



Report

New ESG reporting requirements impact all EU companies

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1 The EU sustainability disclosure regime

In recent years, environmental, social, and governance (ESG) criteria have become a key topic in business and in the popular consciousness, as demonstrated by Google search trends.¹

Growing urgency in relation to environmental and social issues means that this trend is unlikely to diminish. However, the conversation around ESG is often obscured by the complexity of the subject matter. This complexity is, in no small part, driven by the rapidly evolving nature of both the science and the regulation.

This report aims to help give a framework and guidance for understanding some of the main regulatory components of the EU's disclosure regime. Whilst all companies should consider ESG issues (most are subject to regulations in any case), this report will focus on the impact of the EU's ESG disclosure regime for telecoms, media and technology (TMT) actors and investors.

The European Commission and Parliament have been progressive in supporting ESG activities and this regime is likely to encourage other markets to promote standardisation and market efficiency.² In the USA, the Securities and Exchange Commission (SEC) has proposed similar disclosure requirements, although they have not been finalised as we move into 2023.

1.1 An overview of the EU sustainability disclosure regime

The EU's current sustainability disclosure regime has two main objectives, defining sustainability in terms of economic activity and encouraging transparency by mandating certain information disclosure by companies. The regime is principally composed of three interrelated components or 'regulatory instruments'.³

- the EU Taxonomy for Sustainable Activities⁴
- the Non-Financial Reporting Directive⁵ (NFRD)

¹ See Annex – Figure A.1

² In October 2022, the Financial Conduct Authority (UK) set out their Sustainable Disclosure Requirements (SDR) and investment labels in which it stated "We have sought, as far as possible, to achieve international coherence with other regimes – notably the Sustainable Finance Disclosure Regulation (SFDR) in the European Union (EU) and proposals by the Securities and Exchange Commission (SEC) in the United States (US)." (See 1.20) <https://www.fca.org.uk/publication/consultation/cp22-20.pdf>

³ See Annex – Figure A.2

⁴ Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088

⁵ Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups

- the Sustainable Finance Disclosure Regulation⁶ (SFDR).

This regime stipulates minimum standards for sustainability-related disclosures, as well as a market-wide definitions for which economic activities are defined as sustainable. In addition to the general disclosure requirements, there are specific instructions for financial actors (such as funds or other investment managers). These requirements apply to EU-registered companies and to investment managers or advisers based outside the EU who market (or intend to market) their products within the EU.⁷

1.2 The EU Taxonomy for Sustainable Activities

The EU taxonomy provides a market-wide definition of what should be referred to as ‘sustainable’. Article 3 provides the criteria for ‘environmentally sustainable economic activities’.⁸

- The activity must be related to one of the six environmental objectives⁹:
 - climate change mitigation
 - climate change adaption
 - the sustainable use and protection of water and marine resources
 - the transition to a circular economy
 - pollution prevention and control
 - the protection and restoration of biodiversity and ecosystems.
- Companies must show that the economic activity ‘contributes substantially’ to that objective through:
 - substantially contributing activities, i.e. activities with very low or zero emissions¹⁰
 - transitional activities, i.e. activities that cannot be made fully sustainable but are below current industry emissions and do not disincentivise green initiatives¹¹
 - enabling activities, i.e. activities that enable another economic activity to meet its environmental threshold.¹²
- The company must show that the economic activity does not harm any of the other environmental objectives.

⁶ Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector

⁷ See Articles 2 and 42 of Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers

⁸ See Annex – Figure A.3

⁹ Article 9 of the Taxonomy

¹⁰ Article 10 of the Taxonomy

¹¹ Ibid.

¹² Article 16 of the Taxonomy

- The company must show that the economic activity upholds minimum social safeguards including:
 - OECD Guidelines for Multinational Enterprises
 - UN Guiding Principles on Business and Human Rights.
- The economic activity must follow the technical screening criteria relevant to the environmental objective.
 - this is an evolving area, regulators have adopted technical screening criteria for the first two environmental objectives whilst drafting is ongoing for the others.

1.3 The NFRD

The NFRD requires eligible companies¹³ to report selected ESG indicators in their non-financial disclosures. This includes sustainability-related disclosures for:

- environmental protection
- social responsibility and the treatment of employees
- respect for human rights
- the prevention of corruption and bribery.

According to the European Commission's (non-binding) guidelines on the presentation of the sustainability reports, climate-related information can be reported in line with the recommendations prepared by the Taskforce on Climate-related Financial Disclosure (TCFD) on behalf of the Financial Stability Board.

