

Development of the European Sustainability Regulatory Framework

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Abstract. The development of a competitive business is undoubtedly a determining factor for the political and economic stability of a country, and therefore for the well-being of its citizens. But the effects of climate change, the scarcity of critical raw materials, the limitation of ecosystem services, and the disregard for human rights are just a few of the events that have led to rethinking of the concept of business value in the mid-twentieth century. Against this backdrop, Europe's political efforts are turning towards taking decisive steps to address the negative impacts of various economic activities on people and the environment, where the Sustainability reporting becomes an important element of monitoring the effectiveness of measures put in place.

Key words: Sustainability reporting, CSRD, CSDDD, Taxonomy and Omnibus.

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1. Introduction

Sustainability reporting has its background and reasons. In their work "The historical development of sustainability reporting: a periodic approach" from 2020. Soner Gokten, Ph.D., Yıldız Ozerhan, Ph.D. and Pınar Okan Gokten, Ph.D. have presented an analysis of a series of chronological events in the period 1962-2016, determining the need for Sustainability reporting and outlining three main stages of its development: 1) Pre-standardization period (1962-1998); 2) Standardization period (1998-2016); and 3) Post-standardization period. Adhering to this chronological presentation and conditional division of the reporting development periods, we can further elaborate this analysis by pointing out specific events and facts up to February 2025 based on which Sustainability reporting is being institutionalized in Europe.

2. The Paris Agreement

In response to rising global warming and progressive climate change, on December 12, 2015 in Paris during the 21st United Nations (UN) Climate Change Conference, leaders from 196 countries signed a legally binding International treaty that entered into force on November 4, 2016.

The Paris Agreement is the result of a series of climate change-related meetings, including the 1992 meeting in Rio de Janeiro, where countries joined the UN Framework Convention on Climate Change, and the 1997 meeting in Kyoto, where the Kyoto Protocol was signed - the first legally binding document committing developed countries to pursue greenhouse gas emission reduction targets.

The Paris Agreement succeeded, on the one hand, in binding countries such as the US and China (which did not sign up to the Kyoto Protocol) to greenhouse gas reduction commitments, and on the other hand, in setting more specific targets for reducing global warming, namely keeping the global average temperature rise well below 2 °C compared to 1990 levels and making efforts to limit the temperature rise to 1.5 °C compared to 1990 levels.

As a result of the Agreement, all signatories undertake to set their own targets for reducing greenhouse gas emissions, to take the necessary measures to achieve them, to ensure monitoring of their implementation and to report on the progress made.

In the meantime, by the time of the conclusion of the Paris Agreement, the European Union (EU) had already taken steps in line with the United Nations Framework Convention on Climate Change, as well as with paragraph 47 of the final document of the Rio+20 Conference held in 2012, which stresses the importance of corporate accountability on environmental and social impacts. In its resolution of 6 February 2013, the European

Parliament underlines that disclosure of non-financial information is a key element to foster sustainable and resilient economy growth.

On 22 October 2014, Directive 2014/95/EU of the European Parliament and of the Council (NFRD) was adopted. According to the Directive, all large listed entities with an average number of 500 employees during the financial year, shall include a Non-financial Statement in their Management report. There is an option the Reporting to be aligned with International Framework for voluntary reporting, such as the Global Reporting Initiative (GRI) standards. First reporting as per NFRD started in 2018 for financial year 2017.

With the adoption of Directive 2014/95/EU and its transposition into the legislation of all EU Member States, businesses across Europe are for the first time obliged by law to disclose information on environmental and social factors. With this act, the Union hopes to increase transparency regarding the impacts of economic activities on people and the environment, as well as to enable investors to direct financial flows towards sustainable investments.

3. European Green Deal

In Europe 2018 Report, the European Union underlines significant progress towards its 2020 targets to reduce greenhouse gas emissions. However, it highlights that Europe continues to experience rising temperatures, which have led to significant drought in some areas.

The Intergovernmental Panel on Climate Change (IPCC) also confirms that global climate action needs to be urgently accelerated and that to limit temperature rise to 1.5 °C the world will need to reach net zero greenhouse gas emissions by around 2070. All this is a reason the European Union to take more decisive measures not just in the direction of adaptation to climate change, but towards zero neutrality of greenhouse gases by 2050.

