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Approach to CSRD Implementation

May 2024

Agenda

1. CSRD overview and interaction with wider sustainability framework
2. Scope, applicability and key requirements
3. Challenging metrics and discussion
4. Appendices

What is CSRD?

EU regulation to lift sustainability reporting to the same level as financial reporting

The CSRD came into force on 5 January 2023

- The Corporate Sustainability Reporting Directive (CSRD) amends the existing Non-Financial Reporting Directive (NFRD)* and **substantially increases reporting requirements on companies falling within its scope.** (See comparison table in Appendix I for further detail).
- Companies subject to CSRD will have to report according to European Sustainability Reporting Standards (ESRS).

Reporting is primarily dependent on a materiality assessment

- ESRS maintains a "**double materiality**" approach, obligating companies to report both on: (il) **impact materiality** - their wider impact on people and the environment and (ii) **financial materiality** - how ESG issues create financial risk to the company and impacts opportunities attributable to business relationships.
- Metrics or standards must be disclosed if deemed material and companies must consider each materiality perspective in its own right.

Consolidated reporting in annual management report, with "limited assurance" for all sustainability metrics

- All reports must be **audited by an independent 3rd party** (mandatory assurance) and include both financial and non-financial metrics (sustainability/ESG data).
- **Reports must include Scope 3 emissions –** indirect emissions that result from a company's upstream and downstream activities.

Large companies expected to report in 2025, for fiscal year 2024

- **Mandatory reporting for the largest EU companies begins in 2025** for the 2024 reporting year, with mid-size and smaller companies coming in scope in subsequent years (i.e., from 2027 for the 2026 reporting year).

Source: European Commission, Boston College, WSJ, Dechert. K&L Gates
*See page 5 for European reporting progression

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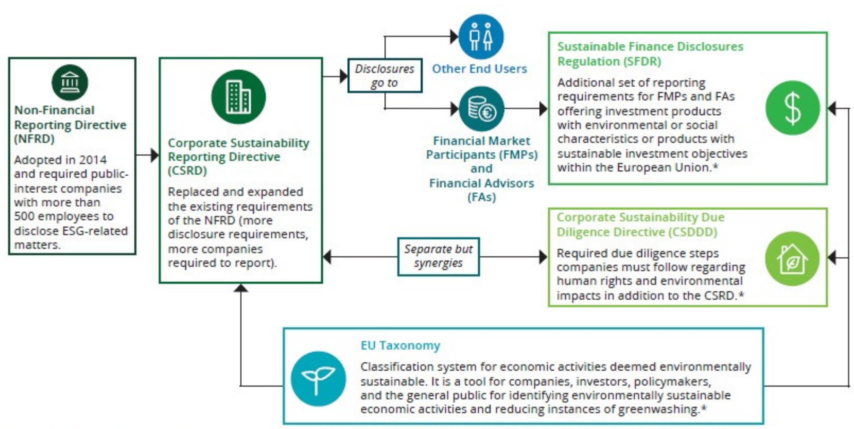
The Bigger Picture – Relationship between CSRD and EU Sustainability Reporting Framework (NFRD, CSRD, SFDR, CSDD, EU Taxonomy)

- CSRD is intended to contribute to the EU's transition to a fully sustainable financial and economic climate, which aligns closely with the European Green Deal and the UN Sustainable Development Goals. CSRD requires companies to disclose any plans they may have to ensure that their business model and strategy are compatible with the objectives of limiting global warming to 1.5 °C in line with the Paris Agreement and achieving climate neutrality by 2050.



Source: Deloitte, https://dart.deloitte.com/USDART/home/publications/deloitte/heads-up/2023/csrd-corporate-sustainability-reporting-directive-faqs
*Specific considerations related to organizational structure and E.U. footprint will dictate further applicability requirements across the additional E.U. standards and regulations.

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CSRD Reporting divided among twelve European Sustainability Reporting Standards (ESRS)

Cross-cutting standards

ESRS 1 - General requirements **ESRS 2** – General Disclosures	**Coming later (by June 2026):** Sector-specific standards SME's proportionate standards

Topical standards (Environmental)

ESRS E1 Climate change	**ESRS E2** Pollution	**ESRS E3** Water and marine resources	**ESRS E4** Biodiversity and ecosystems	**ESRS E5** Resource use and circular economy

Topical standards (Social)

ESRS S1 Own workforce	**ESRS S2** Workers in the value chain	**ESRS S3** Affected communities	**ESRS S4** Consumers and end users

Topical standards (Governance)

ESRS G1
Business conduct

Source: Deloitte, https://dart.deloitte.com/USDART/home/publications/deloitte/heads-up/2023/csrd-corporate-sustainability-reporting-directive-faqs and K&L Gates

