EU SUSTAINABILITY REGULATIONS

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G2Z

G2Z is a sustainable consulting firm partnering with companies in a variety of sectors to tackle their upcoming challenges and unlock opportunities regarding sustainable practices. Our services allow companies to understand their environmental impacts and provide solutions for improvement in order to make the world better every day.

We strive to simplify the intricacies of decarbonization within a business. Whether clients are struggling to understand the complexities of measuring, communicating and reducing their greenhouse gas emissions, G2Z is well equip to guide them to the right path. By providing all encompassing bespoke solutions we help please stakeholders, gain new customers, access bank financing, and much more.

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About This Report

This report provides a comprehensive analysis of the European Union's environmental regulations. Aimed at business leaders, policymakers, and stakeholders involved in sustainability initiatives, the report uncovers the complexities and intricacies of EU legislative frameworks and regulations.

"EU Sustainability Regulations" is designed to help readers navigate the shifting landscape of EU environmental policy, offering insights into how these regulations can be leveraged to drive corporate and governmental sustainability efforts forward. This report is intended to cultivate a deeper understanding of the EU's ambitious sustainability goals and to stimulate informed discussion and decision-making on environmental compliance and best practices.

Executive Summary

The report extensively covers the evolution and current state of EU sustainability regulations, emphasizing foundational global agreements, the European Union's Legislative Frameworks, and the evolution of EU environmental reporting. The report is broken down as such:

Kyoto Protocol: The Kyoto Protocol marked the initial global effort to legislate carbon emissions reductions. Adopted in 1997 and entering into force in 2005, it was the first international treaty to set binding obligations on industrialized countries to reduce their greenhouse gas emissions. While groundbreaking, the Kyoto Protocol faced criticism for its limited scope and the exclusion of major emitters like the United States and China. Its mechanisms included emissions trading, clean development, and joint implementation, aiming to cost-effectively reduce global emissions.

Paris Agreement: Building on the foundation laid by the Kyoto Protocol, the Paris Agreement, adopted in 2015, represents a pivotal shift in global climate policy. Unlike its predecessor, it includes commitments from all countries to limit global temperature increases and strive for a carbon-neutral world by the second half of the century. The agreement emphasizes a bottom-up approach with Nationally Determined Contributions (NDCs), a global stocktake every five years, and a strong focus on financing for climate change mitigation and adaptation.

European Green Deal: The European Green Deal is the EU's ambitious plan to become the first climate-neutral bloc by 2050. Launched in December 2019, it spans various sectors including energy, buildings, transportation, and agriculture, aiming to decouple economic growth from resource use. The Green Deal is not only a comprehensive strategy to address climate change but also a growth strategy that aims to transform the EU into a modern, resource-efficient, and competitive economy.

Fit for 55 Package: The Fit for 55 package, introduced in 2021, is designed to operationalize the European Green Deal's objectives, setting forth a series of legislative updates to ensure the EU reduces its greenhouse gas emissions by at least 55% by 2030. This package revises and expands EU-wide measures across emissions trading, energy use, transport, and taxation policies, ensuring that the union's climate, energy, land use, transport, and taxation policies all contribute to this ambitious reduction goal.

EU Green Claims Directive: Introduced to combat greenwashing, the EU Green Claims Directive mandates that all environmental claims on products and services are clear, accurate, and substantiated. Proposed in 2023, this directive addresses the pervasive issue of misleading marketing practices, ensuring that businesses adhere to stringent standards in promoting their environmental benefits, thus fostering greater consumer trust and market transparency.

EU Taxonomy: The EU Taxonomy is a classification system established to define what constitutes an environmentally sustainable economic activity across the EU. This regulatory tool helps guide investment by specifying which activities can be considered sustainable, thereby supporting the EU's Green Deal ambitions by directing investments into projects that have a positive environmental impact, ensuring consistency and clarity for investors.

NFRD (Non-Financial Reporting Directive): Adopted in 2014, the NFRD requires large companies to disclose non-financial and diversity information pertinent to understanding their development, performance, and position. This directive aims to enhance transparency and promote the inclusion of social and environmental considerations in the business process.

CSRD (Corporate Sustainability Reporting Directive): Expanding on the NFRD, the CSRD, adopted in 2022, broadens the scope to include more companies and ensures more detailed reporting. It introduces more stringent requirements for reporting on sustainability issues, including the impact of business activities on climate and the impact of climate change on business operations.

ESRS (European Sustainability Reporting Standards): The ESRS, adopted in 2023, are a set of standards developed under the CSRD to enhance the consistency and comparability of sustainability reporting across the EU. These standards are designed to provide a clear framework for detailed reporting on a wide array of sustainability issues, improving the quality of data available to investors and the public.

SFDR (Sustainable Finance Disclosure Regulation): Effective from March 2021, the SFDR requires financial market participants to disclose sustainability risks and how their investments affect ESG factors. This regulation aims to prevent greenwashing by ensuring that financial products marketed as sustainable genuinely adhere to strict environmental, social, and governance criteria.

CSDDD (Corporate Sustainability Due Diligence Directive): Proposed in 2022, the CSDDD aims to ensure that companies operating in the EU market, whether based in the EU or elsewhere, conduct due diligence on their supply chains. This directive focuses on mitigating risks associated with adverse impacts on human rights and the environment, reflecting the EU's commitment to ethical and sustainable business practices across global supply chains.

Introduction

In an era where environmental concerns are increasingly shaping global policies and economic strategies, the European Union stands at the forefront of integrating sustainability into legislative frameworks. This report, prepared by G2Z, delves into the comprehensive landscape of EU environmental regulations. It aims to provide a thorough understanding of the strategic initiatives and legislative measures that the EU has adopted to promote a sustainable, climate-resilient future.