The European Commission plans to replace the NFRD with the Corporate Sustainability Reporting Directive (CSRD) from 2024 onwards. The new CSRD aims to provide an even greater level of standardisation to enable investors to better evaluate the investment's 'green' bona fides

1.4 The SFDR

The SFDR applies to all financial market participants (FMPs) who sell financial products in the EU (e.g. funds sold by asset managers).¹⁴ The requirements for the level of disclosure under the SFDR is dependant on the nature of the financial product, with products classified in one of three ways:

- Article 6: financial products without a sustainability scope
- Article 8: financial products that claim to promote environmental or social characteristics (also referred to as 'light green')

¹³ Companies with over 500 employees; and a balance sheet of over EUR20 million, or net turnover of over EUR40 million (see Article 4(4) of the NFRD)

¹⁴ See Annex – Figure A.4

- Article 9: financial products that have sustainable investment as their objective (also referred to as ‘dark green’).

Products which claim to have a level of sustainability as part of their objective (Article 8 and 9 financial products) are subject to higher disclosure requirements to prevent asset managers greenwashing by claiming a higher level of sustainability than is measurable.¹⁵

The SFDR requires FMPs to provide pre-contractual and ongoing entity level disclosures (also referred to as ‘Level 1’)¹⁶ and product level disclosures (also referred to as ‘Level 2’)¹⁷ on how the FMP considers and assesses various sustainability factors.

Entity level disclosures require information about FMP policies on the identification and prioritisation of sustainability risks and the principal adverse impacts using the prescribed ‘Principal adverse sustainability impacts statement’ template.¹⁸ Entity’s must provide this information on the entity’s website. This template is composed of a grid of key performance indicators including 64 disclosures across three tables:

- Table 1 contains the 18 mandatory indicators:
 - 14 principal adverse impact (PAI) indicators applicable for all investments, and more disclosures if investments relate to: sovereign and supranational entities, or real-estate assets.
- Table 2 contains the 22 optional other climate- and environment-related indicators.
- Table 3 contains the 24 optional other indicators for social and employee, respect for human rights, anti-corruption, and anti-bribery matters.

Product level disclosures are more extensive and include pre-contractual disclosures as well as ongoing periodic reporting and website product disclosures. Product level disclosures came into effect on 1 January 2023.¹⁹

¹⁵ Annexes 2–5 of the Commission Delegated Regulation (EU) 2022/1288 of 6 April 2022 supplementing Regulation (EU) 2019/2088 provide the additional disclosure requirements for Article 8 and Article 9 products

¹⁶ Article 4 of Regulation (EU) 2019/2088

¹⁷ Article 7 of Regulation (EU) 2019/2088

¹⁸ Annex 1 of the Commission Delegated Regulation (EU) 2022/1288 of 6 April 2022 supplementing Regulation (EU) 2019/2088

¹⁹ EU Commission to the Council of the European Union and the European Parliament (letter, 25 November 2021) *Information regarding regulatory technical standards under the Sustainable Finance Disclosure Regulation 2019/2088*.

Available at https://www.esma.europa.eu/sites/default/files/library/com_letter_to_ep_and_council_sfdr_rts-j.berrigan.pdf

2 Implications for stakeholders

2.1 TMT companies

The EU disclosure regime discussed in this report is broadly industry-agnostic. However, TMT players ought to consider their position in light of these regulations as it will require them, like others, to disclose their ESG performance to ensure compliance. TMT companies can view these ESG disclosure requirements as an opportunity to more effectively advertise the sustainability initiatives that they might be undertaking. Environmental issues are top of mind for many, but social initiatives (such as digitalisation and social inclusion) are an enabler for several sustainable development goals that TMT companies might also be able to showcase.

Analysys Mason's experience in ESG assessments has discovered that TMT companies face particular challenges and opportunities (especially in the current macroeconomic environment) related to energy optimisation, the transition to low-carbon energy sources, waste management and mitigating against the physical effects of climate change.

2.2 Investors and financial actors

The ESG disclosure regime outlined in this report has specific guidance for investors and financial actors which both reflects and encourages the trend we have been seeing of ESG matters gaining importance in investment decisions.

Investors are increasingly putting additional value on companies with strong ESG initiatives, which means that displaying ESG credentials will likely continue to grow in importance as part of the transaction process. From a buy-side perspective, these ESG factors are becoming a priority for two primary reasons. First, ESG can have a significant impact on a company's overall performance. Second, each purchase made by an investor may need to be disclosed in the buyer's own ESG reporting, which could detrimentally impact the buyer's ESG position. From a sell-side perspective, companies that do not visibly demonstrate their ESG efforts risk missing investment. Companies must establish their ESG credentials in a clear, consistent way to attract investors.