On December 11, 2019, the European Commission presents the European Green Deal, which introduces the ambitious goal of making Europe the first climate-neutral continent by 2050. It introduces a phased approach to achieving the target, namely: by 2030 reducing greenhouse gas emissions to 55% compared to 1990 levels; by 2040 reducing greenhouse gas emissions to 90% compared to 1990 levels; and by 2050 achieving climate neutrality (Net Zero). The Green Deal stresses the need for changes in all economic sectors to ensure that its strategic objectives are met. This has led to a number of amendments to existing EU regulations and the establishment of new ones, including setting specific targets for different sectors of the economy. At the same time, the fact that significant financial resources need to be allocated to achieve the objectives is not disregarded. Thus, the European Commission commits to mobilizing at least EUR 1 trillion by 2030.

4. Corporate Sustainability Reporting Directive

The process of amending and supplementing European regulations as a result of the European Green Deal does not miss the Reporting Framework.

In 2020, the European Commission is conducting a stakeholder consultation, which has resulted in several areas of concern in the implementation of NFRD in terms of the correctness, comparability and relevance of data, as well as the information completeness compared to the requirements of investors, NGOs and rating agencies. One of the main reasons for this appears to be the lack of clear criteria on what needs to be reported.

At the same time, the stakeholders involved in the consultation give their strong support for the use of common reporting standards tailored to the size of the companies, the extension of the scope of obliged entities to report, the introduction of mandatory audit of the information disclosed, the mandatory disclosure of the materiality assessment approach, the digitalization of the Reports and correlation of the information disclosed with the requirements of the Taxonomy Regulations.

Taking into account the results of the public consultation, Directive (EU) 2022/2464 of the European Parliament and of the Council on corporate sustainability reporting (CSRD) was adopted on 14 December 2022. The Directive substantially increases the scope of obliged entities for reporting a non-financial information by including companies that meet, at individual and/or consolidated levels, two of the following three criteria: 1) balance sheet - EUR 25,000,000; 2) net turnover - EUR 50,000,000; and 3) average number of employees - 250. In addition, the reporting is obligatory for listed SMEs, small and non-complex institutions, captive insurance companies, subsidiaries and branches of EU companies established in a third country depending on specific conditions as per the CSRD. The reporting should be done in 3 stages - the so-called "three waves of reporting": 1) 2025 for financial year 2024 - large listed companies for which at individual and/or consolidated level the average number of employees at the end of the reporting year is more than 500 employees ; 2) 2026 for financial year 2025 - other companies meeting the criteria for large entity at individual and/or consolidated levels; 3) 2027 for financial year 2026 - all other companies covered by CSRD.

These companies now have an obligation to report not only on their own activities, but also on risks, impacts and opportunities related to their value chains, while disclosures types and number depends on the outcomes from the Double Materiality Assessment.

CSRD introduce the term "sustainability statement" by requiring clear distinction between financial and non-financial reporting and good interoperability between both. Similarly to the financial reports, the Sustainability Statement is subject on mandatory audit, where auditors must meet certain professional qualification requirements. The Sustainability Statement should be published in a single electronic format and its structure and content should comply with tailored Sustainability Reporting Standards.

All Member States have to transpose the requirements of the Directive into their local legislation by 6 July 2024. As of February 2025, the only Member States that have not transposed the Directive are Germany, Spain, Cyprus, Luxembourg, Malta, the Netherlands, Austria and Portugal, while Bulgaria is the only Member State that has transposed the requirements and subsequently amended them with a legislative act by introducing one-year postponement for all three reporting waves.

5. European Sustainability Reporting Standards

In parallel with the development of a Corporate Sustainability Reporting Directive, the European Commission is also working to create a single reporting framework by developing European Sustainability Reporting Standards (ESRS).

In the summer of 2023, Commission Delegated Regulation (EU) 2023/2772 supplementing Directive 2013/34/EU of the European Parliament and of the Council as regards sustainability reporting standards was adopted. As per the delegated act the Sustainability Reporting of all obliged entities, regardless of the sector in which they operate, should comply with the requirements of twelve standards (ESRS) - two horizontal and ten topical. The number of reporting data points amounts to approximately 1100, of which 161 are mandatory and 622 are subject to double materiality assessment (this number does not include the minimum reporting requirements for policies, actions and targets under ESRS 2).