The foundation of the EU's environmental efforts is underpinned by global agreements such as the Kyoto Protocol and the Paris Agreement. These pivotal agreements have set the stage for ambitious EU-specific measures, including the transformative European Green Deal and the subsequent Fit for 55 package, which are designed to steer the EU towards becoming a climate-neutral bloc by 2050.

This report explores the intricate landscape of EU sustainability regulations, ranging from the Green Claims Directive that tackles greenwashing to the complex yet crucial Taxonomy for sustainable activities. It also covers the evolution from the Non-Financial Reporting Directive (NFRD) to the more robust Corporate Sustainability Reporting Directive (CSRD), alongside the pioneering efforts through the Sustainable Finance Disclosure Regulation (SFDR) and the Corporate Sustainability Due Diligence Directive (CSDDD).

Through a critical lens, the report addresses the challenges and criticisms these regulations face, including issues of enforcement, economic impact, and the need for regulatory agility. Moreover, it highlights emerging trends that will shape the future direction of EU environmental policy, such as digital integration in environmental governance, the expansion of the circular economy, and the emphasis on biodiversity.

By offering a detailed examination of these elements, this report aims to equip stakeholders, policymakers, and businesses with the insights needed to navigate the complexities of EU environmental regulations and to participate effectively in the ongoing dialogue about sustainable development within the European Union.

Foundational Global Agreements

As a basis for the EU regulations, there are 2 foundational global agreements at the core; The Kyoto Protocol & The Paris Agreement.

Kyoto Protocol

The Kyoto Protocol, adopted in 1997 and entering into force in 2005, was the first international treaty to address controlling and reducing greenhouse gas emissions, aiming to reduce the emission of six greenhouse gasses in 41 countries plus the European Union to 5.2 percent below 1990 levels. The protocol was designed to reduce the emission of gasses contributing to global warming, following the United Nations Framework Convention on Climate Change (UNFCCC). The protocol's key people included Jack Layton and Stéphane Dion.

The protocol provided several means for countries to reach their targets, including making use of natural processes, called "sinks," that remove greenhouse gasses from the atmosphere and the Clean Development Mechanism (CDM), which encouraged developed countries to invest in technology and infrastructure in less-developed countries, where there were often significant opportunities to reduce emissions. The protocol also allowed participating countries to buy and sell emissions rights, placing an economic value on greenhouse gas emissions.

The protocol represented a landmark diplomatic accomplishment, but its success was far from assured. Reports indicated that most participants would fail to meet their targets, and even if they were met, the ultimate benefit to the environment would not be significant, according to some critics. The protocol did not bind China and the United States, the world's leading and second-largest emitters of greenhouse gasses, respectively.

Despite these challenges, the Kyoto Protocol was extended until 2020 at the 18th Conference of the Parties (COP18), held in Doha, Qatar, in 2012. Delegates also reaffirmed their pledge from COP17, held in Durban, South Africa, in 2011, to create a new, comprehensive, and legally binding climate agreement by 2015, which is where the Paris Agreement comes into play.

Paris Agreement

The Paris Agreement, a landmark international treaty on climate change adopted in 2015 and entering into force in 2016, is a legally binding agreement that aims to strengthen the global response to climate change by keeping global temperature rise well below 2 degrees Celsius above pre-industrial levels and pursuing efforts to limit the temperature increase to 1.5 degrees Celsius. This agreement includes commitments from all countries to reduce their emissions with the ultimate goal of reaching net-zero.

Net-zero emissions refer to a state in which the greenhouse gasses going into the atmosphere are balanced by removal out of the atmosphere, effectively stopping global warming. The Paris Agreement requires states to achieve a balance between anthropogenic emissions by sources and removals by sinks of greenhouse gasses, which is essential to reach net zero.

This marked the beginning of a shift towards net-zero emissions, emphasizing the need for front-loaded emission reductions, a comprehensive approach to emission reductions, cautious use of carbon dioxide removal and storage, effective regulation of carbon offsets, an equitable transition to net zero, alignment with broader socio-ecological objectives, and pursuit of new economic opportunities. Many countries have committed to reaching net-zero emissions by 2050, setting ambitious targets to reduce greenhouse gas emissions and transition towards sustainable, climate-resilient economies.

Unlike the Kyoto Protocol, which imposed binding emission reduction targets only on developed countries, the Paris Agreement recognizes the principle of common but differentiated responsibilities and respective capabilities, acknowledging that all countries have a role to play in addressing climate change. One of the key aspects of the Paris Agreement is the concept of nationally determined contributions (NDCs), which requires all countries to set their own targets for reducing greenhouse gas emissions based on their individual circumstances.

The Paris Agreement also emphasized the importance of transparency, accountability, and global cooperation in achieving its goals. Moreover, the agreement emphasizes the importance of climate finance to help vulnerable countries cope with the impacts of climate change and transition towards sustainable, climate-resilient economies. It also underscores the need for education, training, public awareness, and public participation to enhance climate change action globally.

The transition from the Kyoto Protocol to the Paris Agreement reflects a maturation of international climate governance, moving towards a more inclusive, bottom-up approach that recognizes the shared responsibility of all countries in combating climate change. While the Kyoto Protocol laid the groundwork for global cooperation on emissions reduction, the Paris Agreement represents a more comprehensive and collaborative effort to address the urgent challenges of climate change in a way that is equitable, transparent, and sustainable.

