VIK-Response

to the proposed European Corporate Sustainability Reporting Directive

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The German association of industrial energy consumers (VIK e.V.) welcomes an opportunity to provide feedback on the Proposal for a Directive of the European Parliament and of the Council amending Directive 2013/34/EU, Directive 2004/109/EC, Directive 2006/43/EC and Regulation (EU) No 537/2014, as regards ***corporate sustainability reporting****.*

With this legislative proposal, the European Commission is aiming to increase the impact of the financial sector in achieving the objectives of the European Green Deal as well as to provide the coherence of reporting requirements between the Non-Financial Reporting Directive (Directive 2014/95/EU, NFRD) and other sustainable finance legislation, including the Sustainable Finance Disclosure Regulation and the Taxonomy Regulation. It has been indicated that current obligations addressed in the NFRD are not providing sufficiently relevant and reliable information for investors and civil society, which presumably creates investment risks and inhibits financial flows to activities that address the sustainability crisis.

The draft of the proposed CSR-Directive which is supposed to amend the directives mentioned above has several objectives, which will improve non-financial reporting for the European companies and therefore, contribute to the transition towards a sustainable financial system. The EU-Commission indicates the following objectives: reducing of systemic risks to the economy by increasing the number of green investments; improving the allocation of financial resources, so that the investments will be undertaken to companies that primarily address social and environmental problems; making companies more responsible for their impact on society and the environment, thereby strengthening the interdependence between companies, banks and society.

The EU-Commission is expecting the applicability of the CSR-Directive under the jurisdiction of the member-states by 1 December 2022 and its further implementation from the financial year 2023, if in the next legislative stage, the European Council and Parliament will reach a corresponding agreement in the first half of 2022.

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The specific amendments of the proposal are following:

- to enlarge the scope of reporting obligations to all large companies, including the capital market-oriented and non-capital market-oriented companies. It is expected that the current list of 11,600 companies will be extended to 50,000 companies;
- to define the detailed reporting information for the companies according to the obligatory European sustainability reporting standards (currently, the companies decide on their authority, what kind of data will be officially published);
- to introduce a general EU-wide assurance of the sustainability information;
- to replace the previous finance reporting regulation by the application of double materiality principle[1];
- to ensure the availability of non-financial information in a digital format.

In this position paper, we analyse the above-mentioned amendments from the view of the VIK member companies.

Introduction of the common European standards for non-financial reporting

The VIK generally supports the initiative concerning the introduction of mandatory and harmonised standards for non-financial reporting. The proposed initiative offers a good opportunity for the EU to become a global leader in establishing and recognition of the sustainability reporting standards. However, the introduction of a European sustainability standard for a global market should be fundamentally discussed, especially the legal compatibility of European reporting standards and International Financial Reporting standards (IFRS). The possible application of european and global standards in the EU should not cause bureaucratic complications and double regulations of financial reporting.

Currently, the stakeholders have considerable discretion in deciding what information to report and how to applicate the double materiality principle. By the same time, the decision usefulness of the information for potential investors should be an important part of the proposed sustainability reporting. The new obligations which oblige companies to report on potential "sustainability" impacts and forward-looking information, including the information about the value chain, will be generally difficult to perform and provide accurate results. To avoid possible double regulations, the reporting obligations should be explained and be consistent with the future European initiative on due diligence.

It is also important to highlight a short timeline within the EU-Commission is planning to develop the standards. They are being currently discussed parallel with CSRD-consultation. To avoid legislative inconsistency, the standards should be developed, in our opinion, after the adoption of the future CSR-Directive.

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[1] A double materiality perspective means that companies have to report information not only on how non-financial issues affect the company ("outside-in" perspective), but also regarding the impact of the company itself on society and the environment ("inside-out" perspective), Definition is taken from "*Impact assessment on Proposal for a Revision of the Non-Financial Reporting Directive"*
https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52021SC0150

The future separate delegated act for the European mandatory reporting standards should be sufficiently discussed and consulted with all relevant stakeholders to ensure the needed feasibility. The companies should not be put at risk, especially by a possible publication of sensible financial and non-financial information. The proposed submission of reports in a digital standardised manner increases bureaucratic formalities as well, therefore, the possibility to report in electronic format should be proposed on the voluntary basis.

Avoidance of additional costs for companies

The Inception Impact Assessment of the CSR-Directive indicates the total estimated costs of the new non-financial reporting for preparers between 1,200 million euros in one-off costs and 3,600 million euros in annual recurring costs. The EU-Commission defines these costs as short-term costs, which could be reduced sooner on the mid-and long-term perspective. However, due to the current economic crisis and consequences of the Corona Pandemic, a high number of businesses, especially SMEs, are already operating at a subsistence level. The Commission's assumption that most companies will anyway face increased costs (the possible reason is that investors will persistently demand corporate sustainability information in the future) seems to be overestimated because economic development and pandemic-consequences in the EU member-states differ distinctively.

