EU Newsletter
#1 Sustainability Reporting

December 2021

The period we are going through reinforces the importance of sustainable development issues and raises the question of the meaning of our economic models and the long-term vision.

It has become clear that economic growth that has a negative impact on society is not sustainable, neither for Countries, nor for the economy, and ultimately, not for humanity.

In short, there will be no entity winning in a world that loses. In this context, sustainability reporting is taking on a considerable importance in view of the developments of the last few months. We have chosen to initiate this Newsletter and hope this will help with you to drive forward your sustainability agenda.

Enjoy your reading

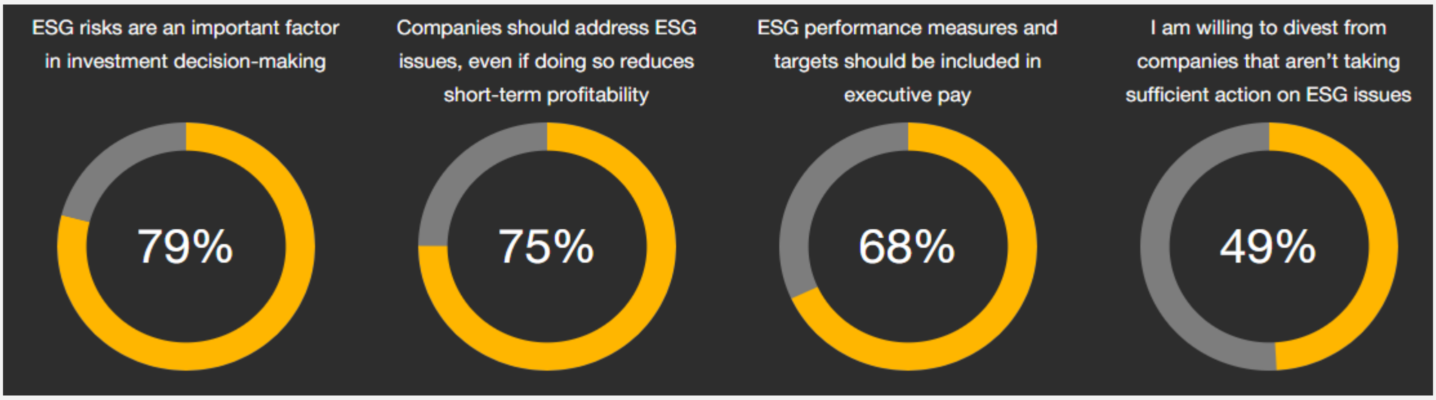
Olivier Schérer
Partner PwC

pwc

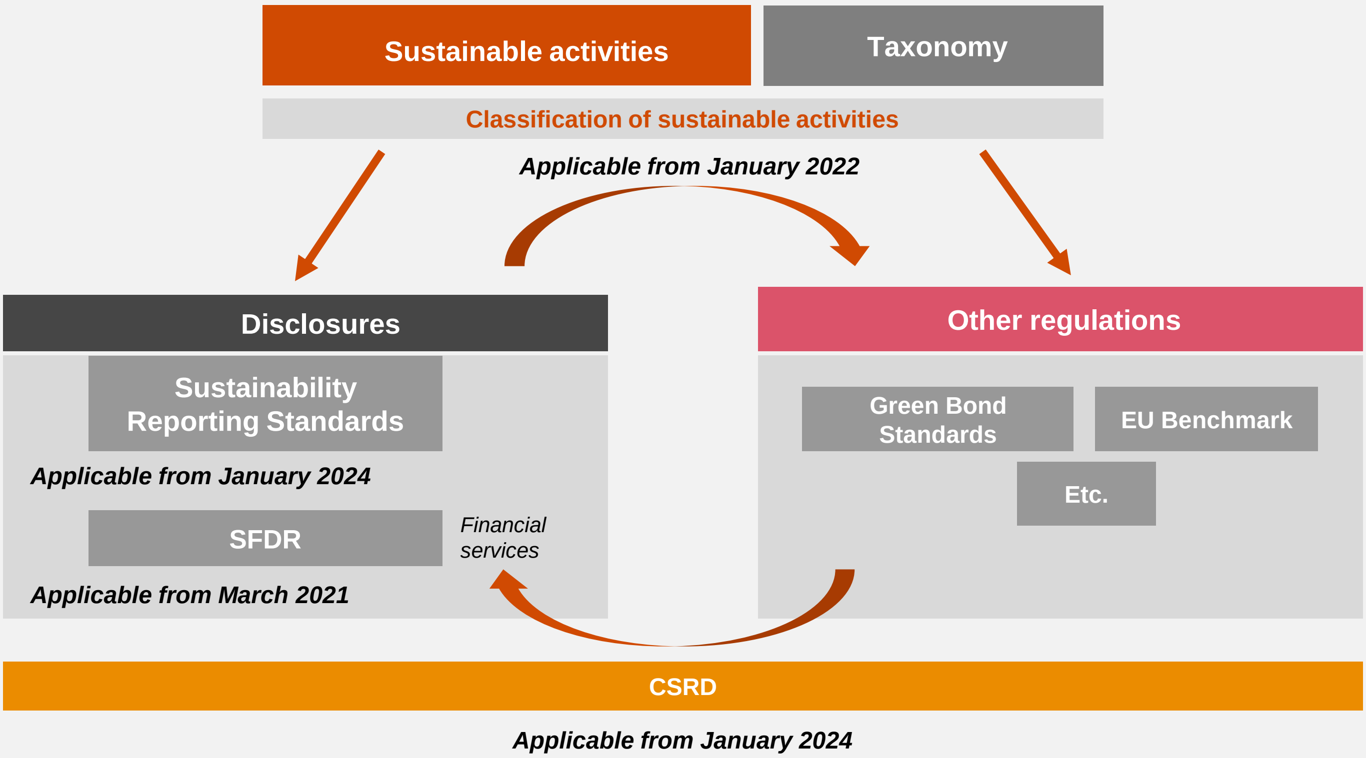
Agenda

Editorial

One in two investors is willing to sell their stake if a company does not take action on sustainability issues. As our PwC Global Investor ESG Survey 2021 indicates, environmental, social and governance factors are becoming increasingly central to investment strategies :



Stakeholders need useful information to be able to direct capital flows towards sustainable investments. The European Union (EU) has launched several ambitious initiatives:



These initiatives are part of the EU Sustainable Finance strategy (⇒ here and factsheet here).

Taxonomy

The Taxonomy Regulation establishes a classification system to identify economic activities considered sustainable and it requires undertakings to publish the sustainable portion of their activity (that is sustainable turnover, capex, opex for non-financial undertakings).

The Taxonomy regulation is the subject of much debate, with support from some sides and criticism from others. In any case, the text is applicable from January 2022 on the basis of 2021 reporting, with a simplification measure for this first reporting period.

CSRD and standardisation of sustainability reporting

Sustainability information is currently lacking in quality, quantity and comparability. It is essential to have a reliable and consistent set of data on sustainability issues, and for this sustainability information (formerly known as non-financial information) to have the same level of quality and rigour as financial information. This is the objective of the Corporate Sustainability Reporting Directive (CSRD), designed to extend the scope of undertakings concerned and information to be provided starting from 2024 on the basis of 2023 reporting.