EU Legislative Frameworks

European Green Deal

The European Green Deal, approved in 2020, is a comprehensive set of policy initiatives by the European Commission with the overarching aim of making the European Union (EU) climate-neutral by 2050. This ambitious plan encompasses a wide range of measures aimed at transforming the EU into a fair and prosperous society with a modern and competitive economy, emphasizing the need for a holistic and cross-sectoral approach where all relevant policy areas contribute to the sustainability agenda.

Objectives:

- **Climate Neutrality:** The primary objective of the European Green Deal is for the EU to become the world's first "climate-neutral bloc" by 2050, aligning with the commitments under the Paris Agreement and aiming to reduce greenhouse gas emissions significantly.

- **Economic Growth:** The deal seeks to unlock opportunities for economic growth, new business models, markets, jobs, and technological development through the transition to climate neutrality.

- **Environmental Protection:** It aims to protect human life, animals, and plants by reducing pollution and promoting clean products and technologies.

Role in Driving EU's Sustainability Agenda:

- **Transformation:** The European Green Deal is driving a transformation of the EU's economy, industry, and society towards sustainability, aiming to lead the way in the global fight against climate change.

- **Innovation:** It fosters innovation, new business models, and markets, creating opportunities for economic growth and technological development while ensuring a level playing field for industries in the transition to a greener economy.

- **Collaboration:** The deal emphasizes collaboration across sectors and stakeholders, providing a platform for organizations, communities, and individuals to participate in climate and environmental action, promoting real change and measurable impact.

The overarching goal of the European green deal is to reach the metrics outlined in *figure 1* below.

Figure 1: Key Figures of The European Green Deal

The first climate-neutral continent	At least 55% less	3 billion
by 2050	net greenhouse gas emissions by 2030, compared to 1990 levels	additional trees to be planted in the EU by 2030

Source: European Commission

Key Policies of The European Green Deal

- **Fit for 55 Package:** This package translates the climate ambitions of the Green Deal into law, revising climate, energy, and transport-related legislation to align with the EU's climate goals. It ensures a just and socially fair transition while maintaining innovation and competitiveness in EU industries. The package is covered in more detail on the next page.

- **European Climate Law:** This legislation turns the political ambition of reaching climate neutrality by 2050 into a legal obligation for the EU, committing to cutting net greenhouse gas emissions by at least 55% by 2030 compared to 1990 levels. It provides a legal framework for achieving climate objectives and promoting sustainable finance initiatives.

- **EU Strategy for adaptation to climate change:** The strategy aims to increase the EU's resilience to climate change and ensure that the EU's policies and actions contribute to the adaptation goals of the Paris Agreement.

- **EU Biodiversity strategy for 2030:** This strategy aims to protect nature and reverse the degradation of ecosystems in the EU, setting a target for a 50% reduction in the use and risk of chemical pesticides and restoring at least 30% of the EU's land and sea areas as nature protection areas.

- **Farm to fork strategy:** This strategy aims to ensure that agriculture, fisheries, and aquaculture, and the food value chain contribute appropriately to the objective of a climate-neutral Union by 2050, focusing on reducing food waste, promoting sustainable diets, and empowering consumers to make informed choices.

- **European industrial strategy:** The strategy aims to ensure a future-ready economy, promoting sustainable and digital industries, and supporting the transition to a climate-neutral and circular economy.

- **Circular economy action plan:** This plan aims to keep resources in economic cycles as long as possible, addressing key product value chains such as electronics, batteries, vehicles, packaging, plastics, textiles, and food.

- **Batteries and waste batteries:** The EU aims to promote sustainable batteries and manage waste batteries effectively, ensuring a circular economy for batteries and reducing their environmental impact.

- **A just transition:** The EU aims to ensure that the transition to a climate-neutral economy is socially fair and just, supporting regions and communities most affected by the transition.

- **Clean, Affordable, and Secure Energy:** With 75% of EU greenhouse gas emissions coming from energy use and production, decarbonizing the energy sector is a crucial step towards a climate-neutral EU. The EU is working on various initiatives to achieve this, including promoting sustainable mobility and smart transportation strategies.

- **EU chemicals strategy for sustainability:** The strategy aims to protect human health and the environment from the risks posed by chemicals, promoting safe and sustainable chemicals and ensuring a level playing field for the EU chemicals industry.

- **Forest strategy and deforestation:** The EU aims to ensure effective afforestation, forest preservation, and restoration in Europe, and to address deforestation and forest degradation globally through new regulations.

Timeline of The European Green Deal

The following milestones illustrate the EU's strategic actions and legislative measures to address climate change, promote sustainability in various sectors, and move towards achieving a carbon-neutral economy by 2050. The timeline reflects the EU's commitment to integrating environmental concerns into all aspects of economic policy and its efforts to ensure a just transition for all sectors and regions.

11 December 2019

The European Green Deal was officially presented, setting the EU on a path to sustainability.

14 January 2020

Introduction of the European Green Deal Investment Plan and Just Transition Mechanism.

10 March 2020

Adoption of the European Industrial Strategy to modernize the economy.

2020-2021

Various legislative proposals were put forth including the Climate Law, Biodiversity Strategy, and the Farm to Fork Strategy.

2021-2022

Proposals related to energy, sustainable products, and deforestation were adopted.

22 March 2023

Adoption of new rules promoting the repair of goods to support the right to repair.

1 October 2023

Implementation of the transitional phase of the Carbon Border Adjustment Mechanism (CBAM).

5 July 2023

The EU unveiled a package for the sustainable use of natural resources.

26 April 2023

The ReFuelEU Aviation initiative aimed at decarbonizing the aviation sector received political agreement.

