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Sustainability reporting and disclosure rules: clarity or confusion?

Blog post by Climate and Sustainability Practice Lead Elizabeth Beall, 15 March 2021

A little under two years ago, I wrote about whether the introduction of a 'green taxonomy' in the EU would set the stage for a transformation of not just the financial system but how we define sustainability. Over these last two years the EU has drafted an ever-growing list of regulations aimed at providing guidance for both investors and corporates on i) what can be labelled as green, and ii) what is required to back up those claims. That list of regulations is accompanied by an even longer list of acronyms and jargon that many would argue has worked against the clarity sought. Instead it has left everyone more confused.

The first of those regulations, which came into force last week - the Sustainable Finance Disclosure Regulation (SFDR) - sets out rules around disclosure for investors and the type of information that they will need to be collecting from companies to show how they are addressing environmental, social, and governance (ESG) risks in their investment decisions. The underlying regulatory technical standards (RTS – I warned you that this was going to be acronym-heavy) will not come into effect until 2022, which is where the real detail on specific indicators for disclosure will emerge. This has left many wondering what they need to do now and when there will be clarity around what is expected in 2022.

Alongside the SFDR, and closely linked, the **taxonomy regulation and associated Technical Screening Criteria (TSC)** have been under development. The idea is that the taxonomy provides the definitions that the SFDR then draws upon in guiding investors on disclosures. The problem is that the SFDR was finalised before the criteria for the taxonomy – which are also now delayed. The first two delegated acts related to climate mitigation and adaptation are now due in April but with the other four (a total of six environmental objectives are included under the taxonomy) will not be finalised until the end of the year at the earliest.

While investors are struggling with understanding what they need to change in terms of marketing of ESG or green products, the real burden is going to fall on corporates who are soon to be inundated with requests from investors for data that they have probably not been collecting. Corporate disclosures are governed by the **Non-Financial Reporting Directive (NFRD)** which is set to be revised – again in line with the taxonomy not yet finalised – in April.

If you have made it through all the acronyms and are still reading, you are probably familiar with the so-called 'alphabet soup' of ESG standards. The EU policy architecture, while attempting to provide clarity and harmonisation, has advanced uncertainly, and with voluntary ESG standards and domestic taxonomies in the works in China, the UK and elsewhere the window for the EU to set a global standard may be passing. Diverging definitions will complicate reporting for corporates and investors – as is the case today – but may ultimately result in a higher baseline for what is considered 'sustainable' overall. Investors are scrambling to turn portfolios green and asset managers are launching new products. But there is an inevitable question about how many of these investments will remain ESG aligned when the dust settles around definitions and harmonised standards – and who will be aligned with what.

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