The CSRD proposal poses several challenges: EU leadership, double materiality, stronger governance, and consistency with other EU regulations reflecting Europe's ambition (such as the Taxonomy Regulation, SFDR Regulation, Sustainability Reporting Standards, Green Bond Standards, Sustainable Corporate Governance proposal).

- PwC welcomed the announcement of the creation of the International Sustainability Standards Board (ISSB) by the IFRS Foundation.
- PwC welcomed the ambition of the European Financial Reporting Advisory Group (EFRAG), but also the principle of converging towards a single framework.
- PwC is assisting EFRAG's standard-setting by assigning experts to the project.
- PwC is also proud to announce the appointment of Eelco van der Enden (former PwC Global ESG Platform Leader – Tax, Legal, People & Organisation Services) as the new CEO of the Global Reporting Initiative (GRI), a leader in existing sustainability reporting standards and a partner to the EFRAG initiative.

In light of these commitments, we are pleased to present this Newsletter on sustainability reporting.

This first edition covers:

1. The Taxonomy Regulation
2. The CSRD proposal
3. Sustainability reporting standards
    - EFRAG developments
    - ISSB developments
4. Climate reporting: EFRAG's proposal
5. The priorities of the European Securities and Markets Authority (ESMA) on sustainability reporting from 2021 onwards
6. The Sustainable Finance Disclosure Regulation (SFDR)
7. Climate change and financial reporting

This Newsletter aims at providing keys to better understand and manage the challenges ahead.

Taxonomy Regulation

Overview

The EU Taxonomy is designed to map out the European economy in order to identify, in a standardised and transparent manner, the percentage of business activity which aligns with sustainability objectives.

The Taxonomy will first focus on climate change objective (mitigation and adaption) and will add other objectives in the coming years.

When?

2021 Reporting

First publication in 2022

Where?

Non-financial statement

What?

Sustainable share

Non-financial undertakings

% of turnover

% of CAPEX

% of OPEX

within the meaning of the Taxonomy (restrictive list)

Financial undertakings

→ **Specific KPIs** set for financial market participants (green asset ratio in particular)

Background

The Taxonomy Regulation is a key component of the European Commission's action plan to reorient capital flows towards a more sustainable economy. It represents an important step towards achieving carbon neutrality by 2050, since the Taxonomy is a classification system for 'sustainable' activities.

The Taxonomy Regulation follows a step-by-step approach, starting with a Taxonomy on climate change targets. The Taxonomy for four other environmental targets is currently under development.

The Taxonomy will be extended to cover social objectives and to address support needed for the environmental transition needed in the whole economy.

Sustainable activity?

Defined according to 6 environmental objectives:

Climate change mitigation	Adaptation to climate change	Sustainable use of water and marine resources	Circular economy	Pollution prevention and control	Prevention and restoration of biodiversity and ecosystems	Social Taxonomy	Harmful & No Significant Impact Taxonomy
from 2022 on 2021 reporting		*from 2024 on 2023 reporting?*				*To be defined*	

There will be some challenges along the way as the Taxonomy is applied, such as:

- Keep to a tight timeframe.
- Correct textual defects and resolve problems of interpretation and application issues.
- Deal with the lack of available information and inadequacy of the groups' IT systems.
- Need to cover more activities, including many discussions around nuclear and natural gas, for example.

Scope

The scope of the Taxonomy Regulation includes undertakings which are subject to the obligation to publish a (consolidated) non-financial statement pursuant to Article 19a (29a) of the Accounting Directive (Directive 2013/34/EU of 26 June 2013).

These undertakings must provide investors with a basis for their investment decision by disclosing information on how and to what extent the company's activities are associated with environmentally sustainable economic activities (Article 8 of the Taxonomy Regulation).

Undertakings are classified into two categories to determine the type of Key Performance Indicators to be presented:

- non-financial (that is corporate) undertakings; or
- financial undertakings :
  - asset managers, or
  - credit institutions, or
  - investment firms, or
  - insurance and reinsurance undertakings.

As of 1 January 2024 (that is for the reporting period 2023), the scope will be enlarged in the context of application of the Corporate Sustainability Reporting Directive (see the section on CSRD Proposal below).

Authoritative literature

European Union law is a set of texts that do not all have the same legal value. In particular :

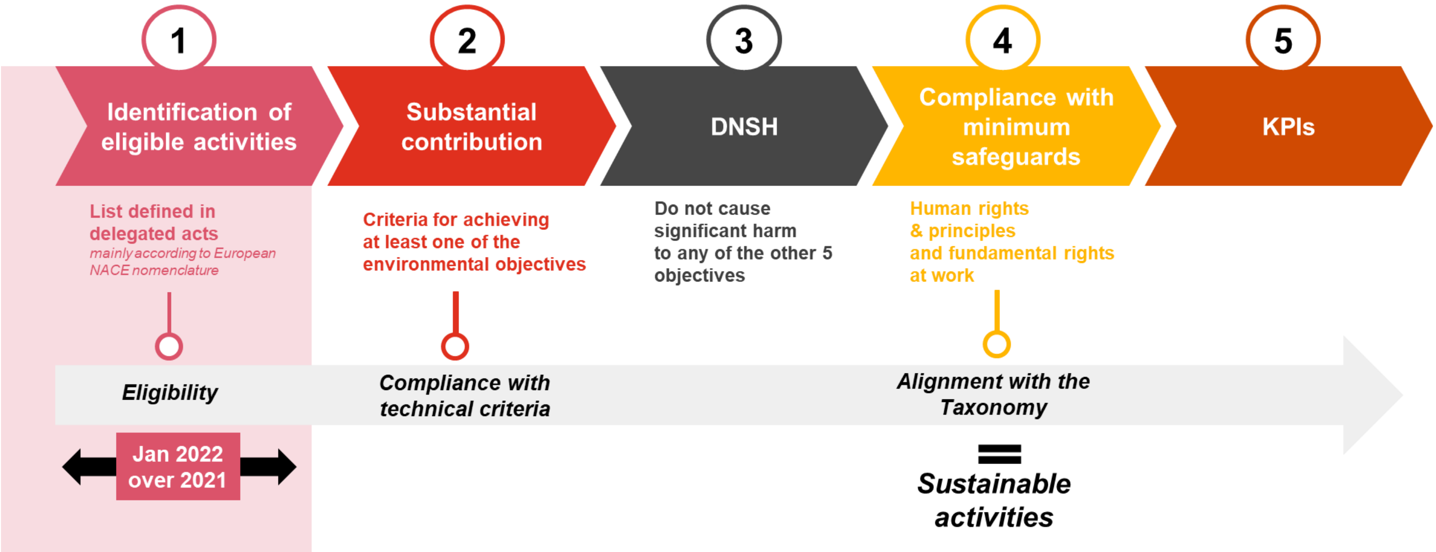
- *Regulations are legislative acts that apply automatically and uniformly in all EU countries as soon as they enter into force, without having to be transposed into national law. They are binding in their entirety in all EU countries.*
- *Directives are binding as to the result to be achieved but leave Member States discretion as to how to achieve it. Directives must be transposed into national law.*
- *Delegated acts are legally binding acts adopted by the European Commission that serve to amend or supplement the non-essential elements of the legislation – to define detailed measures, for example.*

The European Commission has adopted the Taxonomy Regulation (⇒ here) and delegated acts :

- *Climate Delegated Regulation, which determines the conditions under which an economic activity can be considered sustainable (that is, a "dictionary" of sustainable activities) (⇒ here)*
- *Delegated Regulation relating to Article 8 of the Taxonomy Regulation (that is, Accounting Delegated Regulation), which specifies the content, methodology and presentation of the information to be provided (⇒ here)*
- *European Commission's FAQ – December 2021 (⇒ here)*
- *Platform considerations on voluntary information as part of Taxonomy eligiblity reporting – December 2021(⇒ here)*
- *Draft reports:*
  - *Four other environmental objectives (⇒ here)*
  - *Social taxonomy (⇒ here)*
  - *Environmental transition taxonomy (⇒ here)*

Application

The Taxonomy follows a five-step process:



The Taxonomy Regulation is applicable from 1 January 2022 (that is, for the 2021 reporting period) with a 1-year or 2-year phase-in period depending on the nature of the reporting entity.