19 December 2023

Political agreement on more resilient and sustainable trans-European transport networks.

8 February 2024

Political agreement on banning remaining uses of toxic mercury in the EU.

10 April 2024

The Commission reviews Clean Transition Dialogues focused on evolving Europe into a clean, efficient, fair, and competitive economy.

Fit for 55 Pacakge

The Fit for 55 package is a set of policy proposals by the European Union (EU) designed to implement the European Green Deal (EGD) and reduce the EU's greenhouse gas emissions by 55% by 2030 compared to 1990 levels. Here are the descriptions for the key policies included in the Fit for 55 package:

- **EU Emissions Trading System (ETS):** The EU ETS is a cornerstone of the EU's climate policy, covering emissions from various sectors, including power and heat generation, industry, and aviation. The Fit for 55 package aims to revise the ETS to align with the EU's 2030 target, including lowering the overall emissions cap, increasing the pace of emissions reductions, and expanding the ETS to cover additional sectors. The EU ETS will be covered in greater lengths in a future report.

- **Social Climate Fund:** The Social Climate Fund is a financial mechanism designed to support vulnerable households and communities in transitioning to a climate-neutral economy. The fund will provide financial assistance for energy efficiency measures, renewable energy installations, and other initiatives aimed at reducing greenhouse gas emissions.

- **Carbon Border Adjustment Mechanism (CBAM):** The CBAM is a mechanism designed to ensure that imported goods from countries with weaker climate policies do not have an unfair advantage over EU-produced goods. The CBAM will apply to a limited number of sectors with a high carbon footprint, including cement, iron, steel, aluminum, and electricity.

- **Member States' emissions reduction targets:** The Fit for 55 package includes binding annual emissions reduction targets for each EU member state, with the aim of achieving a collective reduction of 55% by 2030 compared to 1990 levels. The targets are differentiated based on each member state's economic and energy profile.

- **Emissions and removals from land use, land use change and forestry (LULUCF):** The Fit for 55 package includes measures to ensure that the LULUCF sector contributes to the EU's climate goals. This includes measures to promote sustainable land use, reduce deforestation, and increase carbon sequestration in soils and forests.

- **CO2 emission standards for cars and vans:** The Fit for 55 package includes stricter CO2 emission standards for cars and vans, with the aim of reducing emissions from these sectors by 55% by 2030 compared to 2021 levels. The new standards will also encourage the adoption of zero-emission vehicles.

- **Reducing methane emissions in the energy sector:** The Fit for 55 package includes measures to reduce methane emissions from the energy sector, including requirements for regular inspections and repairs of oil and gas infrastructure, as well as the use of methane-reducing technologies.

- **Sustainable aviation fuels:** The Fit for 55 package includes measures to promote the use of sustainable aviation fuels, including incentives for the production and use of these fuels, as well as requirements for their use in the aviation sector.

- **Decarbonized fuels in shipping:** The Fit for 55 package includes measures to promote the use of decarbonized fuels in shipping, including incentives for the production and use of these fuels, as well as requirements for their use in the shipping sector.

- **Alternative fuels infrastructure:** The Fit for 55 package includes measures to promote the development of alternative fuels infrastructure, including requirements for the deployment of charging and refueling infrastructure for electric and hydrogen vehicles.

- **Renewable energy:** The Fit for 55 package includes measures to promote the use of renewable energy, including targets for increasing the share of renewable energy in the EU's energy mix, as well as incentives for the production and use of renewable energy.

- **Energy efficiency:** The Fit for 55 package includes measures to promote energy efficiency, including targets for reducing energy consumption, as well as incentives for the adoption of energy-efficient technologies and practices.

- **Energy performance of buildings:** The Fit for 55 package includes measures to promote the energy performance of buildings, including requirements for the renovation of existing buildings and the construction of new buildings to high energy efficiency standards.

- **Hydrogen and decarbonized gas market package:** The Fit for 55 package includes measures to promote the development of a hydrogen and decarbonized gas market, including incentives for the production and use of these fuels, as well as requirements for their integration into the EU's energy system.

- **Energy taxation:** The Fit for 55 package includes measures to reform the EU's energy taxation system, including the introduction of carbon pricing and the removal of fossil fuel subsidies

EU Green Claims Directive

The EU Green Claims Directive is a policy proposal aimed at preventing greenwashing and promoting transparency in environmental claims made by businesses. The origin of the Green Claims Directive can be traced back to the need to address greenwashing, which is the practice of making false or misleading environmental claims to promote products or services. The directive aims to ensure that environmental claims made by businesses are accurate, verifiable, and not misleading to consumers.

The European Commission proposed the Green Claims Directive in March 2023, acknowledging the necessity for clearer and more reliable environmental information in the market. The purpose of the Green Claims Directive is to establish a common framework for environmental claims made by businesses in the EU. It sets out rules for making environmental claims, including the requirement for substantiation, transparency, and consistency. The directive also establishes a mechanism for verifying environmental claims and enforcing the rules.

The implications for businesses are significant. The Green Claims Directive requires businesses to provide evidence to support their environmental claims and to ensure that their claims are not misleading. As such, businesses will need to invest in developing robust systems for measuring and reporting on their environmental impact. They will also need to ensure that their marketing and advertising materials are accurate and transparent. This applies to all sectors and sizes of companies, except for micro-SMEs with less than 10 employees or less than €2 million in annual turnover.

The Green Claims Directive plays a crucial role in preventing greenwashing and promoting transparency in environmental claims. It complements other initiatives under the EU Green Deal, such as the EU Eco Label and EMAS (Eco-Management and Audit Scheme), which provide a framework for certifying products and services that meet environmental standards.

