Cefic views on the European Commission proposal for a Corporate Sustainability Reporting Directive

With the publication of the proposed Corporate Sustainability Reporting Directive (CSRD), Cefic welcomes further development of the EU Sustainable Finance Agenda. **Reliable, comparable and relevant information on companies' exposure to sustainability risks will enable informed decision-making that fosters investment in economic activities contributing to the socially just and sustainable economic transition.**

The European chemical industry is a valuable part of Europe's economic infrastructure – with over 1.1 million workers, €543 billion turnover and €9.3 billion in research and innovation (R&I) investments, the European chemical industry is a wealth generating sector and a major contributor to building a sustainable future for Europe.[1] As with other EU energy intensive industries (EIIs) operating in complex value-chains while exposed to international competition, the chemical sector contributes to a broad range of technological pathways with the potential to deliver significant emission reductions.
Given the strategic importance of the chemical industry and supply chain complexities, company materiality must be the starting point for all reporting – disclosure must be meaningful and reporting requirements adding additional cost, but with limited value, should be avoided.

Building on Cefic contributions[2] to the EU Sustainable Finance Agenda and conclusions reached by similar entities[3], and with reference to the CSRD proposal, Cefic recommends the following:

1) Adequate flexibility for undertakings to adjust to changing reporting obligations

The CSRD Impact Assessment[4] concludes current reporting practices are underdeveloped and the market for assurance of non-financial information is immature. Undertakings will bear additional compliance costs for the collection, organization, validation and disclosure of sustainability reporting information (i.e. IT system retrofitting [pending availability], certification of translations for reporting publications in multiple languages, adaptation to a single electronic reporting format etc.). Therefore, in the first instance, Cefic agrees limited assurance is the right policy choice and would recommend the Commission issue guidance on practical implementation and parameters.

Important to note, introducing requirements for detailed forward-looking reporting represents a significant increase in the scope of reporting, and it should be recognized that including forward-looking information in reporting requirements will increase both the cost and complexity of even

[1] 2021 Facts and Figures of the European Chemical Industry
[2] Cefic – Sustainable Finance
[3] European Sustainable Finance Survey 2020
[4] CSRD Impact Assessment

limited assurance. Given its nature, forward-looking information cannot be entirely accurate, and the CSRD must acknowledge this limitation.

Transition

Cefic believes integration of financial and sustainability reporting creates added value and recommends flexibility for companies to adapt existing financial transaction processing and reporting systems, in addition to the decision-making process on what information is disclosed, how it is used and where it is made available.

The scope of reporting under the proposed CSRD is significantly expanded relative to the existing NFRD, and with the lower qualification thresholds for reporting under the CSRD, the number of companies brought within scope will also be greatly increased. Sufficient time (24-36 months after all associated legislation is final, including the first set of sustainability standards and ratification by the European Parliament and Member States) is therefore recommended beyond 2023 before compliance with the sustainability reporting requirements is enforced with financial consequences or liability for accuracy. With reference to the phase-in period for SMEs, we would recommend a similar approach for EU subsidiaries of ultimate parent companies in non-EU countries which may not have an EU Taxonomy equivalent in place (but work is ongoing).

Implementation

There should also be flexibility to not to have sustainability reporting integrated in the financial management reporting. The former could be a separate report, as in the absence of fully automated ERP systems for non-financial metrics, sustainability reporting takes longer to prepare in comparison to financial reporting. Furthermore, IT systems that may help with the new CSRD reporting obligations, in addition to the EU Taxonomy disclosures, are unlikely to work retroactively (i.e. for transactions already booked in 2021 which would need to be reported in 2022).

Given uncertainties in upcoming disclosure obligations, such as those under the Taxonomy Regulation (which are set to apply from 1 January 2022), and the European Financial Reporting Advisory Group's (EFRAG) intention to issue the first set of European Sustainability Reporting Standards by the end of 2022, there must be sufficient time for transition and implementation. We recommend full consideration of the time and costs required for companies to prepare for reporting as uncertainties in content and timeframes will significantly increase costs.

European Sustainability Reporting Standards

In its proposals for an EU Sustainability Reporting Standard, EFRAG states that in the short term, international initiatives cannot match the speed and scope of EU ambitions. Given many companies have a global footprint, it is integral that EU efforts converge with the ongoing work of international partners (including the IFRS, the Value Reporting Foundation [VRF – formerly IIRC and SASB], TCFD and GRI) and global efforts such as the WEF IBC common metrics initiative.[5] Further, similar to the

[5] Measuring Stakeholder Capitalism: Towards Common Metrics and Consistent Reporting of Sustainable Value Creation

Taxonomy Regulation Article 8 draft delegated act, an equivalence provision may be introduced.[6] For instance, companies with a global footprint may not all report based on IFRS, or do so on a limited subsidiary basis.

In this regard, the EFRAG rightly concludes that there is a need to promote "mutually reinforcing cooperation" between EU standards and international initiatives.[7] As such, there must be greater clarity in the determination of the equivalence of sustainability reporting standards, information and criteria regarding accounting standards and financial and sustainability-related reporting standards used by non-EU companies and EU companies with a global footprint.

2) Coherence with existing reporting requirements/upcoming initiatives and consideration of international circumstances

The CSRD proposal recognizes the need for consistency within the EU Sustainable Finance Agenda, (including with the Taxonomy Regulation) and for a strong cooperation with the EU Platform on Sustainable Finance. As such, it is important that there is linguistic coherence, meaning the environmental factors listed in Article 19b(2)(a) should align with the environmental objectives listed in the Taxonomy Regulation and with upcoming legislative initiatives such as the Sustainable Product Initiative and Safe and Sustainable by Design. Similarly, to ensure consistency with global commitments, the language in Article 19a(2)(a)(iii) should align with the Paris Agreement.

