b.

Level of detail of the level 1 requirements - SME standards (Article 19c)

Article 19c empowers the Commission to adopt SME standards that are proportionate to the capacities and characteristics of SMEs, framing the objectives, contents and scope of the delegation. Given that not all information required by Article 19a is necessarily relevant for SMEs, the only way of meeting such proportionality requirement is by adopting standards that focus on the elements of Article 19a that are relevant to SMEs. It is not possible to have proportionate standards if the starting point is that all reporting areas of Article 19(a) have to be covered. Therefore, SME standards should specify which reporting areas/elements from Article 19a are relevant for SMEs, and hence, which information SMEs should report.

The proposed Directive does not include a reduced list of the reporting areas of Article 19a, but provides flexibility to the standards to decide on this point in a delegated act. The need for a highly technical assessment to specify which reporting areas should be reported by SMEs is the reason why these areas are not specified in the directive. This assessment requires the careful consideration of the needs of various stakeholder groups, and the proper analysis of the different kinds of SMEs concerned and the situations in which they may need to disclose sustainability information (as clients of banks, as suppliers of large companies etc.). It would be very cumbersome and not flexible enough to include in the CSRD directive such analysis and make the necessary distinctions. In addition, the Commission together with the European supervisory authorities (ESAs) is working to further incorporate ESG factors into the prudential framework for credit institutions and insurance undertakings, which may create new data needs regarding companies, as clients of these institutions. This further underlines the need for flexibility in the Directive. The Commission has already asked EFRAG’s Project Task Force to analyse the above mentioned issues/variables as a first step, in order to define at a second stage what exactly needs to be disclosed by (which) SMEs.

² <https://www.efrag.org/Lab2>

Member States involvement

The Commission services believe that Member States should be involved in the development and adoption of sustainability reporting standards. This is reflected in the following:

- The CSRD proposal includes an explicit requirement on the Commission to consult the Member State Expert Group on Sustainable Finance (MSEG SF) prior to the adoption of sustainability reporting standards (amendments to Article 49 of the Accounting Directive). This follows a parallel approach to the agreed text on the Taxonomy Regulation and formalises the procedure laid down in the Interinstitutional Agreement between the European Parliament, the Council of the European Union and the European Commission on Better Law-Making to consult Member States' experts. The reason for choosing the MSEG SF as the expert group to be consulted, is the existing link between the CSRD and other SF legislation, and the need to ensure coherent requirements. The Commission assumes and expects that Member States will coordinate to involve the relevant Ministries during this consultation.
- The Commission asked Jean Paul Gauzès, EFRAG's Board President, to provide recommendations on an *ad personam* basis about potential changes to the governance of EFRAG, if the latter were entrusted with the development of EU sustainability reporting standards. After 2 rounds of consultation on his report, and after having shared a questionnaire with Member State representatives in the Accounting Regulatory Committee (ARC), Jean Paul Gauzès proposes in his final report that National Organisations (National Authorities/Ministries or National Standard Setters or other forms of bringing national stakeholders together) are invited to be Member Organisations of EFRAG and form one of the four Chapters of the EFRAG General Assembly.³ These members will appoint their representatives in the various governance bodies of EFRAG for the seats allocated to them, in particular to the Sustainability Reporting Board. The General Assembly will provide a discussion forum for the member organisations to debate on strategy and broader orientations. Member States that decide to join EFRAG will have access to these discussions and will be consulted on the future strategy of EFRAG. In addition, a Consultative Forum of representatives with relevant expertise of National Authorities, National Standards Setters of Member States, existing global initiatives and other players will be established. This Forum will be consulted by the NFRB and the NFR TEG for advice on the draft standards.

3. Choice of legal instrument: Delegated Acts

First, building on the arguments presented under point 2, the Commission services find that Delegated Acts are needed to specify the information to be disclosed under Articles 19a and 29a.

The Commission services are of the view that an amending Directive containing all disclosure requirements with no empowerment to the Commission to adopt Delegated Acts would not meet the objective of harmonising reporting by companies. The amending Directive would be subject to transposition by Member States that could lead to inconsistent implementation across the EU. This

³ <https://www.efrag.org/Assets/Download?assetUrl=%2Fsites%2Fwebpublishing%2FSiteAssets%2FJean-Paul%20Gauz%C3%A8s%20-%20Ad%20Personam%20Mandate%20-%20Final%20Report%20-%2005-03-2021.pdf>

concern adds to the unfeasibility and impracticality of including in the Directive an exhaustive list of elements to be disclosed, as explained in point 2. On the contrary, the Delegated Acts to be adopted by the Commission will take the form of directly applicable Delegated Regulations ensuring consistent and comparable reporting across companies in all Member States (single rule book) and a timely implementation of the requirements. Delegated Regulations are therefore necessary in order to achieve the main objectives of the proposal.

Reporting standards need to be able to incorporate relevant elements to the required disclosures as necessary. Rapid adjustments might be needed as knowledge of sustainability impacts and risks is developing speedily. For this reason, the legal framework for the CSRD must remain flexible and easy to adjust. The most appropriate approach is therefore to empower the Commission to adopt Delegated Acts for developing and revising sustainability reporting standards.

Second, the Commission services are of the view that Delegated Acts are the appropriate legal instrument for the adoption of sustainability reporting standards.

The envisaged content of the level 2 measures determines the appropriate legal instrument. In formulating its proposal for the use of Delegated Acts, the Commission has carefully considered the non-binding criteria contained for the application of Articles 290 and 291 TFEU (2019/C 223/01). Sustainability reporting standards will specify in detail what information needs to be disclosed by companies in scope of the CSRD provisions, adding non-essential elements to the Directive. This is clear from the wording in the empowerments contained in the level 1 Directive.⁴ In accordance with Article 290 TFEU, the delegated acts envisaged in the CSRD proposal are measures of general application that will supplement the directive by adding new non-essential elements; by defining what needs to be disclosed according to the legislative act, they would lay down additional rules building upon or developing the content while coming within the regulatory framework defined by the basic act. The objectives, contents, scope and duration of the delegation are defined in the directive, via the insertion of new Articles 19b and 19c of the Accounting Directive and via amendments to Article 49 of the same directive, as explained in point 2.

Moreover, the non-binding criteria state that Delegated Acts should be chosen in the case of “measures affecting in substance the rules laid down in the basic act and allowing the Commission to ‘flesh out’ the basic act, provided that they do not touch on its essential elements.” This is the precisely the case of sustainability reporting standards under the CSRD.

By contrast, Implementing Acts should be used if the additional rules are intended only to implement or to give effect to the rules already defined in the level 1 by specifying in further detail the content

⁴ Article 19b of the Accounting Directive: “*The Commission shall adopt delegated acts in accordance with Article 49 to provide for sustainability reporting standards. Those sustainability reporting standards shall specify the information that undertakings are to report in accordance with Articles 19a and 29a and, where relevant, shall specify the structure in which that information shall be reported.* In particular: [...]”

Article 19c of the Accounting Directive: “*The Commission shall adopt delegated acts in accordance with Article 49 to provide for sustainability reporting standards proportionate to the capacities and characteristics of small and medium-sized undertakings. Those sustainability reporting standards shall specify which information referred to in Articles 19a and 29a small and medium-sized undertakings referred to in Article 2, point (1)(a) shall report.* They shall take into account the criteria set out in Article 19b, paragraphs 2 and 3. They shall also, where relevant, specify the structure in which that information shall be reported.”

of that act, without affecting the substance of the legislative framework. In this particular case, implementing acts would not be appropriate, as reporting standards will add non-essential elements to the legislation.

