PRI POSITION PAPER

SCOPE OF THE CORPORATE SUSTAINABILITY REPORTING DIRECTIVE

11 February 2022

INTRODUCTION

Investors regularly report to the PRI that a lack of consistent and comparable sustainability information is a substantial barrier to their responsible investment practice[1]. For investors selling and/or marketing products in the EU, access to comparable, consistent, and high-quality corporate sustainability disclosure is even more important to meet the increasing sustainability-related disclosure requirements under Regulations such as the Sustainable Finance Disclosure Regulation (SFDR) and EU Taxonomy.

In September 2021, the PRI published an investor statement of support for the EU Corporate Sustainability Reporting Directive (CSRD), signed by 54 PRI signatories representing approximately 9.2 trillion USD in AUM. The statement sets out six key aspects which co-legislators should take into account to align the CSRD with the EU strategy for financing the transition to a sustainable economy and enable investors to actively contribute to the EU's high ambition for a green recovery and emission reduction targets of at least 55% by 2030 and climate neutrality by 2050. These six aspects cover scope, double materiality, integrated reporting, assurance, standards setting, the single electronic reporting format, and timeline.

This paper further elaborates PRI's position on the scope of the CSRD, building on PRI's extensive work on corporate disclosure[2] and our response to the European Commission's consultation on the review of the Non-Financial Reporting Directive. The PRI welcomes the extension of the scope of companies reporting under the CSRD to all large companies and all companies listed on regulated markets (except listed micro-enterprises). Investors need sustainability information from all large public interest and listed companies. **However, co-legislators must ensure coherency between CSRD and SFDR reporting for financial market participants. There is some overlap between these two forms of disclosure and further analysis is required to assess whether SFDR disclosures could be sufficient for financial market participants to demonstrate compliance with certain CSRD reporting requirements**.

Furthermore, the extension of scope to listed SMEs must be maintained, and the European Commission must undertake further research on how private SMEs[3], which are likely to enter situations of high risk, could be brought into the scope of the CSRD in a proportionate manner. In addition, the parent undertakings of subsidiaries, which are either large or listed SMEs, should be allowed to report certain sustainability information at the subsidiary level in their consolidated reports. This could include a breakdown of information relating to targets and progress; due diligence, principal adverse impacts in value chains and actions taken to remedy/mitigate; and management of principal risks. This extension of scope would support investors to access the data they need for investment decisions and in their engagement with investees.

As European Sustainability Reporting Standards (ESRS) are being developed by EFRAG while negotiations are coming to an end at European Parliament level on CSRD, it is important to ensure that any extension of CSRD scope must not compromise the quality of the ESRS. These standards

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[1] 2019 PRI Signatory survey.

[2] See PRI's driving meaningful data programme.

[3] SMEs are defined as undertakings which on their balance sheet fall in between at least two of the three following ranges: (a) balance sheet total: EUR 4 000 000 - 20 000 000; (b) net turnover: EUR 8 000 000 - 40 000 000; (c) average number of employees during the financial year: 50 - 250 (Directive 2013/34/EU, Article 3(2) and Article 3(4)). Private undertakings are defined as undertakings which are not public-interest entities as defined in Article 2(1), Directive 2013/34/EU.

should reflect Europe’s high ambition in sustainable finance and contribute to international standard-setting initiatives driven by IFRS and IOSCO to establish a global common baseline on enterprise value creation.

Precise suggestions for article amendments to incorporate these recommendations are detailed below.

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RECOMMENDATIONS

1. ENSURE COHERENCY BETWEEN CSRD AND SFDR REPORTING FOR FINANCIAL MARKET PARTICIPANTS

Background

Under the non-financial reporting directive (Directive 2014/95/EU (NFRD)), an undertaking has to disclose sustainability information if its average number of employees during the financial year exceeds 500[4]. The CSRD proposal replaces this, including in its scope all large undertakings and all public-interest SMEs provided they meet two out of three criteria based on balance sheet total, net turnover, and average number of employees during the financial year[5].