Non-financial undertakings:

From 1 January 2022 based on 2021 reporting period, only the proportion of Taxonomy-eligible and the proportion of Taxonomy non-eligible economic activities shall be disclosed in relation to the following three KPI's, i.e.:

- eligible and non-eligible turnover;
- eligible and non-eligible capex and,
- eligible and non-eligible opex.

From 1 January 2023 (that is, for the 2022 reporting period) non-financial undertakings shall disclose required KPIs alongside qualitative information.

Financial undertakings:

From 1 January 2022, until December 31, 2023, that is, based on 2021 and 2022 reporting periods, financial undertakings should also apply a simplified reporting based on eligibility.

As of January 1, 2024 (that is, for the reporting period 2023) the Article 8 Delegated Regulation will be fully applicable, with the exception for credit institutions of the KPI's on fees and commissions and on the trading portfolio that are required as of 1 January 2026 (reporting period 2025).

Subject to confirmation, the other four environmental targets should apply from 1 January 2024 (2023 reporting period).

Disclosure requirements

Article 8 of the Delegated Regulation of the Taxonomy lays down the content, calculation methods and presentation of the indicators.

In particular, the information should be presented using the templates provided in the annexes to the delegated regulation.

Overview of main KPIs by type of undertaking:

Type	Key Performance Indicators
Non-financial undertakings	• Turnover KPI • Capital expenditure (Capex KPI) • Operating expenditure (Opex KPI)
Financial undertakings	
• Asset managers	• Green Investment Ratio
• Credit institutions	• Green Asset Ratio (GAR) • Green ratio for financial guarantees to corporates (FinGuar KPI) • Green ratio for assets under management (AuM KPI) • Fees and commission income (F&C KPI) • Trading book KPI
• Investment firms	• KPI for services and activities dealing on own account • KPI for other services and activities
• Insurance and reinsurance companies	• KPI related to investments • KPI related to underwriting activities

Next steps

- Complementary Climate Delegated Act (focusing on natural gas and nuclear): January 2022?
- FAQ (batch 2) to help undertakings with application of the Taxonomy: January 2022?
- Delegated Act on other environmental objectives: first half of 2022
- Final reports on social taxonomy and on the extended taxonomy to support economic transition: Q1.2022

Find out more

- EU Taxonomy Compass tool developed by the European Commission allowing users to check activities and criteria (⇒ here)
- Mapping of NACE codes to other industry classification systems (⇒ here)

CSRD Proposal

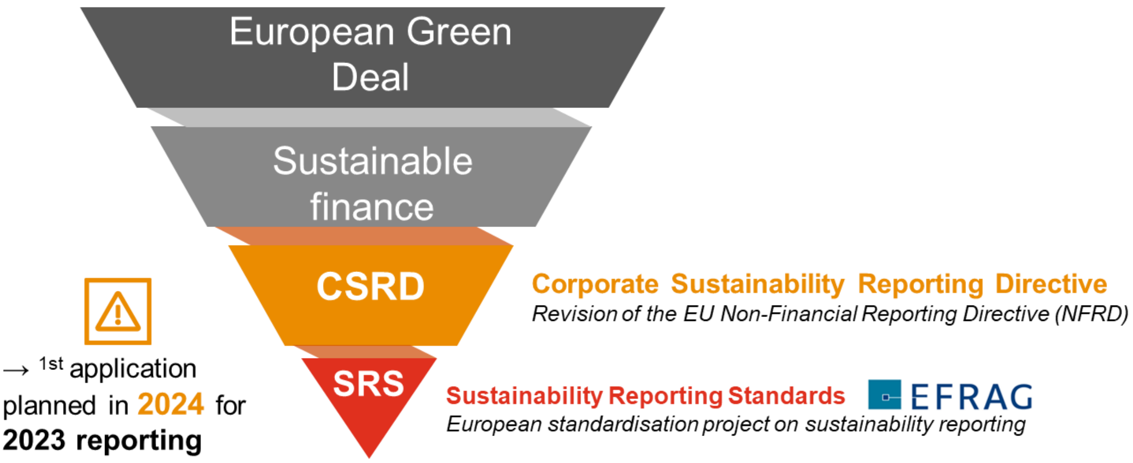
Overview

On 21 April 2021, the European Commission published a draft Directive on sustainability reporting (⇒ here). Known as the Corporate Sustainability Reporting Directive (CSRD), it will in principle replace the Non-Financial Reporting Directive (NFRD) from January 2024 (ongoing discussions regarding a potential postponement of one year).

The main challenge for companies is to plan ahead for these new requirements to ensure they are prepared, particularly in view of the more demanding reporting requirements.

What is the goal?

The CSRD proposal is designed to improve and standardise the disclosure of sustainability information by companies, thereby ensuring that comparable, reliable sustainability information is available to financial companies, investors and the general public. It aims to create a set of rules that will over time bring sustainability reporting up to the same level of quality as financial reporting.



What are the consequences, and who will be impacted?

Reporting
More detailed but simplified sustainability reporting as a result of the creation of European Sustainability Reporting Standards that complement the CSRD framework will be required and will avoid significant disparities among standards and benchmarks. The standards are developed by EFRAG (⇒ standardisation of sustainability reporting article).

In parallel, other standardisation initiatives are being developed, including:

- International initiative: standards developed by the ISSB, which is part of the IFRS Foundation (an initiative comparable to the IASB for the development of standards for financial statements).
- US initiative: standards developed by the Securities and Exchange Commission (SEC)

Impacts and challenges for entities
Beyond the reporting requirement itself, there are many significant challenges for companies, such as performance measurement, access to financing, and communication (financial and non-financial), but also a strengthened role for audit committees on the effectiveness of the internal control system with regard to sustainability reporting.

Extended scope
Mandatory reporting will be required for all listed undertakings on EU regulated markets (except listed micro-enterprises, but including non-EU issuers) and for all large undertakings/groups (at least two criteria: balance sheet total > €20 million, turnover > €40 million, > 250 employees).

Nearly 50,000 EU undertakings are expected to be impacted, compared to 11,000 under the current Directive.

Audit
Reporting will be a subject to verification, initially to the standard of a 'review'.

Management report and tagging
Information will be published in the management report, and digital tagging (similar to ESEF) is required to feed into the European single access point project.