In addition, ESRS 1 also addresses two other categories of standards - sector and entity specific - and states that companies should report on these as well, where the development and introduction of sector standards is planned to be done by the EC over the next 3 years. At the same time, the EC continues to develop the Standards for listed SMEs and the Voluntary Standards for SMEs, which are available as drafts by February 2025.

The European Sustainability Reporting Standards define the concept of "qualitative information" and specify criteria that must be met to be classified as such. It is noteworthy that, in addition to quantitative data on specific indicators, companies are required to disclose qualitative information related to their Double Materiality Assessment (DMA) approach, the integration of the DMA into the Risk Management System, the due diligence process. Emphasis is placed on the experience of administrative, management and supervisory bodies in managing sustainability topics, as well as building internal capacity and ensuring dialogue with stakeholders. A clear reporting structure is presented, including on the topical standards, with the following logical sequence: significant impacts, risks and opportunities identified, company strategy related to them, policies and measures/actions put in place to address them, strategic objectives and results achieved.

In developing the European Sustainability Disclosure Standards, the European Commission is ensuring their alignment with globally recognized Frameworks on Sustainability Reporting, including the Global Reporting Initiative (GRI), the Sustainable Development Standards Board (SASB), the Task Force on Climate-related Financial Disclosures (TCFD), the Task Force on Nature-related Financial Disclosures (TNFD). It also aligns the terminology related to financial reporting under International Financial Reporting Standards (IFRS), as well as disclosure requirements against the Taxonomy Regulations and Regulation (EU) 2019/2088 of the European Parliament and of the Council on sustainability-related disclosures in the financial services sector.

6. Sustainable Investments and Taxonomy

The adoption of Regulation (EU) 2019/2088 (SFDR) precedes the development and publication of Directive (EU) 2022/2464 as well as the ESRS. This Regulation responds to the Paris Agreement and the need to shift cash flows towards low greenhouse gas emitting and climate resilient investments. It aims to ensure good principal-agent information exchange on the integration of sustainability risks, the reporting of adverse sustainability impacts, incentives for environmental or social performance and for sustainable investments.

The regulation also defines terms such as "sustainable investments" and "sustainability risk". It applies from March 1, 2021 to financial market participants and financial advisers, as the obliged subjects are required to disclose information on sustainability risk management policies, adverse sustainability impacts at product level,

remuneration policy and its relationship to the integrated sustainability risks, the integration of sustainability risks into investment decisions/advice and/or insurance advice, incentives with environmental and social characteristics, an index of sustainable investments, etc.

Reporting under this Regulation requires the collection and analysis of information from clients in the portfolio of the relevant obliged subjects. In this regard, Directive (EU) 2022/2464, the ESRS and the Taxonomy Regulations make a significant contribution to providing such information.

Between 2020 and 2024, the European Commission is preparing a series of acts called the Taxonomy Regulations. The EU Taxonomy aims to help direct investment towards economic activities in line with the objectives of the European Green Deal. It covers obliged entities under Directive 2022/2464 whose economic activities are included in these Regulations (taxonomy eligible activities). It defines criteria that an economic activity should meet to be defined as sustainable (taxonomy aligned activities) and reporting is carried out on three main indicators: "Green CAPEX", "Green OPEX" and "Green Turnover". Taxonomy disclosures are phased in from 2021 depending on the date of publication of the relevant Delegated acts.

7. Carbon Border Adjustment Mechanism

In 2023, Regulation (EU) 2023/956 of the European Parliament and of the Council (CBAM) was adopted. CBAM aims to protect the low carbon production by requiring the carbon footprint of imported EU goods to be considered in the taxation. The importers are obliged to purchase a Certificate and to report on the CO₂ emissions imported in EU on an annual basis. The Regulation will be in force from the Year 2026, and till then the reporting is relevant for the cement, iron and steel, aluminium, fertilizers, electricity and hydrogen industries only.