Financial market participants (FMPs) may also, or instead, be required to perform entity and product level disclosures under the SFDR[6]. At entity level, an FMP must disclose their policies on the integration of sustainability risks in their investment decision-making process[7]. In addition, if they have on average at least 500 employees during a financial year, or if they consider the principal adverse impacts of their investment decisions on sustainability factors[8], then they must disclose a statement on their due diligence policies with respect to the principal adverse impacts of their investment decisions on sustainability factors[9]. FMPs must also disclose against these principal adverse impact indicators at product level, to a varying extent dependent on the objectives/characteristics of the product[10].

PRI recommendation

There must be coherency between reporting requirements for FMPs under the CSRD and SFDR. These two forms of disclosure have different reporting requirements, and both are needed. However, there is some overlap and **further analysis is required to assess whether SFDR disclosures could be sufficient to demonstrate compliance with certain CSRD reporting requirements.** Enabling cross referencing to SFDR disclosures for instance could avoid an increased burden on FMPs, while ensuring sustainability information reaches intended audiences. For example, the Commission should consider how a FMP's SFDR disclosure regarding their policies on the integration of sustainability risks[11] overlaps with the requirement to disclose a "*description of the principal risks to the undertaking related to sustainability matters, including the undertaking's principal dependencies on such matters, and how the undertaking manages those risks*"[12]. Similar potential overlaps could occur regarding policies on the identification, prioritisation, and actions regarding principal adverse sustainability impacts (SFDR, Article 4(2) vs CSRD Article 3(1) amending Article19a(2d) of the

[4] Article 1(1) of Directive 2014/95/EU (NFRD) inserting Article 19a to the accounting directive (Directive 2013/34/EU).
[5] The definitions of large, medium and small undertakings used in the CSRD are based on Article 3 paragraphs 2-4 of the Accounting Directive.
[6] Regulation (EU) 2019/2088 on sustainability-related disclosures in the financial services sector. The full scope of the SFDR is defined under Article 2 paragraphs 1 and 11.
[7] Article 3(1) Regulation (EU) 2019/2088.
[8] Article 4 paragraphs 1, 3 and 4 Regulation (EU) 2019/2088.
[9] Article 4(1) Regulation (EU) 2019/2088.
[10] Articles 7-11 of Regulation (EU) 2019/2088, and Articles 14, 16(3), 21, 23(3), 30, 34(2), 47, 59, 61, 63(1), 65, 67(1), 69 and 71(2) of the draft regulatory technical standards.
[11] Article 3(1) Regulation (EU) 2019/2088.
[12] Article 1(3) of the CSRD proposal, amending Article 19a(2f) of the Accounting Directive.

Accounting Directive) or due diligence (SFDR, Article 4(2) vs CSRD Article 1(3) amending Article 19a(2e) of the Accounting Directive).

In addition, given the change in criteria for scope, from a single employee threshold to a two-out-of-three requirement for balance sheet total, net turnover and/or employee count, many financial products/funds will be newly brought under corporate reporting requirements. Considering the SFDR is tailored for sustainability reporting for financial products, **financial products/funds should be excluded from CSRD reporting requirements**[13].

2. MAINTAIN THE INCLUSION OF LISTED SMES AND CONDUCT RESEARCH ON FURTHER EXTENSION TO PRIVATE SMES

Background

Article 1(3) of the CSRD proposal replaces Article 19a[14] of the Directive 2013/34/EU ('Accounting Directive') to increase[15] the scope of the companies with a duty to disclose sustainability information to all large undertakings[16], and, as of 1 January 2026, public-interest[17] small and medium-sized undertakings (SMEs)[18].

