

Regulatory Hotline

April 17, 2024

EU ESG REGULATIONS RESHAPING GLOBAL BUSINESS

- The European Union (EU) has implemented rigorous ESG regulations like the Corporate Sustainability Reporting Directive and Corporate Sustainability Due Diligence Directive, impacting both EU and non-EU companies operating within its jurisdiction, with penalties for non-compliance.
- Indian companies face challenges in adapting to these regulations, including resource-intensive reporting requirements and the need to go beyond existing SEBI framework to align with EU standards.
- However, embracing ESG principles presents opportunities for Indian companies to gain a competitive edge in EU markets, attract international investment and enhance brand value through sustainable practices.

INTRODUCTION

The European Union (EU) has been instrumental in spearheading sustainability initiatives through stringent Environmental, Social and Governance ("ESG") regulations. These regulations not only affect EU-based companies but also have far-reaching implications for non-EU entities operating within the EU's jurisdiction. This article explores the transformative impact of EU ESG regulations on global businesses, with a focus on non-EU companies and delineates the implications for India's corporate landscape.

EU ESG REGULATIONS

The EU has introduced a comprehensive suite of ESG regulations aimed at fostering sustainable business practices and mitigating environmental and social risks. The cornerstone of these regulations is the Corporate Sustainability Reporting Directive ("CSRD") and its underlying European Sustainability Reporting Standards,¹ which mandates large public-interest entities to disclose detailed ESG information. Additionally, the impending Corporate Sustainability Due Diligence Directive ("CSDDD" or "CS3D") imposes stringent due diligence obligations on companies, emphasizing accountability across global value chains.²

1. CSRD: The CSRD developed from pre-existing Non-Financial Reporting Directive ("NFRD"), mainly focuses on increasing the transparency and comprehensiveness of sustainability reporting for companies operating in EU. Entities subjected to the CSRD regulation must ensure the adoption of a robust financial and impact materiality assessment in place to ensure the disclosure of all sustainability information necessary to meet the objectives and requirements.³

CSRD shall be applicable to the following companies:⁴

| Category | Eligibility Criteria | Reporting |
|--|---|---|
| Large "public interest" undertakings ⁵ | Large public listed undertakings on EU-regulated market and which have an average employees exceeding 500. | FY starting on or after 1 st January, 2024 |
| Large undertakings ¹ . | Large EU companies, including subsidiaries of non-EU companies who meet at least two of the following: <ol style="list-style-type: none"> 1. More than 250 or more employees; 2. Net turnover of > € 50 million; or 3. Total assets exceeding € 25 million. This includes the EU parent if a larger group that meets the above criteria on consolidated basis. Furthermore, these thresholds apply regardless of whether the entity is listed or not. | FY starting on or after 1 st January, 2025 |
| Listed small and medium-sized enterprises ("SMEs") | SME listed on an EU-regulated market, excluding "micro undertakings" | FY starting on or after 1 st January, 2026 (*with an opt-out right for an |

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| | | additional 2 years) |
| Non-EU undertakings / Third country undertakings | Non-EU company with a net turnover of \geq 150 million in EU at a consolidated level, conducting "significant activities" in EU. | FY starting on or after 1 st January, 2024 |

2. CS3D: The CS3D which recently received the consensus of the EU Council, imposes obligation on the companies to address the negative impacts of both an environmental and human rights perspective. According to the latest compromise text, the CS3D will be applicable to the following companies:⁶

| Companies | Eligibility Criteria |
|--|--|
| Group - 1 Companies | All EU limited liability companies with 1000 (previously 500+) employees and \geq 450 million (previously \geq 150) in net turnover worldwide in the last financial year. |
| Group - 2 Companies | Other EU limited liability companies operating (to the extent of 50% of turnover generated) in defined high impact sectors such as textiles, agriculture and mineral extraction, which do not meet both Group 1 thresholds, but have 250+ employees and a net turnover of \geq 40 million+ worldwide in the last financial year. |
| Non-EU Companies active in the EU | Turnover thresholds generated in the EU should be more than \geq 450 million. |

As per the latest revised version of CS3D approved by the EU Council, the compromise sets out a phased manner of implementation as set out below for EU and Non-EU (group of) companies, except for non-EU companies the employee threshold does not apply:

| Workforce | Reporting |
|--|----------------------|
| More than 5,000 individuals and turnover of \geq 1.5 billion | Within 3 year period |
| More than 3,000 individuals and turnover of \geq 900 million | Within 4 year period |
| More than 1,000 individuals and turnover of \geq 450 million | Within 5 year period |

Impact on non-EU companies

The extraterritorial reach of EU ESG regulations extends to non-EU companies conducting business activities within the EU's jurisdiction. Such companies are obligated to comply with ESG disclosure and due diligence requirements if they meet specified thresholds outlined by the CSRD and CS3D legislations. Compliance entails significant operational adjustments, resource allocation and governance enhancements to meet stringent regulatory standards. Potential penalties for non-compliance can include fines and exclusion from public tenders.