Article 19b(2)(b)(iii) of the proposed CSRD outlines various international social principles such as the International Bill of Human Rights and other core UN Human Rights Conventions, among others. While this list recognizes global standards, it is framed broadly, and it is unclear of how this will be implemented in practice. Additionally, a dedicated Sub-Group in the EU Platform is currently evaluating the development and application of a social taxonomy. We would recommend a consideration of EU Platform work, while balancing international discussions.

Furthermore, an update of the CSRD at least every three years is challenging for companies from a resource perspective as well as coverage of the full review process (including consultations, etc.).

International standards & EU companies outside the EU/Non-EU companies operating in the EU

Cefic recommends prioritizing a limited number of meaningful disclosures as it is more impactful than including many elements that may not be as essential. This discipline in defining the scope of the CSRD will facilitate international convergence, as we expect it will greatly help global alignment on what common set of disclosures is most productive.

Our European industries are firmly integrated in global markets and business models – the CSRD needs to be designed with a diversity of economic actors in mind. Participants in the EU market with an ultimate parent company in a different jurisdiction could end up with a multitude of reporting requirements, and not make real use of the parent exemptions in the EU. Added to the fact that these companies are often non-listed, it is possible a lot of work and cost needs to be incurred for what may be incremental added value.

[6] Cefic views on the Commission draft Delegated Act on the obligation for certain companies to publish non-financial information
[7] Final Report – Proposals for a Relevant and Dynamic EU Sustainability Reporting Standard-Setting

Furthermore, the expanded scope of the CSRD will include EU-subsidiaries not involved in manufacturing or product sales (based on total number of employees and total balance sheet size), rather providing certain services. Cefic recommends excluding these companies from the CSRD coverage. Additionally, the exemption regime needs to be more precise, especially for multinational companies and to avoid double reporting under the CSRD and the Taxonomy Regulation.

Finally, Cefic recommends clarification as to whether, for EU subsidiaries with non-EU parent companies, the Minimum Social Safeguards of the non-EU parent companies can be considered as equivalent to EU standards.

3) <u>Clarity of reporting requirements and key definitions</u>

Cefic recommends greater clarity on the consolidated reporting requirements and boundaries in the CSRD and stresses the need for a balanced and flexible approach. For instance, the proposed text does not specify whether companies should apply the equity share or operational control approach when reporting ESG data. Companies use different ways of consolidating entities for financial reporting and should have flexibility in deciding on consolidating reporting in groups separate from the decision taken on financial reporting.

Disclosure should be meaningful and reflect basic reporting principles – focusing on materiality is important, as is the need for concise and reliable data that provides a fair and true picture. The choices preparers make regarding the metrics they deem material will become part of their audited external reporting – the CSRD must be specific to avoid the risk of liability for such choices. This does not necessarily require a defined list, but clear statements on what should be treated as relevant for a materiality assessment should be provided. It is important to note that materiality will change over time and there may be a need to develop new disclosures, while others may become less relevant.

Throughout the CSRD proposal, several terms are employed, such as “political engagement”, “business relationship” and “business partner”. Such terminology is vague, and in the case of the latter, it is important that commercially sensitive data and information (performance, investments, etc.) is respected. Additionally, the proposal discusses reporting along the supply chain, although it does not specify to which level. In such instances, Cefic recommends that whenever there is not enough clarity on definitions, undertakings are allowed to apply best judgement.

The CSRD proposal appears to recognize in the final paragraph of Article 19(a)(3) that disclosure about future plans may conflict with the need to safeguard commercially sensitive information or avoid breaches of confidentiality obligations; however, the proposed exception is too narrowly defined. There is an opportunity to clarify that this should be established at the level of the Directive rather than leaving to the discretion of Member States.

Given the complexities of implementing new disclosure requirements in the EU Sustainable Finance Agenda, Cefic recommends the Commission establish a dedicated functional inbox or helpdesk for companies to ask practical questions. For instance, it is not clear how to communicate economic activities not yet covered by the EU Taxonomy without creating reporting distortion or how to approach economic activities indirectly supporting currently defined enabling activities. From the perspective of the chemicals industry, it is unclear how to approach activities not explicitly mentioned but part of the NACE code, or reporting of chemical intermediates.

Cefic continues to support the European Commission and is committed to contributing to the development, analysis and review of all components in the EU Sustainable Finance Agenda with evidence-based recommendations. This includes active participation of our Permanent Representative in the EU Platform on Sustainable Finance. In addition, our membership is ready to positively collaborate with the Commission with sector-specific input and pilot-testing to inform future policy proposals and ensure sound implementation.

While contributing to this consultation we are very aware we are experiencing unprecedented times, with events none of us have lived through before. Cefic endeavors to maintain a high standard in our responses to public consultations. While we are confident that this contribution adequately reflects our views at the current time, we recognize that public and private sector responses to the crisis and its aftermath, both in the EU and globally, have the potential to significantly affect industry's operating conditions. When investing in the future, industry, governments and institutions will also have to continue to ensure investments align with the policy targets of a climate-neutral Europe. We look to the European Commission to undertake the appropriate assessments and to include these wider considerations in the future framework that will be developed, with the objective of ensuring the EU's post-crisis attractiveness as a place for investing in the industrial transformation required to achieve EU Green Deal objectives.

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About Cefic
Cefic, the European Chemical Industry Council, founded in 1972, is the voice of large, medium and small chemical companies across Europe, which provide 1.1 million jobs and account for 15% of world chemicals production.