PRI strongly supports this scope extension to include listed SMEs from 2026 for a number of reasons[19]:

- **Companies' size is not always a relevant criterion to consider the sustainability risks, opportunities and impacts those businesses have.** As with large undertakings, SMEs face sustainability-related risks and opportunities. They also account for the majority of private sector GDP, and likely make up a significant share of private sector sustainability impacts[20].
- **SMEs and large private undertakings are an important part of the reporting chain. A lack of reporting is a barrier for investors subjected to specific disclosure requirements and an internal risk for all companies to consider**.
  - Investors face increasingly demanding sustainability reporting requirements. Under the SFDR, financial market participants (FMPs) will be subject to numerous disclosure obligations by 2023 at entity and product level, which rely on the data provided by all portfolio companies, regardless of their size or listing[21]. For example, FMPs publishing a 'principal adverse

[13] See also EFAMA's position on the exclusion of financial products, EFAMA's position paper on the scope of CSRD and interplay with SFDR, September 2021.
[14] Article 19a had been inserted through Article 1(1) of the Non-Financial Reporting Directive (NFRD, 2014/95/EU).
[15] The NFRD requires "*large undertakings which are public-interest entities exceeding on their balance sheet dates the criterion of the average number of 500 employees during the financial year"* to disclose sustainability information.
[16] Large undertakings are defined in the Accounting Directive as those which "on their balance sheet dates exceed at least two of the three following criteria: (a) balance sheet total: EUR 20 000 000; (b) net turnover: EUR 40 000 000; (c) average number of employees during the financial year: 250 (Directive 2013/34/EU, Article 3(4)).
[17] Defined in Article 2(1) of the Accounting Directive (Directive 2013/34/EU) as publicly listed companies, credit institutions, insurance undertakings or undertakings designated as public-interest entities by a Member State.
[18] Small undertakings are defined as undertakings which on their balance sheet dates do not exceed the limits of at least two of the three following criteria: (a) balance sheet total: EUR 4 000 000; (b) net turnover: EUR 8 000 000; (c) average number of employees during the financial year: 50. (NB Member states can edit (a) to EUR 6 million and (b) to EUR 12 million max), (Directive 2013/34/EU, Article 3(2)).
[19] These reasons are echoed in bullet point 4 of 'Opportunities and Possible Ways Forward' on page 53 of International Platform on Sustainable Finance State and trends of ESG disclosure policy measures across IPSF jurisdictions, Brazil, and the US. November 2021.
[20] World Bank Small and Medium Enterprises (SMEs) Finance and Commentary to Guiding Principle 14, UN Guiding Principles on Business and Human Rights.
[21] SFDR Draft RTS, Article 5(1), Article 14, Article 16(3), Article 21, Article 23(3), and Article 59.

sustainability impacts statement' will need to include aggregate adverse sustainability indicators for greenhouse gas emissions, biodiversity, water, waste, and social and employee matters covering their investee companies along with efforts to obtain the required information where this is not readily available[22].

- The CSRD will also bring direct benefits and reduced costs for businesses in the medium- and longer-term[23]. Large private companies in Germany for example, recognise this and welcome CSRD scope extension[24]. They, and other large private and public companies rely on disclosures from SMEs to calculate data points such as their Scope 3 emissions. More broadly, under the CSRD, undertakings must consider the entire value chain[25]. Therefore, even without a formal reporting obligation, SMEs that fall within such value chains will need to respond to their stakeholder's information requirements or risk reduced market and capital access, expansion and other commercial opportunities[26]. This is also a risk to investors who may have to reduce the scope of their portfolios if this data is unavailable. Through standardising their reporting requirements, the CSRD limits SME reporting burden by preventing them from having to provide different data (or the same data in different formats) to each interested party, in ad hoc requests[27]. It will also ensure that key stakeholders, particularly investors, receive the data they need, and that this data is reliable and comparable.

PRI recommendation

PRI strongly supports extension in scope to listed SMEs. In addition, **the European Commission must undertake further research on how private SMEs[28], which are likely to enter situations of high risk, could be brought into the scope of the CSRD in a proportionate manner.** This recommendation links to the European Parliament's resolution of 17 December 2020, but instead of focusing solely on sector, it is important to underline that looking at broad environmental, social and/or governance issues, a tailored approach is required to assess an SME's impact – it is dynamic and will depend on many factors beyond sector alone[29]. The European Commission should consider other factors, for instance geographic location and company identification and management of such risks etc.