INDIA AND THE EU ESG RIPPLE EFFECT

India, as a major player in the global economy, is not immune to the reverberations of EU ESG regulations. Though CSRD and CS3D are EU directives, the CSRD applies to entities with a significant presence in the EU, regardless of their origin. This means that an Indian parent company with subsidiaries or significant activities in the EU will have to comply with the EU Directives and non-compliance can lead to penalties. The impact on Indian companies may be twofold:

1. Compliance challenges and opportunities:

- **Navigating complexities:** Indian companies, particularly those with a global footprint and EU market access, will need to adapt to EU ESG regulations. This necessitates reviewing current ESG practices, investing in robust data collection and reporting systems and enhancing stakeholder engagement.
- **Resource Intensity:** Meeting the CSRD's detailed reporting requirements, which cover aspects like greenhouse gas emissions, social impact and gender pay gap, will be resource-intensive for many companies. While the specific requirements may vary by industry, companies will need to independently report and potentially verify a significant amount of sustainability data.
- **Beyond SEBI Framework:** India's existing SEBI Business Responsibility and Sustainability Reporting Framework⁷ for ESG reporting, while a step in a positive direction, has limitations. The "one-size-fits-all" approach might not adequately capture industry-specific ESG metrics. To truly thrive, Indian companies will need to go beyond mere compliance with domestic regulations.

2. Competitive Dynamics and Strategic Imperatives:

- **Level Playing Field:** EU ESG regulations create a level playing field for companies adhering to sustainable practices, influencing global competitiveness. Indian companies that proactively embrace ESG principles and align with EU regulatory standards gain a competitive edge in accessing EU markets and attracting international investment that increasingly prioritizes sustainability factors.

■ **Market Differentiation and Long-Term Gains:** Demonstrating a genuine commitment to ESG principles through actions, not just reports, enhances brand value and attracts environmentally and socially conscious consumers. Strong ESG practices throughout the supply chain can also mitigate risks and improve operational efficiency. By embracing sustainability as a strategic imperative, Indian companies can position themselves as leaders in responsible business conduct, driving long-term value creation and resilience in a sustainability-driven world.

CONCLUSION

The transformative impact of EU ESG regulations reverberates across the global business landscape, shaping corporate behaviour, market dynamics and regulatory frameworks. For non-EU companies, particularly those in India, navigating this regulatory landscape presents both challenges and opportunities. By embracing sustainability as a strategic imperative and aligning with EU regulatory standards, Indian companies can position themselves as leaders in responsible business conduct, driving long-term value creation and resilience in an increasingly interconnected and sustainability-driven world.

– Sehar Sharma and Rahul Rishi

You can direct your queries or comments to the authors.

¹The Commission adopts the European Sustainability Reporting Standards, European Commission, 31st July, 2023, https://finance.ec.europa.eu/news/commission-adopts-european-sustainability-reporting-standards-2023-07-31_en.

²Directive (EU) 2022/2464 of the European Parliament and of the Council of 14 December 2022 amending Regulation (EU) No 537/2014, Directive 2004/109/EC, Directive 2006/43/EC and Directive 2013/34/EU, as regards corporate sustainability reporting.

³Distilling the alphabet soup of ESG-related regulation by the EU, Thomson Reuters< <https://www.thomsonreuters.com/en-us/posts/esg/related-eu-regulation/>>.

⁴https://finance.ec.europa.eu/capital-markets-union-and-financial-markets/company-reporting-and-auditing/company-reporting/corporate-sustainability-reporting_en

⁵The definition of "public interest undertaking" includes EU companies that are either: (i) listed on a regulated EU stock market; (ii) a specific form of financial services company (e.g., insurance company or credit institution, meaning that unlisted financial institutions may also be subject to the requirements of CSRD); or (iii) have been specifically designated a public interest entity by their country of incorporation. Such public interest undertakings (that are not micro-undertakings) will be within the scope of the CSRD even if they do not meet the size requirements to be considered a large company.

⁶<https://data.consilium.europa.eu/doc/document/ST-6145-2024-INIT/en/pdf>

⁷GUIDANCE NOTE FOR BUSINESS RESPONSIBILITY & SUSTAINABILITY REPORTING FORMAT< https://www.sebi.gov.in/sebi_data/commndocs/may-2021/Business%20responsibility%20and%20sustainability%20reporting%20by%20listed%20entitiesAnnexure2_p.PDF>.

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