8. Sustainability Due Diligence

As per Directive (EU) 2024/1760 of the European Parliament and of the Council of 13 June 2024 (CSDDD) the entities within the scope of art.2 are obliged to identify and address adverse impacts related to their own operations and to their supply chain. In addition, the entities should on an annual basis report information regarding their due diligence process performed during the relevant year and the outcomes from it. The reporting is planned to take place in stages between 2027 – 2029, and till 2026 the Member states should transpose the Directive into their local legislation.

9. Simplification of the Sustainability Reporting Framework

The beginning of 2025 is characterized by political and social polarizations regarding the EU economy growth. The discussions cover also the Sustainability Regulatory Framework as an administrative burden for companies, especially for SMEs. Mario Draghi's Report 'The Future of Europe's Competitiveness' issued on 19th of September 2024 could be named as one of the initiators of these discussions.

Therefore, on 26th of February 2025 the European Commission came with proposals to reduce administrative burdens on business in terms of sustainability reporting, the so-called "Omnibus Package". This package presents significant amendments to the requirements applicable so far, such as:

- Higher thresholds for large companies;
- CSRD mandatory for large companies as per the new definition only;
- Simplification of ESRS disclosure requirements;
- "Stop-the clock" of CSRD Reporting for the second and third reporting waves with 2 years;
- Performing limited assurance on sustainability statements only;
- Cancelling the development of Sector specific standards;
- Higher thresholds for companies obliged under the Taxonomy Regulation;
- Postponement of the first wave of reporting under CSDDD;
- Limiting due diligence to direct business partners by excluding the SMEs and micro-enterprises;
- Removing the penalty of 5% from the turnover pursuant to Article 27(4) of CSDDD and others.

The Omnibus package raises many reasonable questions among professionals and business, such as: How does the Commission intend to monitor the progress toward its strategic goals, having in mind that its proposals will lead to a significant reduction in the number of obliged entities to report?; How will obliged entities perform their risk assessments?; What should the first wave of CSRD reporters expect and when?; How to act now in terms of CSRD reporting? and etc.

It's interesting to follow the political discussions and suggestions among the different political groups in the European Parliament as well as the relevant Committees and the EU Council, which can be opposite to each other, but in the meantime, there is a risk the Omnibus to turned on as a meaningless game of predominance with a significant negative impact on nature, society and businesses.

Currently, we are testifying to U-turn in political willingness to address the climate change challenges in EU and respectively to increase the transparency regarding the environmental and social impacts on different economic activities under the pretext that there is a need to reduce the administrative burdens for SME's and to boost the EU economic competitiveness. This can be evidenced by reviewing suggestions regarding the scope of CSRD, Taxonomy and CSDDD, where the number of employees for "large entity" varies from 250 to 10 000. There is a similar trend for the economic thresholds as well. The proposed deletion of Transition plan requirements from CSDDD also leads to mixed reactions a sense of "deregulation" among different stakeholders.

10. Conclusion

Sustainable economic growth and climate change are an important topic covered and gradually developed in different EU regulations during the years. This way of regulation establishment creates complexity, overlaps, contradictions in some cases and respectively challenges to be implemented. In this regard the legislation setting process should be subject to ongoing monitoring, adjustments and upgrade. However, there should be bear in mind that urgent changes without proper stakeholder engagement, experts' consultations and impact assessments lead to many uncertainties, losing faith in the objectivity of the EU policy makers and in the resilient economic growth.

Regarding the Sustainability Reporting Regulatory Framework, end of the Year 2025 will be crucial to have clarity on the Omnibus outcomes, hoping that the European Commission, European Parliament and the EU Council will be able to apply a balanced approach, leading to "sanitation" and "synchronisation" based on a "Legislation Health Check" and not on a "simplification" that may compromise the constructive and objective EU policy making process. In the meantime, the ambitious EU goals related to decarbonization and green economy development remains valid. Investors and the financial institutions particularly are determined to increase their sustainability investment portfolio, which means that data availability as a topic will be still valid. Given all this, we can conclude that sustainability will continue to be a key and significant factor in the development of a competitive economy. In this regard, companies that are determined to follow formally adopted sustainability reporting norms to date, conduct due diligence on their value chains, and publish their Sustainability Reports increase the chance to attract investment and new partnerships, as well as to assure resilient and transparent growth.

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