A consistency with reporting requirements with the Taxonomy Regulation is another important issue. Apart from the fact that sustainability-related issues will be included in the reporting standards, the Art.19a of the CSRD proposal contains additional reporting requirements which will be practically out of the scope of the Taxonomy disclosure. The possible risks are related to new costs, as the companies are preparing themselves for taxonomy reporting. The estimated costs for taxonomy reporting are between 40,000-125,000 euros. Therefore, the EU-Commission should consider another cost-efficient and favourable framework for the companies which will help to implement the proposed sustainability reporting.

Establishment of a reliable regulatory framework for fair competition on the global market

The scope of the proposed CSR-Directive should be extended to all companies and manufacturers operating in the European Union. It will ensure a coherent framework and fair conditions for sustainability risks reporting. The scope of the obligatory reporting can be enlarged for non-domestic companies operating in the EU, if they, for instance, will prove their high thresholds for annual global turnover. At the same time, the proposed approach should not create competitive disadvantages for European companies on the global market. In this sense, it is essential to consider and take into account appropriate market protection mechanisms.

Possible emergence of unnecessary bureaucratic burdens

It is expected that many businesses in the real economy will face unnecessary bureaucratic burdens during the preparation of the new sustainability reports and its further audit. An increasing number of new state regulations does not ensure stable planning reliability and security for businesses. A broad range of companies, which will be potentially obliged to report, need enough time and transparency to change their intern workload, create the necessary departments within the companies to meet new and complex reporting requirements. This requirement is especially important for those companies which were not previously obliged to the sustainability reporting. For example, in Germany, the list of the reporting businesses will be enlarged from 500 to 15,000 companies. Especially the SMEs will face the new reporting requirements, which means that companies with 250 employees, having 40 million euro turnover and/or 20 million euro of total assets should be obliged to report on their ESG-activities.

The timeline[2] given for companies to reorganise themselves according to the amended CSR-Directive is too short. The preparation of qualitative and reliable reports requires enough time as well. Companies have already met challenges in the implementation of Art.8 of the Taxonomy Regulation, especially during the collection of data on environmental performances and further preparation of a report under complex technical requirements. As taxonomy-related legislation is still under development, the companies should react immediately to new legislative amendments. Consequently, unpredictable operational risks can emerge on the later phases of CSRD implementation.

Along with the Taxonomy-Compliance, the new reporting standards can change access to the favourable financial terms in the provision of credit by banks. The ECB, for example, currently instructs banks to consider their sensitivity to climate risks when weighing how much capital they need beyond minimum requirements. The President of the ECB, Christine Lagarde considers the Commission’s proposal on corporate sustainability disclosures as a key element on the way to Green Capital Markets Union for Europe because the integration of sustainability disclosures with financial data will create a “one-stop shop” for all critical information about a company, including its green credentials, which would be profitable for investors[3].

However, those companies, which will not meet the new sustainability standards and criteria, could have difficulties, if they are planning to attract new investments or bank loans. It is worth noting that European and national government-funding programs (for example, in Germany) have already been adapted to the European Taxonomy and its accompanying delegated acts.

Initiative on general EU-wide audit (assurance) of sustainability information

The EU proposal introduces a general audit requirement for reported sustainability information. From the two options - “reasonable assurance requirement” and “limited assurance requirement”, the EU-Commission prefers the second option, which is less costly for the companies. However, the preliminary approach will automatically become “a requirement for a reasonable assurance” after the future adoption of special sustainability assurance standards. In this case remains unclear, how these standards will be compiled, what influence on the administrative burdens and future expenditures of the companies it will have. Concerning the qualification of auditors, it is also important to define legally the certification and accreditation procedure of the independent assurance services providers well as the transparent standards for their activities. For example, the reporting of the non-financial information (e.g. contribution to climate mitigation and social impacts) involves certain qualitative data, which is obviously difficult to estimate and verify by auditors if they specialize only in finance.

[2] The companies should reorganise themselves by the end of 2022 and collating data from January 2023
[3] Towards a green capital markets union for Europe, https://www.ecb.europa.eu/press/key/date/2021/html/ecb.sp210506~4ec98730ee.en.html

Is sustainability reporting a financial or non-financial issue?

From our viewpoint, the definition of sustainability as a non-financial issue (as well as the name of this directive) is not sufficiently correct. According to the current legislative initiatives related to the EU Sustainable Finance Package, all relevant stakeholders - companies, governments and banks are already supposed to be oriented on the uptake of sustainable investments. A number of companies even change their business development strategies on the way to support and promote sustainable investments. Therefore, they are already considering their development considering so-called ESG criteria (environment, social sphere, governance), which are definitely related to the financial strategies of the companies. Additionally, the proposed concept of double materiality needs a better clarification, especially if we consider the impact of manufacturers on the environment and society, which is difficult to measure in terms of financial costs and quantitative data. In this case, transparent metrics is essential to define.