The EU Eco Label is a voluntary labeling scheme that recognizes products and services that meet high environmental standards. It covers a wide range of products, including electronics, textiles, and cleaning products. The label is awarded based on a life-cycle assessment of the product, which takes into account its environmental impact from production to disposal.

EMAS is a voluntary scheme that helps businesses and organizations evaluate, manage, and improve their environmental performance. It provides a framework for setting environmental objectives, measuring performance, and reporting on progress. EMAS is recognized as a leading standard for environmental management and is used by businesses and organizations around the world.

In conclusion, the EU Green Claims Directive, along with initiatives like the EU Eco Label and EMAS, plays a critical role in promoting transparency and preventing greenwashing in environmental claims. By establishing a common framework for environmental claims and providing a mechanism for verifying those claims, the directive helps to ensure that consumers can make informed choices about the products and services they purchase. It also provides businesses with a clear set of rules for making environmental claims, which can help to build trust and credibility with consumers.

EU Taxonomy

The EU Taxonomy is a crucial classification system within the EU's sustainable finance framework, aimed at identifying economic activities that are environmentally sustainable.

The EU Taxonomy was established as part of the EU's Action Plan on Financing Sustainable Growth in March 2018. It serves as a tool to guide investors, companies, issuers, and project promoters in transitioning to a low-carbon, resilient, and resource-efficient economy. The Taxonomy aims to provide clarity on which economic activities are sustainable, combat greenwashing, and support investment flows into sustainable assets.

Key Components:

- **Environmental Objectives:** The Taxonomy focuses on six environmental objectives, including climate change mitigation, climate change adaptation, sustainable use and protection of water and marine resources, transition to a circular economy, pollution prevention and control, and protection and restoration of biodiversity and ecosystems.

- **Technical Screening Criteria (TSC):** The TSC defines specific requirements and thresholds for economic activities to be considered sustainable. These criteria are elaborated in secondary legislation called Delegated Acts.

- **Do No Significant Harm (DNSH):** For an activity to qualify as sustainable, it must not cause significant harm to any of the environmental objectives. The TSC set thresholds to define compliance with DNSH.

- **Enabling & Transitional Activities:** The Taxonomy also classifies activities into enabling and transitional categories to allow for activities that may not initially be considered sustainable to contribute to environmental objectives.

Implications and Role:

- **Investment Guidance:** The Taxonomy helps investors assess whether investments meet robust environmental standards and align with high-level policy commitments like the Paris Agreement.

- **Market Transparency:** It provides a common language for investors, issuers, project promoters, and policymakers, enhancing transparency in the sustainable finance market.

- **Preventing Greenwashing**: By defining sustainable economic activities and setting clear criteria, the Taxonomy aims to prevent greenwashing and ensure that investments are truly sustainable.

Future Developments:

- **Expansion and Application:** The Taxonomy is expected to evolve and be applied in new ways, such as in the forthcoming EU Green Bond Standard, creating a more direct link with capital markets and potentially global capital

Evolution of EU Reporting

The Non-Financial Reporting Directive (NFRD)

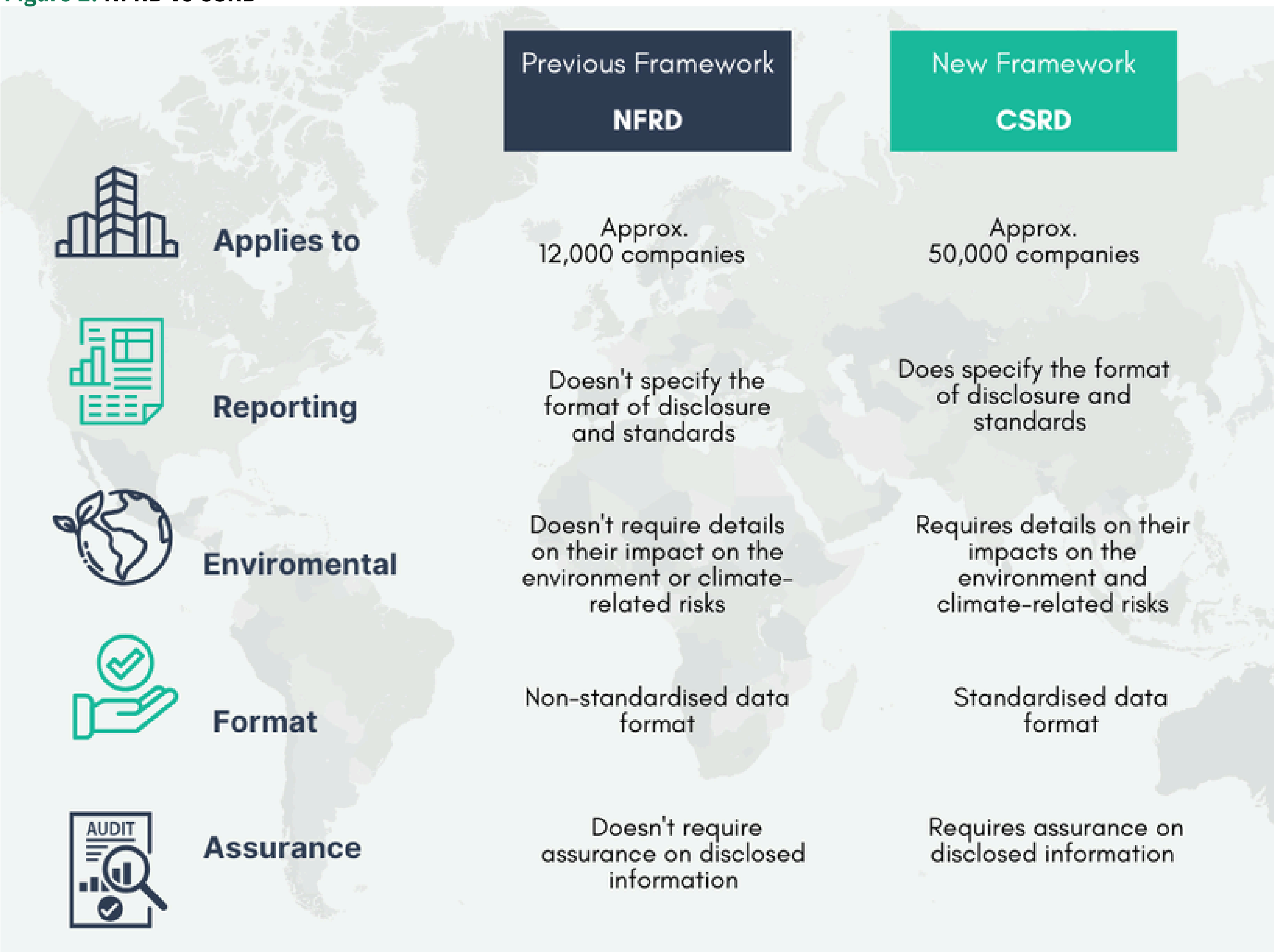
The Non-Financial Reporting Directive (NFRD) is a European Union (EU) regulation that requires certain large companies to disclose non-financial information related to social responsibility, human rights, anti-corruption, bribery, and diversity on company boards. The NFRD was adopted in 2014 and applies to listed companies, banks, insurance companies, and other companies designated by national authorities as public-interest entities with more than 500 employees.

