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The European Union’s ESG Disclosures: A Balanced Stance for Corporate Reporting

Compliance and Ethics

Environmental

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The European Union, in a nod to corporate concerns over extensive environmental regulations, has refined its rules on environmental, social, and governance (ESG) disclosures. USAA's Sustainability & Legal Executive Mike Dillinger reflects on the in-house implications of this regulatory development.

The European Commission, under the leadership of President Ursula von der Leyen, revealed final guidelines this August 7, manifesting a commitment to trimming bureaucratic hurdles in line with her promise to cut red tape.

What are the changes?

The European Sustainability Reporting Standards (ESRS) expounds on the Corporate Sustainability Reporting Directive (CSRD). Large corporations are expected to integrate these within their annual reports for 2024, with smaller entities adopting them by 2026.

Key revelations from the announcement include:

1. Moderation from initial guidelines: The commission's finalized ESRS standards reflect modifications from the original draft suggested by its EFRAG advisory body on accounting rules.

2. Phased implementation for small to medium-sized enterprises: Firms with under 750 employees benefit from added phase-in stipulations, offering a more gradual adaptation timeline.

3. Greater reporting latitude: Corporations now have more discretion in defining what information qualifies as "material" for reporting — a method typically seen in financial reporting. However, in contexts like customer carbon emissions (Scope 3), if considered immaterial, companies need to explicitly mention this rather than omitting such data.

4. Shift from mandatory to voluntary: Certain disclosures, such as those pertaining to biodiversity transition plans, have transitioned from being obligatory to optional.

In-house ripples

Harnessing the winds of change. The EU sets the pace for ESG transparency. Artwork by Martin Bergsma / *Shutterstock.com*

For in-house counsel, these changes carry implications in legal compliance, risk assessment, and strategic business advisory. Given the movement from mandatory to voluntary disclosures and the enhanced discretion granted to corporations, in-house legal teams will be central in guiding their organizations through nuanced interpretations and decisions on what to disclose.

> "Corporate counsel will need to continue being adept at simultaneously managing different compliance jurisdictions. In the US, many sustainability requirements are often driven by dynamic stakeholder sentiment and based on voluntary frameworks or less durable regulatory guidance that can revoked if an administration changes. In addition, there is more of a focus on financial materiality as defined by US law. Conversely, Europe is moving towards sustainability requirements mandated by legislation and regulations that include double materiality going beyond the US legal definition of financial materiality."
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> Michael Dillinger, Sustainability & Legal Executive, AVP of ESG at USAA

Despite these concessions, the commission's decision has garnered mixed feedback. HSBC analysts saw the dilution as a potential "step back" in ambition but acknowledged that it might pave the way for global sustainability reporting convergence. However, sustainable finance advocates, Eurosif, expressed their discontent, particularly over the retreat from compulsory core disclosures.

The mixed feedback on the commission’s decision underscores the diverse perspectives on this topic. Particularly significant is the dialogue with the International Sustainability Standards Board (ISSB). The heavy lean on materiality discussions aids in-house counsel by simplifying and unifying global standards, streamlining the compliance journey for multinational corporations.

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