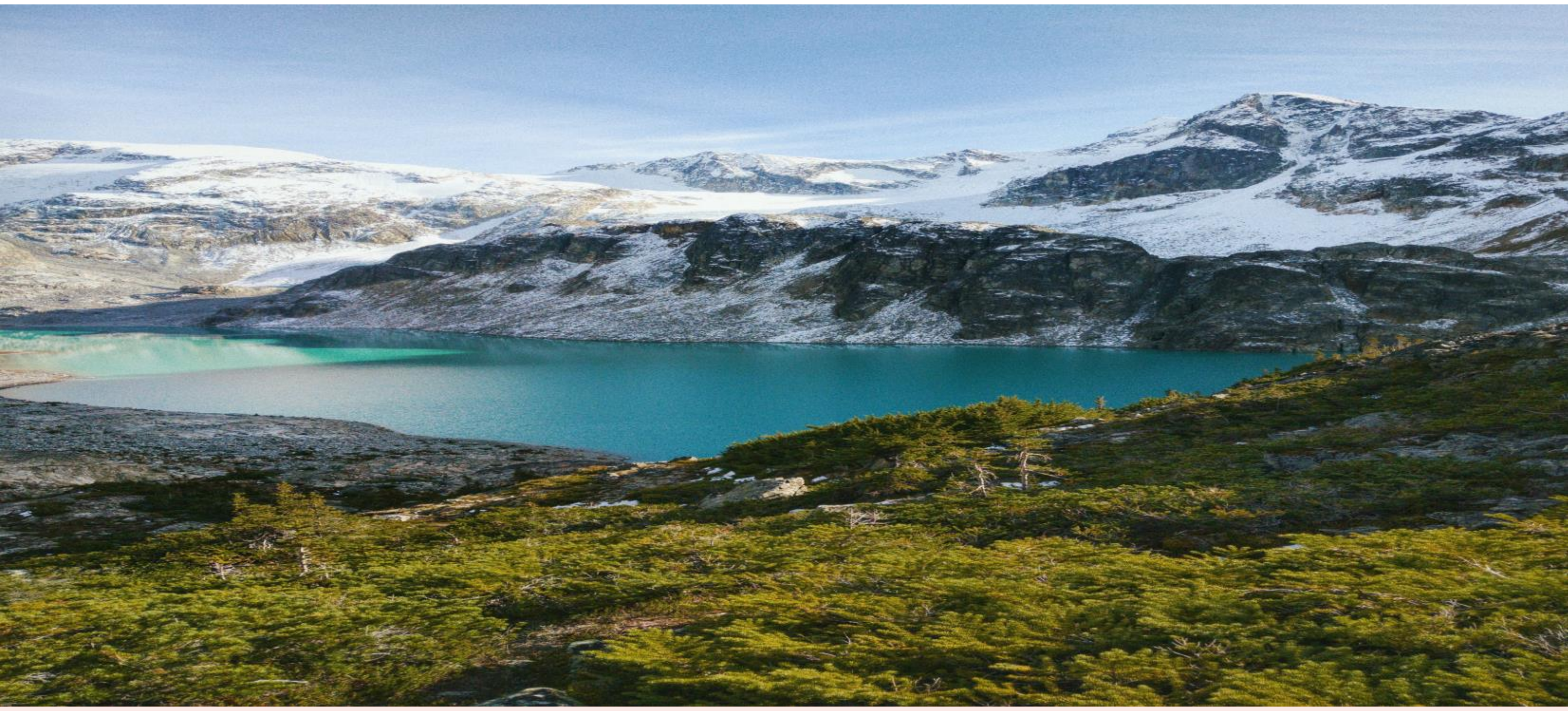
Next steps

First application in 2024, based on 2023 reporting, is subject to the provisions made during transposition into local laws.

Ongoing discussions regarding a possible postponement of one year.

Sustainability Reporting Standards

Focus - EFRAG



Overview

The race to standardise sustainability reporting has begun. In Europe, EFRAG is working on developing its framework, based on the concept of double materiality. Internationally, ISSB focuses on the financial materiality of sustainability and climate risks that could affect investors. EFRAG and ISSB already published draft documents at the end of 2021. The next documents are expected in December 2021/January 2022.

In Europe, EFRAG's standards are expected to come into force in January 2024, on 2023 reporting, with the CSRD (ongoing discussions regarding a potential postponement of one year).

The main challenge for companies is to keep track of these various publications on future standards so that they can be prepared by gradually adjusting their reporting ahead of the mandatory application.

Background

The European Commission's CSRD proposal is aimed, among other things, at creating and adopting European standards on sustainability reporting. The European Commission mandated EFRAG to develop these standards.

EFRAG is the European Financial Reporting Advisory Group for International Financial Reporting Standards (IFRS).

A working group (Project Task Force on European Sustainability Reporting Standards – PTF-ESRS) has been set up to put forward draft standards to the European Commission. The work is structured around ten clusters:

CLUSTER 0: COORDINATION & MONITORING

CLUSTER 1: CONCEPTUAL GUIDELINES & CROSS-CUTTING STANDARDS

CLUSTER 2: ENVIRONMENT – CLIMATE MITIGATION AND ADAPTATION

CLUSTER 3: ENVIRONMENT – WATER & MARINE RESOURCES, POLLUTION, CIRCULAR ECONOMY, BIODIVERSITY & ECOSYSTEMS

CLUSTER 4: SOCIAL – WORKFORCE

CLUSTER 5: SOCIAL – WORKERS IN THE VALUE CHAIN, AFFECTED COMMUNITIES, CONSUMERS/ END-USERS

CLUSTER 6: GOVERNANCE+

CLUSTER 7: SECTOR SPECIFIC STANDARDS

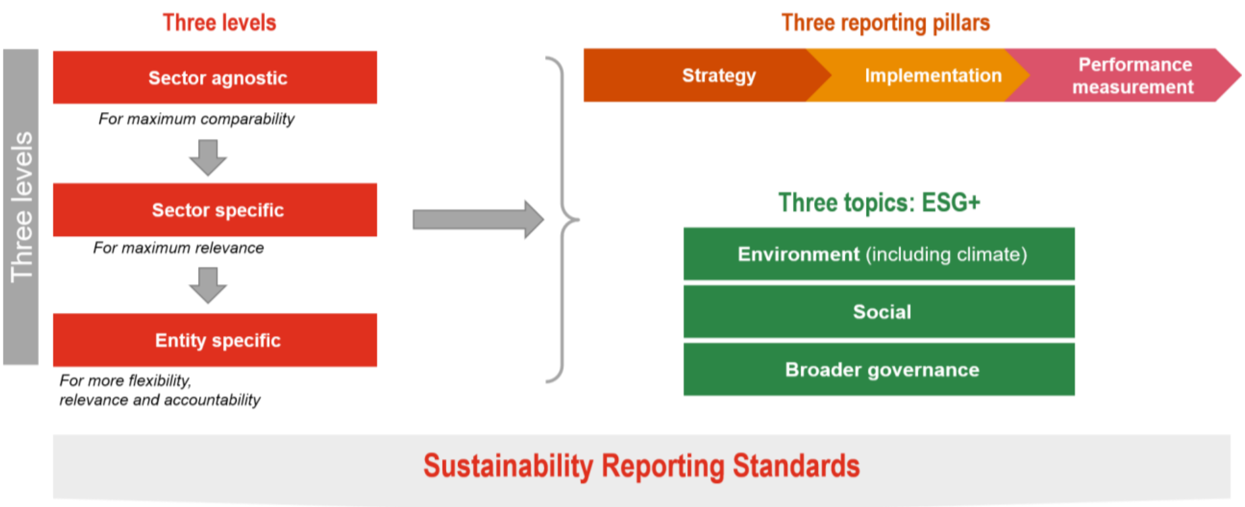
CLUSTER 8: SMEs

CLUSTER 9: FORMAT

⇒Click here to follow the progress of the work

Structure of standards

In accordance with the provisions of the CSRD proposal, EFRAG is developing its standards in line with an overall architecture described as the 'rule of three', which will be consistent across the different standards:



Interaction with other initiatives

Extensive cooperation and discussions are taking place with key international initiatives to support and contribute to the co-construction and convergence of sustainability reporting standards.

