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Non-EU Companies Face Challenges Preparing for Europe's Corporate Sustainability Reporting Directive

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Key Points

- Detailed rules governing some of the upcoming requirements for sustainability disclosures will help companies prepare to comply, but many requirements have still not been specified.
- The rules for non-EU companies will not be available until 2026, giving those companies less time than they had assumed to begin preparing to collect and share the required information.
- Non-EU companies that want to begin making ESG disclosures ahead of the EC deadlines could find themselves having to comply with inconsistent requirements, because it is not clear which alternative disclosure regimes the EC will deem equivalent to its rules.

The European Union's Corporate Sustainability Reporting Directive (CSRD), under which reporting will start in 2025, covers companies operating in the EU, including multinational groups with European operations.

The European Commission (EC) expects that approximately 49,000 entities will be required to report under the CSRD, versus the 11,000 under the existing Non-Financial Reporting Directive (NFRD). Thus, many non-EU companies find themselves with a need to analyze their obligations to comply with the new reporting regime in the coming years.

However, a delay in the publication of detailed CSRD reporting requirements means that non-EU companies will not have as much time to prepare for compliance as previously expected.

Applicability to Non-EU Companies

Broadly, the CSRD will apply to non-EU companies:

- that have securities listed on an EU-regulated market (excluding EU multilateral trading facilities), or
- that exceed one or both of two revenue thresholds (Turnover Test):
  - annual net turnover in the EU at the consolidated or individual level exceeding €150 million for each of the last two consecutive financial years, and/or
  - a qualifying EU subsidiary or branch that generated annual net turnover in excess of €40 million in the preceding financial year.

Non-EU companies caught by the first test must report starting in 2025, 2026 or 2027, depending on their size. Non-EU companies that satisfy the Turnover Test must report starting in 2029. For additional information, see our October 9, 2023, client alert "Q&A: The EU Corporate Sustainability Reporting Directive – To Whom Does It Apply and What Should EU and Non-EU Companies Consider?"

The European Sustainability Reporting Standards and 'Double Materiality'

On July 31, 2023, the EC formally adopted the first set of detailed reporting requirements under the CSRD, known as the European Sustainability Reporting Standards (ESRS). The ESRS consists of two general standards ("General Requirements" and "General Disclosures") and 10 "topical standards" — environmental, social and governance (ESG) matters where the company's impact must be assessed and, if material, disclosed. These range from climate change to pollution, water and marine resources, biodiversity, workers in the value chain, and consumers and end users.

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Whether a company is obliged to report its impact under the 10 topical standards depends on whether the issue or standard is "material" for its business model and activity. In assessing materiality, a company must consider both:

i. value creation for the company; and

ii. the wider impact the company has on the economy, environment, nature and communities.

Together, (i) and (ii) are referred to as the "double materiality" standard, because a company must consider both. Satisfying either test amounts to a standard being "material." If, following a thorough assessment, a company determines information to be material, disclosure is mandatory.

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Of particular note is the topical standard on climate change (ESRS E1), which is subject to a comply-or-explain requirement: If a company concludes that climate change is not a material topic and it therefore does not report on that topic, it must provide a detailed explanation of its conclusion. This requirement applies only to determinations regarding climate change.

Supplemental ESRS for Non-EU Companies

In addition to the details in the first ESRS, the CSRD authorizes the EC to develop supplemental ESRS for non-EU companies that satisfy the Turnover Test. Those standards will provide the details necessary for non-EU companies to determine the kinds of information they will need to gather in order to meet their reporting requirements starting in 2028.

But the target date for publication of these supplemental ESRS has been postponed from June 30, 2024, until June 30, 2026. Similarly, the EC expects to publish sector-specific ESRS around that time. This delay means that non-EU companies will have substantially less time than previously indicated to establish compliance processes and gather the necessary information for disclosure.

The shortened time to prepare is significant given the changes that were ultimately made to the draft sector-agnostic ESRS. For instance, in the final ESRS, the EC opted to allow flexibility for companies not to disclose certain information that is not material to them for a greater number of topical standards than originally proposed. The EC also made more data points (such as reporting a biodiversity transition plan) voluntary rather than mandatory.

As was the case with sector-agnostic standards, it is possible that the EC will adopt final standards for non-EU companies and sector-specific standards that deviate significantly from the draft submissions. Non-EU companies preparing for their eventual disclosures should build some flexibility into their reporting systems in case the EC's final requirements differ from current expectations.

The CSRD requires information on entire value chains, and there may be friction between the competing or misaligned deadlines of various companies that fall within the scope at different moments. To the extent possible, companies should prepare to cooperate on information-sharing with business partners and key counterparties at an earlier or later time than expected.

Early Disclosure: What Are the Risks?

Some non-EU companies that have been tracking the development of the CSRD and other European ESG-related legislation may be considering making disclosures ahead of EC deadlines, either as part of their preparatory steps for mandatory disclosure or to burnish their ESG credentials. However, there are some risks to consider in being ahead of the requirements.

In order to ease the compliance burden for multinational groups, the CSRD gives the EC the ability to recognize other reporting standards as equivalent to the ESRS. However, as of yet, no equivalency decisions have been made, and none are expected until mid-2024. As a result, companies risk reporting without certainty regarding which reporting standards will be declared as equivalent for CSRD purposes.

The International Sustainability Standards Board (ISSB) is developing its own set of global rules for sustainability disclosures. Although the European Financial Reporting Advisory Group (EFRAG), which was responsible for drafting the ESRS, has indicated that it continues to work alongside the ISSB to optimize compatibility of the ESRS and ISSB standards, the extent of overlap is not yet fully determined. In addition, companies could face requirements to comply with disclosure mandates in non-EU jurisdictions that diverge from both CSRD and ISSB standards.

Companies deciding to disclose ahead of time run the risk of collating data or establishing systems that do not ultimately enable the company to comply with CSRD without further changes. The lack of certainty also means that non-EU companies that disclose earlier than is necessary could expose themselves to potential liability if their disclosures are not consistent with the final CSRD requirements.

Timeline for CSRD Reporting

Reports Due	For Full Financial Years Ending in	Companies Subject to Requirements
2025	2024	Any EU-incorporated company already subject to the NFRD.
2026	2025	Large companies[1] incorporated in the EU and EU-incorporated parents of large groups (including non-EU subsidiaries), including captive insurance and reinsurance undertakings, as well as small and non-complex institutions that meet the large company requirements.
2027	2026	Small and medium-sized entities listed on an EU-regulated market.
2029	2028	Companies whose ultimate parent company is outside the EU but which have a significant presence in the EU; report must encompass the whole global group, including non-EU companies.

1 Large companies are defined as those with a net turnover of more than €50 million, balance sheet total assets greater than €25 million and/or more than 250 employees.