The NFRD aims to improve the disclosure of non-financial information by these companies and requires them to report on their business models, policies, outcomes, risks, risk management, and key performance indicators (KPIs) relevant to their business. The NFRD is part of the EU's strategy to encourage corporate social responsibility and allows companies to adopt a variety of benchmarks to complete the disclosure process, such as national, international, and EU guidelines.

The NFRD requires around 12,000 of the largest EU companies to disclose non-financial information. However, the NFRD leaves flexibility in the implementation of its provisions, allowing companies to disclose relevant information in the way they consider most useful, such as including a non-financial statement in their management report or preparing a separate report. Companies can use international, European, or national guidelines to produce their statements, such as the Global Reporting Initiative (GRI), Sustainability Accounting Standards Board (SASB), International Integrated Reporting Framework (IIRC), Task Force on Climate-related Financial Disclosures (TCFD), United Nations (UN) Guiding Principles Reporting Framework, UN Global Compact, OECD guidelines for multinational enterprises, and ISO 26000, which will all be covered in future reports.

The NFRD is currently limited to public-interest entities in the EU, but there have been calls to extend its scope to non-EU companies operating in the EU or listed in the EU and non-listed companies without changing the size criteria. A significant overhaul of the NFRD, is the Corporate Sustainability Reporting Directive (CSRD). The differences between the two reporting directives convey a positive shift towards more inclusion, as seen in *figure 2*, which will be covered in the following section.

Figure 2: NFRD vs CSRD



Source: Pace ESG

The Corporate Sustainability Reporting Directive (CSRD)

The Corporate Sustainability Reporting Directive (CSRD) is a regulation introduced by the European Union (EU) that requires certain companies to disclose non-financial information related to environmental, social, and governance (ESG) matters. The CSRD aims to improve the disclosure of non-financial information by companies, making it reliable, comparable, and accessible to investors and other stakeholders.

The CSRD is a significant expansion of the Non-Financial Reporting Directive (NFRD), which was introduced in 2014 and covered around 12,00 companies in the EU. The CSRD, on the other hand, will cover around 50,000 companies, including listed SMEs and some non-EU companies with significant EU operations.

The key features of the CSRD include the requirement to report on sustainability matters using European Sustainability Reporting Standards (ESRS), covered in the next section, obtain assurance on disclosed information, and provide more detailed reporting on sustainability impacts, opportunities, and risks. The CSRD also introduces the concept of double materiality, requiring companies to report on how their business activities affect the planet and its people, and how their sustainability goals, measures, and risks impact the business's financial health. Finally, its reporting aligns with the Sustainable Finance Disclosure Regulation (SFDR), covered in a later section and the previously mentioned EU Taxonomy Regulation.

The CSRD was adopted in November 2022 and will start applying between 2024 and 2028. The rules will apply to large public-interest companies (with over 500 employees) already subject to the NFRD from January 1, 2024, large companies that are not presently subject to the NFRD (with more than 250 employees and/or €40 million in revenue) from January 1, 2025, and listed SMEs and other undertakings from January 1, 2026.

The CSRD is expected to have a significant impact on corporate sustainability practices, requiring companies to gather and consolidate large volumes of data, report on their carbon footprint, and provide more detailed sustainability disclosures. The CSRD also mandates third-party auditing of all disclosures for accuracy and completeness, making it essential for companies to ensure their sustainability reporting is reliable and comparable. The CSRD represents a significant step towards improving sustainability reporting in Europe, ensuring that companies report reliable and comparable sustainability information to drive investments towards sustainable activities.