One of the major differences is the concept of double materiality: EFRAG considers the principle of double materiality and goes beyond financial materiality (impact of sustainability factors on the company) by considering the impact of the company on society and the environment. On the other hand, ISSB is focusing on reporting to assess the impact of ESG performance on the valuation of the company, that is, from an 'investor' perspective (enterprise value).

Planning

For climate, companies disclosing information in line with the recommendations of the Task Force on Climate-Related Financial Disclosures (TCFD) will not be disappointed: three reporting pillars selected by EFRAG - Strategy, Implementation and Performance Measurement - are compatible with the TCFD's approach in terms of content, which is based on four pillars: Governance, Strategy, Risk Management, and Measurement and Objectives.

Companies should implement these changes in their sustainability reporting for the financial year 2023 (to be published in 2024). These developments bring real added value for all stakeholders and for the company itself.

Next steps

In October 2021, EFRAG published a Working Paper 'Climate Standard Prototype' (⇒ here) and in December 2021/January 2022 will publish a set of draft standards, including:

- climate (amended version) and;
- environment and;
- social and;
- governance and;
- conceptual framework.

Each Working Paper will be accompanied by a 'Basis for Conclusions', explaining the rationale behind each disclosure.

Public consultation is expected to start in early 2022.

EFRAG expects to present to the European Commission:

- first set of Sustainability Reporting Standards by mid-2022; and
- second set of Sustainability Reporting Standards, specifying supplementary and sectoral information, as well as specific reporting standards for small and medium-sized enterprises (SMEs), by mid-2023.

EFRAG plans to use the term 'Sustainability Statements", mirroring "Financial Statements'.

Sustainability Reporting Standards
Focus - ISSB

Background

While Europe is making progress towards its ambition to produce a Sustainability Reporting Standards framework, the international initiative is also moving forward.

IFRS Foundation Chairman Erkki Liikanen announced on 3 November at COP 26 in Glasgow:

1. The creation of an international sustainability reporting standards body, the ISSB, to develop high - quality sustainability reporting standards to meet the information needs of investors.

2. The commitment of the leading sustainability reporting organisations (the Climate Disclosure Standards Board [CDSB] and the Value Reporting Foundation [VRF], which covers the Integrated Reporting Framework and SASB standards) to consolidate into the ISSB by June 2022.

3. The publication of 'general requirements prototype' and 'climate - related disclosure prototype', developed by the Technical Readiness Working Group (TRWG). TRWG is a group formed by the trustees of the IFRS Foundation to undertake preparatory work for the ISSB. These prototypes (⇒ here) are the result of six months of joint work with representatives from the CDSB, the IASB, the TCFD, the VRF, and the World Economic Forum, with the support of the International Organization of Securities Commissions (IOSCO).

4. The location of the ISSB in Frankfurt (Board headquarters and Chair's office), Montreal, San Francisco and London. Further discussions will continue, with a proposal for offices in Beijing and Tokyo to finalise the organisation of the new Board in the Asia-Oceania region.

Emmanuel Faber is appointed to serve as Chair of the ISSB, effective 1 January 2022 (⇒ here).

Content

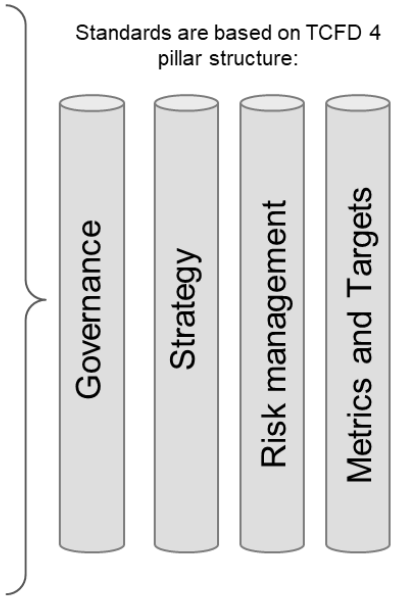
ISSB's standards architecture has three components: a Presentation Standard, Thematic Standards and Industry Standards:

Presentation Standard (general requirements)

- Sets out hierarchy if no specific guidance within an ISSB standard
- Covers application of materiality
- Clarification that reporting entity's boundary for its general purpose financial reporting shall be the same for its:
  (a) financial statements; and
  (b) sustainability-related financial disclosures.

Climate-related Disclosures prototype

- First thematic standard
- Includes narrative and cross industry metric disclosure requirements
- Technical protocols supplement includes industry specific disclosures - largely based on existing SASB industry standards
- Like TCFD, this Standard applies to:
  (a) climate-related risks that the entity is exposed to, including but not restricted to:
    (i) physical risks from climate change (physical risks); and
    (ii) risks associated with the transition to a lower-carbon economy (transition risks); and
  (b) climate-related opportunities available to and considered by the entity.