The reporting of such private SMEs would be beneficial to investors and companies not only for the reasons listed above. Accessing data from private SMEs would also support investors in reporting their adherence to internationally recognised standards of due diligence under Article 4(2d) of the SFDR. Furthermore, in the case of fixed income and private equity (PE) investors, consistent and

[22] SFDR Draft RTS, Article 6(1) and Article 7(2).
[23] Alliance for Corporate Transparency The business case is won - how the benefits of mandatory sustainability reporting by business, really do outweigh the costs – Part One | Alliance for Corporate Transparency.
[24] In a survey of 104 large unlisted companies carried out by the German Banking Association in June 2021, three quarters welcomed the expansion of scope of the CSRD.
[25] Commission CSRD proposal Articles 1(3) and 1(7).
[26] EFRAG Proposals for a relevant and dynamic EU sustainability reporting standard-setting, page 53 paragraphs 170,171.
[27] European Commission Impact Assessment for CSRD proposal: If standards were to completely eliminate the need for additional information requests to preparers, the average EU company would save EUR 24'200 – 41'700 per year. Also, 88% of respondents to the open public consultation who are or who represent SMEs indicated that simplified standards would be useful for SMEs (66% saying a simplified standard would limit the burden from information requests).
[28] SMEs are defined as undertakings which on their balance sheet fall in between at least two of the three following ranges: (a) balance sheet total: EUR 4 000 000 - 20 000 000; (b) net turnover: EUR 8 000 000 - 40 000 000; (c) average number of employees during the financial year: 50 - 250 (Directive 2013/34/EU, Article 3(2) and Article 3(4)). Private undertakings are defined as undertakings which are not public-interest entities as defined in Article 2(1), Directive 2013/34/EU.
[29] For example see "Limitations" in Annex 1 of UN Environment Programme, UNEP Finance Initiative and Global Canopy Beyond 'Business as Usual': Biodiversity targets and finance. Managing biodiversity risks across business sectors. UNEP-WCMC.

comparable sustainability information from private SMEs would be a valuable resource. For example, there are significant benefits to PE investors embedding strong human rights due diligence processes into formerly high-risk portfolio companies and demonstrating this to buyers[30]. This requires assessing actual and potential human rights impacts and tracking progress[31] and thus depends on clear sustainability disclosure from private SMEs. Disclosures from private SMEs would enable investors to better capture sustainability risks and impacts throughout the reporting chain. Private SME disclosure would also be important for large companies as they start to assess their supply chains, under the upcoming mandatory human rights due diligence requirements of the sustainable corporate governance initiative. SMEs must be supported to meet the reporting requirements under the CSRD so that the data they disclose is accurate and useful while disclosure requirements are proportionate.

Proposed Amendment

CSRD Article 1 (3). Article 19a of the Accounting Directive has a new paragraph 8 inserted:

8. By 1 January 202x*, the Commission shall publish a report describing the provisions that would be required to extend the scope of this Directive to include private, small and medium-sized undertakings or parent undertakings which are considered to likely enter situations of high risk.

*This date should be at least one year before listed SME disclosures begin.

3. ALLOW PARENT UNDERTAKINGS TO DISCLOSE CERTAIN INFORMATION AT SUBSIDIARY[32] LEVEL

Background

The CSRD proposal states[33] that "*An undertaking which is a subsidiary undertaking shall be exempted from the [disclosure] obligations […] if that undertaking and its subsidiary undertakings are included in the consolidated management report of a parent undertaking" […]. The management report of an undertaking that is exempted from the obligations […] shall contain all of the following information: (a) the name and registered office of the parent undertaking that reports information at group level […] (b) the fact that the undertaking is exempted from the obligations*.