The European Sustainability Reporting Standards (ESRS)

The European Sustainability Reporting Standards (ESRS) were formally adopted by the European Commission on July 31, 2023, marking a pivotal advancement in sustainability reporting within the EU. These standards are a cornerstone of the Corporate Sustainability Reporting Directive (CSRD), striving to elevate sustainability reporting to the same level of rigor and scrutiny as financial reporting. The ESRS are designed to ensure that companies provide relevant, reliable, and comparable information regarding their sustainability-related impacts, risks, and opportunities.

The ESRS consist of twelve finalized standards, which include two cross-cutting standards applicable to all sustainability matters, and ten topical standards addressing a broad spectrum of environmental, social, and governance (ESG) issues. The cross-cutting standards outline general reporting principles and the fundamental concepts of the CSRD, such as double materiality (considering the impact of sustainability issues on the business and vice versa) and reporting boundaries. Meanwhile, the topical standards detail specific reporting requirements for environmental, social, and governance matters.

The adoption of the ESRS represents a significant collaboration and alignment effort with global standards to ensure a high degree of interoperability and to avoid unnecessary duplication in reporting. The European Commission has engaged in discussions with the International Sustainability Standards Board (ISSB) and the Global Reporting Initiative (GRI) to ensure that the ESRS are compatible with existing global standards. This effort aims to facilitate the reporting process for companies and enhance the utility of sustainability reports for investors and other stakeholders.

Following the adoption of these standards, a scrutiny period by the European Parliament and the Council of the EU commenced, which, upon completion without objection, will see the ESRS apply from January 1, 2024. This phased implementation aims to assist companies in adapting to the new requirements while reducing the reporting burden, especially for first-time reporters. Additional reliefs and voluntary disclosures have been introduced to further ease the transition for companies.

The Sustainable Finance Disclosure Regulation (SFDR)

The Sustainable Finance Disclosure Regulation (SFDR) is a regulation introduced by the European Union (EU) that promotes and facilitates sustainable private sector investment by imposing disclosure obligations on financial market participants and financial advisors with 500 or more employees. The SFDR, effective from March 10, 2021, requires these organizations to disclose information about their Environmental, Social, and Governance (ESG) policies, risks, impacts, and performance at the entity and product levels. It is part of a broader EU initiative to channel capital towards sustainable investments and increase transparency concerning sustainability risks and opportunities. Additionally, SFDR complements other legislative measures like the Taxonomy Regulation and the Low Carbon Benchmarks Regulation arising from the European Commission's Action Plan on Sustainable Finance. The Regulation applies to a wide range of financial market participants, including banks, insurance companies, institutional investors, asset managers, and pension funds.

The SFDR aims to prevent "greenwashing" and improve transparency in the market for sustainable investments by requiring financial market participants and financial advisors to disclose the following entity-level ESG information: sustainability risks, principal adverse impacts (PAI) on sustainability factors, and the promotion of environmental or social characteristics and sustainable investment objectives. Additionally, these organizations must disclose the sustainability profile of the investment products they produce or market in pre-contractual documents, on websites, and in periodic reports.

The SFDR requires financial market participants and financial advisors to categorize and disclose their sustainability investments based on the degree of sustainability of a financial entity and its products. The disclosure requirements are divided into two levels: core disclosures (Level 1) and enhanced disclosures (Level 2). Level 1 disclosures apply at the entity level to sustainability risks and principal adverse impacts (PAI) and at the product level to Article 8 and Article 9 investment products. Level 2 disclosures apply at the entity level to PAI and at the product level to Article 8 investment products.

The regulation has been subject to amendments to include more detailed requirements, such as the inclusion of gas and nuclear-related activities that comply with the EU's Taxonomy Regulation in financial disclosures. It specifies the content, methodologies, and presentation of information to be disclosed, improving the quality and comparability of such information. The European Commission has also launched consultations to assess the framework further and tackle issues like legal certainty and greenwashing

The SFDR represents a significant step toward integrating sustainability into the financial sector, encouraging the alignment of investment with broader EU sustainability goals, such as transitioning to a net-zero economy. By setting out rules for financial market participants, it ensures that investors have access to the information needed to make informed choices aligned with sustainability objectives.

The Corporate Sustainability Due Diligence Directive (CSDDD)

The Corporate Sustainability Due Diligence Directive (CSDDD) is an initiative by the European Commission introduced on February 23, 2022, to ensure sustainable and responsible corporate behaviors throughout their operations and governance. The directive emphasizes the integration of human rights and environmental considerations into the core operations and strategies of companies. It mandates companies to identify, prevent, mitigate, and account for negative human rights and environmental impacts within their own operations, their subsidiaries, and across their value chains.

The CSDDD is set to affect a broad range of companies operating within the EU, including both EU and non-EU entities that meet specific criteria based on employee numbers and turnover thresholds. Large companies with over 500 employees and a net worldwide turnover of more than EUR 150 million, as well as companies in certain high-impact sectors such as textiles, agriculture, and mineral extraction with over 250 employees and a net turnover over EUR 40 million, are expected to comply with the directive. It also outlines similar criteria for non-EU companies operating in the EU.

The directive involves a phased approach for compliance, with expectations that the largest companies will need to comply by 2027, and all companies within its scope by 2029. It prescribes comprehensive due diligence steps aligned with the OECD Due Diligence Guidance for Responsible Business Conduct, covering the entire value chain from identifying and addressing potential and actual adverse impacts to engaging with value chain entities to prevent or mitigate these impacts.

A notable aspect of the CSDDD is the introduction of climate transition planning, making it the first EU legislation requiring large companies to adopt a plan ensuring their business models are aligned with the goal of limiting global warming to 1.5 °C, as outlined in the Paris Agreement. This requirement underscores the EU's commitment to sustainability and climate change mitigation at a corporate level.