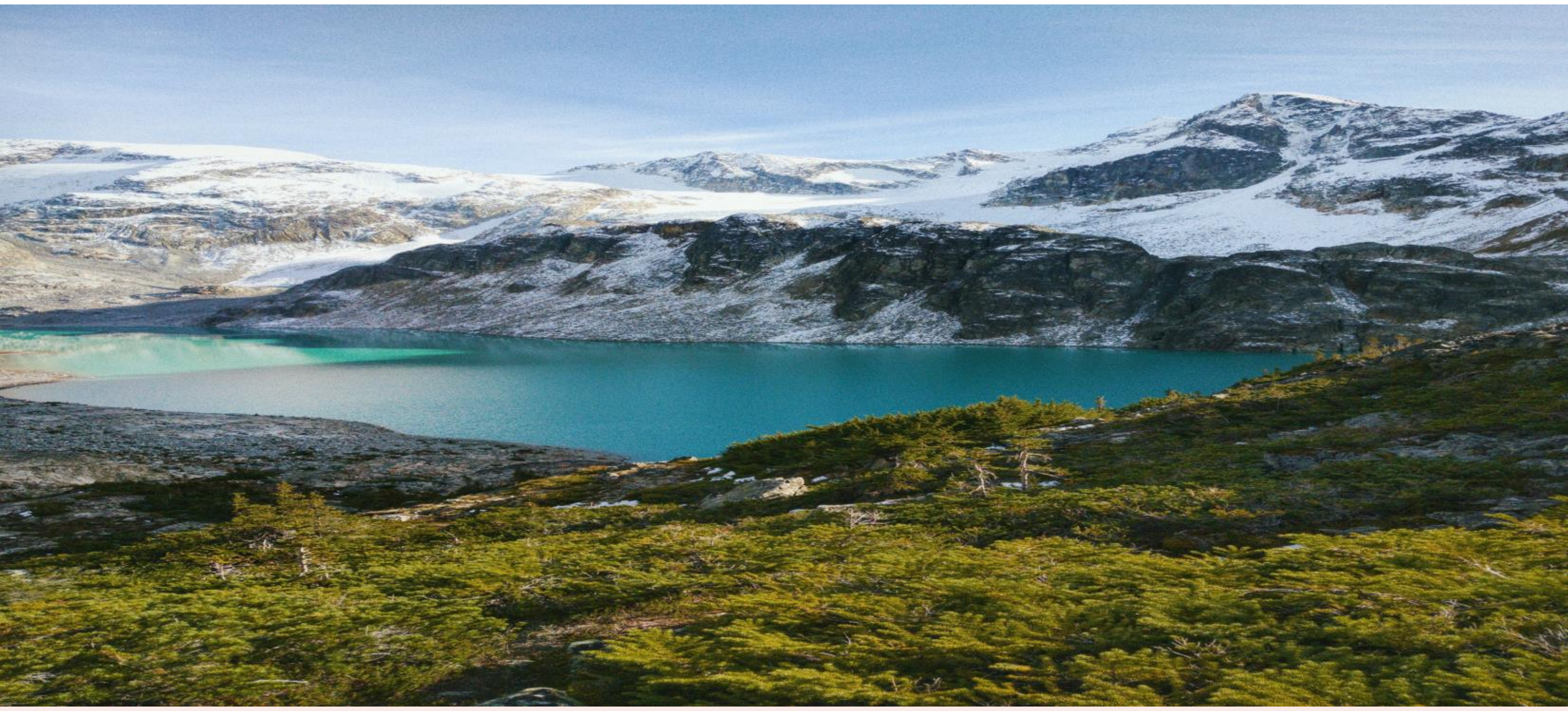
Source: IFRS Advisory Council: Update on the work of the Technical Readiness Working Group

Next steps

The ISSB will focus on climate reporting based on the recommendations of the TRWG.

Extensive public consultation is expected in 2022 and be fast moving to offer all stakeholders worldwide the opportunity to give their views on the initial proposed standards.

Climate Reporting: EFRAG's Proposal



Overview

EFRAG has published a Working Paper 'Climate Standard Prototype' that provides an overview of the future European Climate Standard. Companies are encouraged to plan for these developments and to look ahead to the future for the climate. Companies that are experienced in areas such as TCFD, CDP and the Global Reporting Initiative (GRI) will be able to capitalise on this.

The challenge for companies is to be aware of the expectations beforehand so that they can prepare effectively. The proposal is ambitious and requires complex information, such as details of greenhouse gas (GHG) emissions by scope but also by decarbonisation lever.

Towards the future climate reporting standard

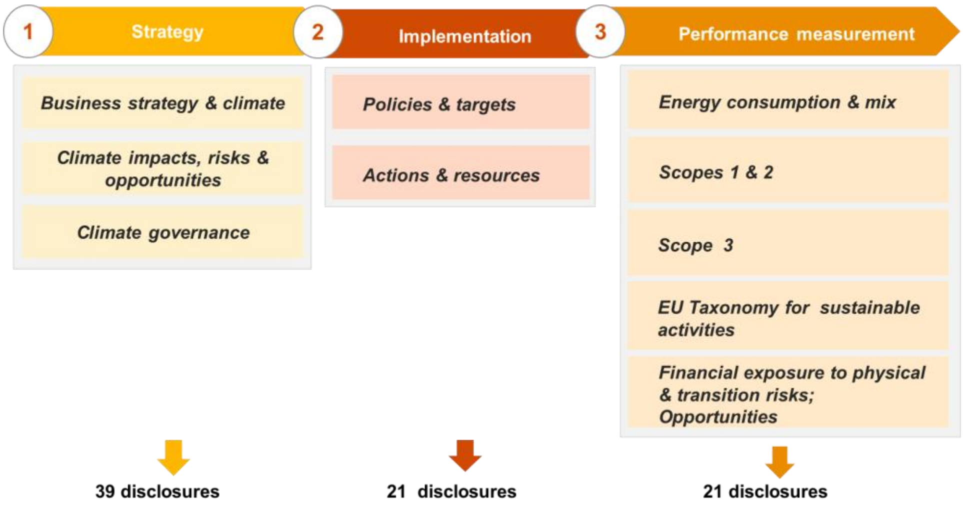
At the end of 2021, EFRAG proposed a draft version of a Climate Standard Prototype (⇒ here) for companies. This initial document will lead to a final version to be presented to the European Commission by mid-2022.

It clarifies what information is important with regards to climate targets and net zero ambitions, and in what form this information should be provided.
It provides a comprehensive structure for the presentation of climate-related information to simplify assessment and comparison by investors.

EFRAG expects compatibility with other European texts (Taxonomy, SFDR, etc). As for the other standards, this Climate Standard Prototype is based on the three pillars of reporting: strategy, implementation, and performance measurement. It is inspired and designed to be compatible with existing reporting standards and initiatives (TCFD, CDP, GRI, etc).

Each pillar is based on concrete indicators and includes a list of disclosures to be provided, known as 'data points'. In total, it sets out more than a hundred pieces of information to be published, both qualitative and quantitative. The prototype is based on a set of mandatory and optional data.

The Basis for Conclusions document that accompanies this initial version of the standard provides detailed explanations of EFRAG's choices and considerations, and presents templates on how to disclose information (for example, on the breakdown of energy consumption or scope 1, 2 and 3 emissions).



Pillar – Strategy

Limiting global warming to 1.5°C, in line with the Paris Agreement, requires a transition to a carbon-neutral economy by 2050. Companies must therefore ensure that their business model and strategy are compatible with the upcoming transition. It is important that companies create transparency on how climate-related risks and opportunities can affect their strategies in a double materiality approach. This means taking financial materiality into account alongside the impact on the value of the company, but also how GHG emissions and other negative or positive impacts affect climate change. For illustrative purposes, here are some concrete examples of what companies might have to publish:

- Disclose **the share of turnover from Taxonomy-aligned activities** in comparison to Taxonomy-eligible activities and provide an estimate of this ratio in 5 years.
- Describe the processes for identifying and assessing short-, medium- and long-term risks and opportunities along the value chain, **including a definition of time horizon and scenario analysis.**
- Describe plans to ensure compatibility with the transition to carbon neutrality in line with the Paris Agreement.
- **Number of climate-related decisions** taken by the Board

Pillar – Implementation

The climate prototype sets out the information to be provided on the company's climate change targets.

The aim of the standard is to ensure transparency and comparability on the following:

- the company's **commitments** to climate change mitigation and adaptation, and
- **targets** on energy intensity, GHG emission reduction, carbon neutrality and other EU-specific objectives.