The consolidated reporting prescribed in Article 1(7) of the CSRD proposal[34], does not encourage any disclosure of information at subsidiary level. This is a risk to investors and companies because:

- **Consolidated group-level disclosures may hide risks, opportunities and impacts that are material at subsidiary level but not at group level, especially since these vary by country of operation[35].** For instance, a group's human rights performance may be good relative to competitors, but one subsidiary's practices could cause it to face regulatory risk domestically. Investors need to understand the levels at which risks, opportunity and impacts occur in order to

[30] BIICL and PRI Workshop on Human Rights in Private Equity: Information and Summary, page 5.
[31] Guiding Principle 17, UN Guiding Principle on Business and Human Rights.
[32] A subsidiary undertaking means an undertaking controlled by a parent undertaking, including any subsidiary undertaking of an ultimate parent undertaking.
[33] CSRD proposal Article 3(1) replacing Article 19a (7) of the Accounting Directive.
[34] Which replaces Article 29a of the Accounting Directive.
[35] EFRAG Proposals for a relevant and dynamic EU sustainability reporting standard-setting page 72, paragraphs 268-270.

conduct effective due diligence and engagement. This is particularly the case for large conglomerates that operate in diverse sectors, where group-level sustainability information is difficult to interpret when aggregated. Subsidiary-level information would help investors in their engagement with parent companies, to better understand and assess subsidiary roles and contributions to group-level sustainability performance.

- **Investors would be able to meet disclosure requirements more accurately with subsidiary disclosures.** The SFDR requires investors to assess the underlying investments of investee holding companies and consider total adverse impacts arising from them. It states that '*where they [investors] do not have such information, they cannot be considered to take into account the principal adverse impacts of their investment decisions on sustainability factors*'[36]. CSRD disclosures from subsidiaries would provide valuable context on these underlying investments, allowing investors to better assess their adverse impacts.

PRI recommendation

To increase the granularity of data available to investors and ensure that management reports don't significantly increase in length and complexity, **the Commission should allow, and encourage through guidance, metrics which are material and useful to users to be disclosed on aggregated and disaggregated (subsidiary) levels in the consolidated reports**. This could be for metrics covered by paragraphs 2(b), 2(e) and 2(f) of Article 19a of the Accounting Directive i.e. those metrics relating to targets and progress; due diligence, PAIs in value chains and actions taken to remedy/mitigate; and management of principal risks. The timeline for such voluntary reporting should match the timeline for reporting of different types of non-subsidiary undertakings (in terms of size and listing).

Co-legislators should note that the PRI does not recommend a removal of the exemption of subsidiary reporting under Article 1(7) of the CSRD. This could inadvertently create incentives for entities to shift activities with "negative" sustainability information to other group entities out of scope of the CSRD. This would result in misleading, and less useful, "positive" sustainability disclosures.

Proposed Amendment

CSRD Article 1(7). Article 29a of the Accounting Directive has a new paragraph 2i inserted:

2i. Parent undertakings shall be permitted to disclose the information referred to in paragraphs 2(b), (e) and (f) at a consolidated level and at disaggregated level, providing a breakdown of individual values for each large subsidiary it controls, and as of 1 January 2026, each small and medium-sized subsidiary undertaking it controls, which are undertakings referred to in Article 2, point (1), point (a). Subsidiaries which are private SMEs may also be included in such disaggregated reports following the results of the Commission's report as stated in Article 19a (8).

ESMA shall adopt guidelines for voluntary subsidiary reporting to ensure such reporting is useful and tailored to user's information demands.

[36] ESAs' Final Report on draft Regulatory Technical Standards (SFDR), page 12 paragraph 4.

ABOUT THE PRI

The Principles for Responsible Investment (PRI) is the world's leading initiative on responsible investment. The PRI has now over 4,700 signatories (pension funds, insurers, investment managers and service providers) to the PRI's six principles, representing US $121 trillion in assets under management.

The PRI supports its international network of signatories in implementing the Principles. As long-term investors acting in the best interests of their beneficiaries and clients, our signatories work to understand the contribution that environmental, social and governance (ESG) factors make to investment performance, the role that investment plays in broader financial markets and the impact that those investments have on the environment and society as a whole.

The PRI works to achieve this sustainable global financial system by encouraging adoption of the Principles and collaboration on their implementation; by fostering good governance, integrity and accountability; and by addressing obstacles to a sustainable financial system that lie within market practices, structures and regulation.