Analysys Mason has supported several clients incorporating ESG assessments into the due diligence process (from both buy- and sell-side perspectives) and has seen the increasing attention that boards, and investment committees are paying to ESG considerations.

Annex

Figure A.1: Google search trends for “ESG” [Source: Google, 2023]

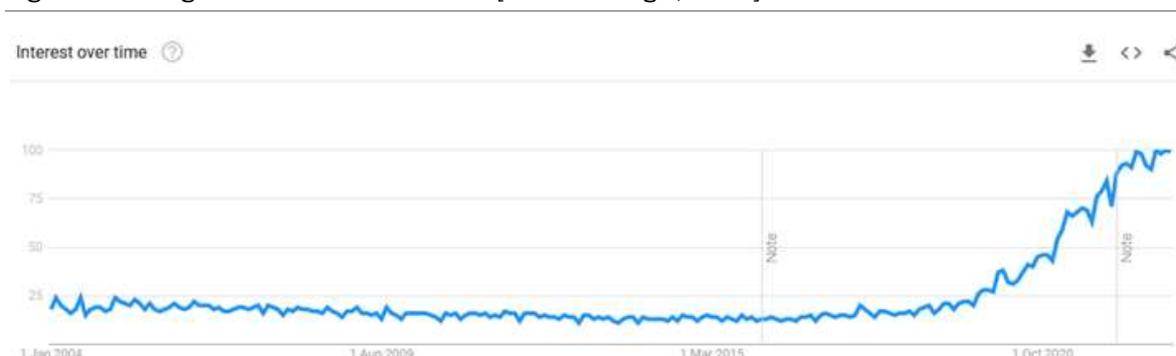


Figure A.2: EU sustainability disclosure regime summary [Source: Analysys Mason, 2023]

	Non-Financial Reporting Directive	EU Taxonomy for Sustainable Activities	Sustainable Finance Disclosure Regulation
Scope	<ul style="list-style-type: none"> European listed and large public interest companies 	<ul style="list-style-type: none"> Companies in scope for NFRD FMPs in scope for SFDR that promote environmental characteristics in their financial products (Article 8 and Article 9 financial products) 	<ul style="list-style-type: none"> All FMPs based in the EU Investment managers or advisers based outside of the EU who market (or intend to market) their products to EU clients
Compliance requirements	<ul style="list-style-type: none"> Companies have to publish policies regarding: <ul style="list-style-type: none"> environmental protection social responsibility and treatment of employees respect for human rights anti-corruption and bribery company board diversity There are no disclosures related to the EU Taxonomy required under NFRD, but this is subject to change 	<ul style="list-style-type: none"> Companies and asset managers will have to report the percentage of their turnover, capital expenditures, and operational expenditures aligned with the EU taxonomy Asset managers must report the percentage of their portfolio invested in activities aligned with the EU taxonomy 	<ul style="list-style-type: none"> Mandatory disclosures for all managers with additional requirements for financial products that claim to have an ESG focus (Article 8 and Article 9 financial products) How market participants are assessing the sustainability risks that could negatively impact their financial returns and how their investment could adversely impact sustainability factors (the 'double materiality' of sustainability)

Article 3

Criteria for environmentally sustainable economic activities

For the purposes of establishing the degree to which an investment is environmentally sustainable, an economic activity shall qualify as environmentally sustainable where that economic activity:

- a) contributes substantially to one or more of the environmental objectives set out in Article 9 in accordance with Articles 10 to 16;
- b) does not significantly harm any of the environmental objectives set out in Article 9 in accordance with Article 17;
- c) is carried out in compliance with the minimum safeguards laid down in Article 18; and
- d) complies with technical screening criteria that have been established by the Commission in accordance with Article 10(3), 11 (3), 12(2), 13(2), 14(2) or 15(2).

Article 2

Definitions

For the purposes of this Regulation, the following definitions apply:

1. 'financial market participant' means:

- a) an insurance undertaking which makes available an insurance-based investment product (IBIP);
- b) an investment firm which provides portfolio management;
- c) an institution for occupational retirement provision (IORP);
- d) a manufacturer of a pension product;
- e) an alternative investment fund manager (AIFM);
- f) a pan-European personal pension product (PEPP) provider;
- g) a manager of a qualifying venture capital fund registered in accordance with Article 14 of Regulation (EU) No 345/2013;
- h) a manager of a qualifying social entrepreneurship fund registered in accordance with Article 15 of Regulation (EU) No 346/2013;
- i) a management company of an undertaking for collective investment in transferable securities (UCITS management company); or
- j) a credit institution which provides portfolio management;