Companies should report their detailed emission reduction targets in absolute terms (scope 1, scope 2 and significant categories of scope 3 emissions), as well as in carbon intensity, where appropriate, depending on the sector. These targets should be in line with the CSRD proposal and 55% net GHG reduction target by 2030, as well as net zero target by 2050. For illustrative purposes, here are some concrete examples of what companies will have to describe:

– commitments related to climate change mitigation and adaptation: **content, scope in relation to the value chain and how they are communicated to stakeholders;**
– scope 1, 2 and 3 targets for **2025 and 2030 and, if appropriate, every 5 years from 2030 to 2050;**
– whether the company has a carbon neutral/net zero target**, including scope, target year and action plan with levers;**
– GHG emission reduction targets presented by decarbonisation lever (for example, materials and process efficiency, circular economy and industrial waste, energy efficiency measure).

Pillar – Performance measurement

The core of the Climate Standard Prototype is about metrics and key performance indicators. While companies have flexibility in their strategy, governance, policies and targets, the performance measurement pillar is more rigid and requires the publication of specific data.

The Climate Standard Prototype is based on existing EU indicators (in particular, proposed indicators under SFDR, as well as the requirements of the Taxonomy Regulation). It is fully compatible with TCFD recommendations and is also based on the CDP and GRI standards.

Energy accounts for a significant share of worldwide GHG emissions and their growth. In addition to its significant contribution to climate change, it is commonly agreed that human production and use of energy have further impacts on the environment. These effects, particularly on climate change, can only be remediated in the long term. Transparency is therefore required from companies on how their energy consumption and mix leads to GHG emissions and other adverse impacts on climate change.

For illustrative purposes, here are some examples of the information that companies are expected to publish:

- Total energy consumption.
- Energy mix + **breakdown of renewables/non-renewables.**
- Share of green hydrogen.
- Total Scope 3 **emissions for significant categories, coverage of at least 80%.**
- Scope 3 categories excluded from the inventory **with justification for exclusion.**

Comparison with the ISSB

The EFRAG climate reporting prototype describes three reporting pillars (Strategy, Implementation and Performance Measurement), unlike the ISSB's prototype based on the four pillars of the TCFD: Governance, Strategy, Risk Management, and Metrics & Targets. An analysis is needed to identify the differences between the two frameworks, including the concept of double materiality which appears to be the basis of the future EFRAG standards and which constitutes a major point of divergence between the ISSB's approach and the approach taken by the EU.

Next steps

Public consultation with exposure drafts on the new standards is expected to begin in early 2022.

ESMA's Priorities on Sustainability Reporting

Overview

Regulators are encouraging companies to follow their recommendations on sustainability reporting from 2021 reporting onwards.

The European Securities and Markets Authority recommendations

ESMA sets common European enforcement priorities for reporting each year (⇒ here section 2).
This year's (2021) recommendations focus on three main priorities for non-financial reporting:

Priorities	ESMA recommendations to issuers
1 Impacts of COVID-19	**Publish transparent information on the effects of the pandemic**, including the development of their activities, their action plans and the achievement of their sustainability objectives in this particular context. *For example: the restructuring of supply chains and distribution channels.*
2 Climate-related matters	***Ensure transparency on climate-related matters*** *(policies, risk identification and management, indicators and targets):* transparency of companies on climate commitments and their effects in financial statements and the need for consistency between these two aspects of corporate communications. *For example: providing GHG emissions by country/region or by sector of activity.*
3 Disclosures relating to Article 8 of the Taxonomy Regulation	***Awareness-raising on the information to be provided in relation to Article 8 of the Taxonomy Regulation.*** *For example: planning ahead for the implementation of internal reporting systems to comply with requirements.*

Next steps

Companies are encouraged to implement these recommendations in their non financial statements from 2021 reporting onwards.

SFDR Regulation

Overview

The SFDR lays down harmonised rules for financial market participants when disclosing sustainability-related information on the financial products that they market. This regulation indirectly impacts non-financial undertakings, as financial market participants must obtain underlying data from them to meet their own requirements.

Background

Regulation (EU) 2019/2088 on sustainability-related disclosure in the financial services sector (SFDR) was published in the Official Journal on 9 December 2019 (⇒ here). This text is one of the components of the European Commission's sustainability plan.

Reporting requirements

The SFDR, commonly known since the 'Disclosure Regulation', establishes standardised reporting rules for financial market participants (producers of UCITS, AIFs, life insurance, pension products or portfolio management services) and financial advisers. These rules aim at increasing transparency about:

- the integration of sustainability risks and addressing negative sustainability impacts in processes; and
- the provision of sustainability-related information.

The reporting obligations are set at the entity level and at the product level.

At entity level

Who: Financial market participants
Financial advisers

Disclosure requirements:

- Policies on **integration of sustainability risks** (Art. 3)
- Statement on **principal adverse impacts** (PAIs) of investment decisions **on sustainability factors** (Art. 4)
  ➔Participants > 500 employees: mandatory from 30 June 2021
  ➔Participants < 500 employees: comply or explain
- Integration of sustainability risks in **remuneration policies** (Art. 5)

At product level

All financial products

Who: Financial market participants
Financial advisers

General transparency requirements in pre-contractual product documentation relating to:

- the integration of sustainability risks in investment decisions (Art. 6)
  ➔comply or explain
- consideration of the principal adverse impacts (Art. 7)
  ➔***applicable only to financial market participants***
  ➔comply or explain – by 30 December 2022

Sustainable products (Art. 8 and 9)

Who: Financial market participants

Sustainable products
- Product promoting **environmental and/or social characteristics**, and which invests in companies that follow **good governance practices** (Art. 8)
- Product with **sustainable investment** or **a reduction in carbon emissions as its objective** (Art. 9)

Specific information (e.g., on E/S characteristics or environmental objectives, asset allocation or **alignment of underlying assets with the European Taxonomy**) in:
➔pre-contractual documentation
➔periodic reports
➔Website publications

Requirements specified by RTS

Expected impact on non-financial undertakings

Financial market participants will need adequate information from issuers in order to publish the information required under the Disclosure Regulation. Currently, this information is mostly available for listed entities, because most SMEs are not subject to the NFRD. The CSRD, expected to come into force from 2024 on 2023 reporting, will partly correct this shortcoming.

Where an investee company's data – whether as regards PAI or taxonomy indicators – are not publicly available, financial market participants can rely on information obtained directly from investee companies or from third party data providers. Financial market participants are specifically required to communicate whether taxonomy indicators were subject to an assurance provided by an auditor or a third party.

Next steps

The provisions of the SFDR are applicable as of 10 March 2021. They are rounded out by technical standards prepared (latest consolidated version ⇒ here) by the three European supervisory authorities (the European Securities and Markets Authority [ESMA], the European Banking Authority [EBA] and the European Insurance and Occupational Pensions Authority [EIOPA]).

In November 2021, the European Commission postponed the application of these technical standards from 1 January 2022 to 1 January 2023.

Climate change and financial reporting

Overview

Climate change is a major issue for companies, and the link to financial statements is receiving more and more attention; this is a trend that will continue in future reporting periods.

Transparency and consistency between assumptions made in the financial statements and those presented in the sustainability reporting are important.

All companies are affected by climate change and its impacts, but the financial impacts vary depending on factors such as:

- business sector;
- geographical location;
- type and scale of risks and
- opportunities.

The type and depth of the information to be provided should be adapted to user needs.

Investor expectations

Investor initiatives to support and accelerate action on climate change, and to improve financial and non-financial reporting on climate risk, are becoming increasingly common.