The enforcement of the directive will involve administrative supervision by designated authorities in Member States, capable of imposing sanctions and fines. It also includes a civil liability mechanism where victims can seek compensation for damages resulting from companies' failure to comply with their due diligence obligations.

As the CSDDD is finalized and moves towards implementation, companies within its scope are advised to begin preparing for compliance. This may include evaluating current operations, relationships, and climate transition plans to identify gaps and prioritize areas for improvement

Emerging Trends & Future Direction

Integration of Digital Technology

The EU is increasingly integrating digital technology into environmental governance. This includes the development of digital tools for monitoring emissions and environmental compliance, and utilizing data analytics to optimize resource use and reduce waste. These technologies are set to enhance transparency and accountability in environmental management.

Strengthening Climate Action

The European Green Deal and the Fit for 55 package showcase the EU's commitment to reducing greenhouse gas emissions by at least 55% by 2030. Upcoming regulations are likely to impose more stringent emissions standards, promote renewable energy use, and introduce new measures for carbon pricing.

Expansion of the Circular Economy

The EU is pushing the boundaries of the circular economy beyond recycling, focusing on the entire lifecycle of products—from design to end-of-life management. This involves stricter regulations on waste management, extended producer responsibility, and the encouragement of business models based on product-as-a-service principles.

Social Dimensions of Environmental Policies

The EU is placing a stronger emphasis on the social dimensions of environmental policies, ensuring a just transition for all sectors and communities. This includes financial mechanisms to support regions and industries most affected by the transition to a green economy, as seen in the Just Transition Mechanism.

Emphasis on Biodiversity

With the adoption of the EU Biodiversity Strategy for 2030, there is a growing focus on protecting natural habitats, restoring degraded ecosystems, and legally binding nature restoration targets. This trend reflects a broader recognition of the inherent link between biodiversity and climate objectives, emphasizing ecosystem resilience.

Regulatory Consistency and Enforcement

Future EU regulations are expected to streamline and strengthen enforcement mechanisms to ensure consistent application across member states. This could involve more centralized oversight and the use of cross-border regulatory bodies to oversee compliance.

Challenges & Criticisms

Complex Regulatory Framework

One of the main criticisms is the complexity and volume of EU environmental laws, which can be challenging for businesses, especially small and medium-sized enterprises (SMEs), to navigate. The extensive requirements and administrative burdens are seen as obstructions to economic efficiency and innovation. This complexity can also lead to inconsistencies in enforcement across member states, undermining the effectiveness of environmental protection efforts.

Social and Regional Disparities

The social impact of environmental regulations is also a significant concern. Critics argue that the costs of transitioning to a greener economy are not evenly distributed, potentially leading to social and regional imbalances. While the EU aims to address these issues through mechanisms like the Just Transition Fund, the effectiveness of these supports are often questioned.

Economic Impact

Critics often point to the economic impact of strict environmental regulations, arguing that they can impose significant costs on industries, particularly manufacturing, agriculture, and energy. These sectors argue that too rigid regulations can interfere with competitiveness, especially against global competitors from regions with less strict environmental standards. The debate intensifies around issues like carbon pricing and energy costs, where businesses express concerns about the impact on their operational costs and overall economic sustainability.

Balancing Act with Global Competitiveness

There is an ongoing debate about the EU's environmental ambitions in the context of global economic competitiveness. Some argue that the EU's leading role in global environmental governance places its industries at a disadvantage compared to those in regions with less rigorous regulations. This concern is particularly pronounced in the context of global challenges such as climate change, where one-sided actions might not suffice without similar commitments from other major economies.

Enforcement and Compliance

Despite the comprehensive regulatory framework, enforcement remains a challenge. Differences in resource allocation, administrative capacity, and prioritization among member states can lead to varied levels of compliance and effectiveness. This uneven enforcement not only affects environmental outcomes but also creates an unlevel playing field within the internal market.

Adaptability and Future Challenges

Finally, the dynamic nature of environmental challenges requires regulations that can adapt over time. Critics often highlight the slow legislative process in the EU, which may not be agile enough to respond to emerging environmental issues or technological advancements promptly.

Conclusion

This report has thoroughly examined the European Union's comprehensive approach to embedding sustainability into its regulatory frameworks, highlighting both the progress and the challenges that accompany such ambitious undertakings. The EU's strategic initiatives, such as the European Green Deal and the Fit for 55 package, underscore a commitment to transforming into a climate-neutral economy by 2050, cultivating a more sustainable future for all member states.

Significant strides have been made in refining the legislative landscape, from enhancing transparency in environmental claims with the EU Green Claims Directive to setting rigorous sustainability reporting standards through the CSRD and ESRS. These measures are crucial in guiding both the public and private sectors towards greater environmental accountability and sustainability.

However, as the EU continues to lead on the global environmental stage, it faces inherent challenges such as regulatory complexity, enforcement discrepancies, and the economic impacts of stringent environmental standards. These issues highlight the need for ongoing adjustments and dialogues to ensure that the regulations are both effective and equitable.

Looking ahead, the EU's ability to integrate emerging technologies and create a circular economy will be vital in maintaining its leadership role in global sustainability efforts. Moreover, the emphasis on social equity within environmental policies is essential to ensuring a just transition for all sectors and communities, particularly those most vulnerable to economic shifts.

While there are challenges to overcome, the EU's proactive regulatory framework sets a robust blueprint for sustainable development. Continued collaboration, innovation, and commitment to these goals will be pivotal in achieving the ambitious targets set forth in the European Green Deal, ensuring a sustainable and prosperous future for the next generations.

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