The goal is to enable investors to assess the strength of corporate business plans under different climate scenarios and improve investment decision-making (for example, Climate100+ ⇒ here, IIGCC ⇒ here, CarbonTracker ⇒ here).

No new accounting standard, but additional reminders

In an Educational Material document published in November 2020 (⇒ here), the IASB reiterated that information about how management has assessed the impacts of climate change should be considered material if its omission or alteration could influence the decisions of users of financial statements – in this case, investors. The document itself refers to an In brief publication (⇒ here).

Examples of potential impacts on financial statements

The TCFD provides recommendations for presenting the financial impact of climate change with more transparency on climate-related risks and opportunities (Part B, Tables 1&2 'Examples of Climate - Related Risks and Potential Financial Impacts' ⇒ here) as well as the information needed to assess financial impacts (Part F, Financial Impacts ⇒ here).

Taking climate-related issues into account in the valuation of assets and liabilities, etc.

ASSETS

- Revision of asset lives and residual values
- Impairment tests
- Recoverability of deferred tax assets
- Carbon investments
-

LIABILITIES

- Pollution, dismantling
- Onerous contracts
- Disputes
- New regulations
- Green financing
- etc.

Perform **new sensitivity analyses** (widening ranges/new assumptions)

ANNEX

No checklist approach

Provide information that is not specifically required but is **relevant** and **material** for understanding the financial statements

Adopt a systematic approach to analysis for each of the standards

... consistent with the risk factors, regulations, company strategy, announced commitments, etc. described in the non-financial information

What recommendations?

Climate change will affect many activities, either directly as a result of climate change or indirectly as a result of changes in regulations.

Company management teams should carefully consider the consequences for their operations, risk identification and risk assessment and for their financial statements.

ESMA (⇒ here, section 1.2) made recommendations on taking climate risk into account in financial statements:

A priority for regulators from the 2021 financial statements onwards

esma European Securities and Markets Authority

1 – Work and link between financial/non-financial information

- Identify the impacts of climate change
- Involve all departments
- Ensure consistency between financial and non-financial information

2 – General principles for disclosures

- Disclose judgements/major sources of uncertainty
- Adapt work and information to the scope of the subject
- Consolidate all information (ad hoc notes/footnotes)

3 – Particular points for analysis

- Review asset lives, impairment indicators, etc.
- Impairment tests: consistency with climate strategy/commitments, sensitivity analyses, etc.

Next steps

From 2021 reporting, companies must begin to:

- make links between financial and non-financial information;
- provide transparent and clear information in the financial statements on how climate risks have been taken into account (for example, in depreciation/amortisation periods or asset impairment tests).

Find out more

- In depth | Impact of ESG matters on IFRS financial statements (⇒ here)
- In brief | Impact of the Paris Agreement on Financial Reporting under IFRS (⇒ here)
- PwC IFRS Talks | Green loans under IFRS (⇒ here)

What’s next?

Upcoming publications

Taxonomy

- Complementary Climate Delegated Act (focusing on natural gas and nuclear): January 2022?
- FAQ (batch 2) to help undertakings with application of the Taxonomy: January 2022?
- Delegated Act on other environmental objectives: first half of 2022
- Final reports on social taxonomy and on the extended taxonomy to support economic transition: Q1.2022

Standardisation of sustainability reporting:

EFRAG – draft standards expected to be a priority:

- climate (prototype version 2)
- environment (other)
- social
- governance
- conceptual framework

→ draft publications as from 2021(⇒ here)
→ exposure draft as from 2022

ISSB

→ draft publications as from 2021(⇒ here)
→ exposure draft as from 2022

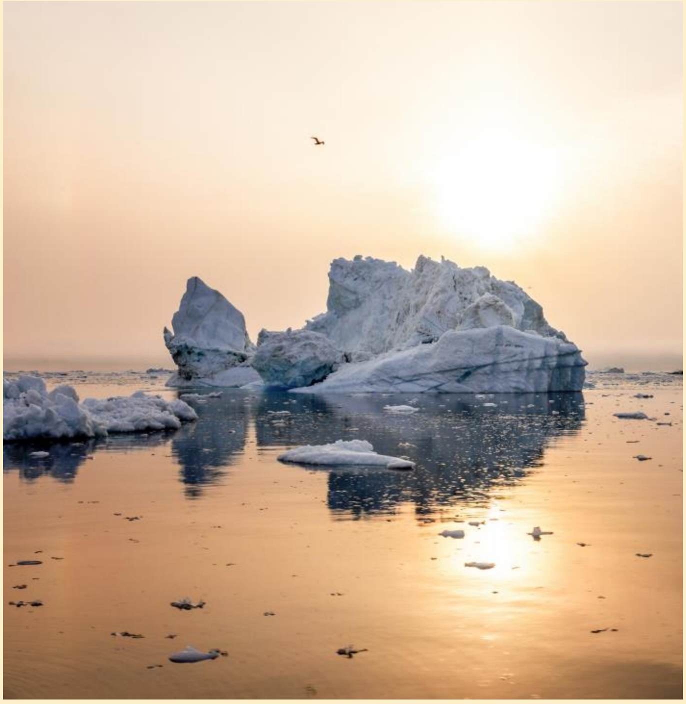
Latest news…

Taxonomy

- European Commission's FAQ (⇒ here)
- Platform considerations on voluntary information as part of Taxonomy eligiblity reporting (⇒ here)
- Mapping of NACE codes to other industry classification systems (⇒ here)

ISSB

- Emmanuel Faber appointed to lead the International Sustainability Standards Board (⇒ here)



Abbreviations

CDP	Carbon Disclosure Project
CDSB	Climate Disclosure Standards Board
CSRD	Corporate Sustainability Reporting Directive
DNSH	Do no significant harm
EBA	European Banking Authority
EFRAG	European Financial Reporting Advisory Group
EIOPA	European Insurance and Occupational Pensions Authority
ESEF	European Single Electronic Format
ESG	Environmental, social and corporate governance
ESMA	European Securities and Markets Authority
GAR	Green Asset Ratio
GHG	Greenhouse Gas
GRI	Global Reporting Initiative
IIGCC	The Institutional Investors Group on Climate Change
IOSCO	International Organization of Securities Commissions
ISSB	International Sustainability Standards Board - IFRS Foundation
KPI	Key Performance Indicator
KPI AuM	Green ratio for assets under management
KPI F&C	Fees and commission income
KPI FinGua	Green ratio for financial guarantees to corporates
NFRD	Non-Financial Reporting Directive
PAI	Principal Adverse Impact
PTF-ESRS	Project Task Force on European Sustainability Reporting Standards
RTS	Regulatory Technical Standards
SASB	Sustainability Accounting Standards Board
SEC	Securities and Exchange Commission
SFDR	Sustainable Finance Disclosure Regulation
SMEs	Small and medium-sized enterprises
TCFD	Task Force on Climate-Related Financial Disclosures
TRWG	Technical Readiness Working Group - IFRS Foundation
VRF	Value Reporting Foundation

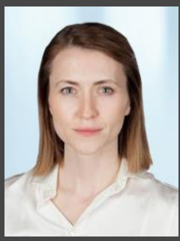
Contact us

Our editorial team

Olivier Schérer
Partner PwC

Anne Lenglet
Senior Manager PwC

Dieynaba Ndoye
Senior Manager PwC



Victoria Savchenko
Manager PwC

Your local contacts