Phased in approach for CSRD reporting

				Enterprise Level
	Reporting for Calendar-Year-End Filers			
	2024 (Reporting in 2025)	2025 (Reporting in 2026)	2026 (Reporting in 2027)	2028 (Reporting in 2029)
Scope	Companies already subject to the NFRD,* including large U.S. companies with more than 500 employees and listed on an E.U.-regulated market	All large** U.S. companies listed on E.U.-regulated markets and all large E.U. subsidiaries of U.S. companies	SME subsidiaries of U.S. companies listed on E.U.-regulated market***	U.S.-based companies that generate a net turnover of more than €150M in the European Union in each of the last two financial years *and* have *any* of the following: (1) At least one large** subsidiary (2) An SME subsidiary listed on an E.U.-regulated market (3) A branch with more than €40M net turnover
Required standards	ESRS (or equivalent[†] standards)		ESRS or specific standards for SMEs	ESRS, equivalent standards, or alternative specific standards for non-E.U. entities to be developed
Reporting level	Stand-alone subsidiary, unless included in the parent's report prepared under ESRS or equivalent standards for non-E.U. parent (i.e., consolidated group level)			*Consolidated group*, including non-E.U. activity
Assurance	Yes, limited assurance over all reported sustainability information			Yes, *limited assurance* over *all* reported sustainability information

*Companies already subject to the Non-Financial Reporting Directive (NFRD) are large public-interest companies with more than 500 employees. Public-interest companies include companies listed on an E.U.-regulated market, banks, insurance companies, and other companies designated by national authorities as public-interest entities.

**Large undertaking/large group is defined by the CSRD as an E.U. entity or an E.U. parent entity (on a consolidated basis) that meets two or more of the following three criteria: >350 employees on average, >EUR 25M balance sheet, >EUR 50M turnover

***Small and medium-sized undertakings (SMEs) can choose to defer reporting for two years until 2028

[t] What may be deemed "equivalent" is yet to be determined by the European Commission (EC)

Source: Deloitte; https://dart.deloitte.com/USDART/image-preview?s=%2Fov-resource%2F1%2F7619eea0-6e19-40e4-8b93-a4541df16d66

Scope and applicability of CSRD

EU Companies

- "Large" companies, i.e., those meeting two of the following three criteria: (i) balance sheet of EUR 25m, (ii) turnover (gross revenue) of EUR 50m, or (iii) 250 average number of employees*;
- Parents of a "large" group (according to the thresholds for "large" above, and where the parent also qualifies as an "undertaking");
- Any EU listed company, excluding micro-enterprises; OR
- Large or listed insurance undertakings or credit institutions.

Non-EU companies

A Non-EU Group or company is in scope if it has a "significant presence" in the EU, i.e., if the company or group has:

- Turnover (gross revenue) of EUR 150 million or more in the EU for each of the last two consecutive financial years, AND

The company has at least one of the following:

- An EU branch with a net turnover of at least EUR 40 million in the EU**; OR
- An EU subsidiary that is a "large" undertaking, i.e., meeting at least two of the above three criteria for "large" companies

Exemptions

- In-scope companies that are subsidiaries and part of a parent company consolidated annual report need not report separately from their parent company, provided that the parent reports in accordance with the prescribed standards and the subsidiary's report contains certain information about reporting status, such as a link to the parent report.
- Therefore, exempted subsidiaries will still need to: (i) publish the consolidated management report of their parent company in accordance with local law requirements; (ii) include a reference in their own individual management report to the fact that they are exempted from reporting sustainability information under the CSRD; and (iii) include clear information and instructions on how investors/consumers may access the consolidated management report.

Source: PIMCO EMEA Regulatory Counsel, Dechert, Deloitte, K&L Gates

*The definition of "employee" and how to calculate the average may vary among E.U. member states (i.e. depends on national law).

**The CSRD does not specify how net turnover should be calculated for this requirement, Deloitte has interpreted it to cover net turnover from the perspective of a global consolidated group to customers in the European Union. Net turnover is allocated according to the location of the customer at the time of the transaction or the place in which a service was provided, irrespective of where the supplier or service provider is located.

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Scope and applicability of CSRD cont.

Exemptions

- Undertakings for the Collective Investment in Transferable Securities ("UCITS") and Alternative Investment Funds ("AIFs") are exempt. However, there are a number of areas that will require clarifications. For example, segregated accounts, co-investment schemes, special vehicles and holding companies are not explicitly exempt. Therefore, asset managers of UCITS and/or AIFs still need to assess carefully to determine whether they (or any of the vehicles they manage and/or underlying products) are in scope.
  - UCITS and AIFs are within scope of alternative reporting requirements in their annual reports under the EU Sustainable Finance Disclosure Regulation ("SFDR"). The ESRS will increase the availability and quality of data available for fund managers to meet their SFDR disclosure requirements, to the extent that their funds invest in companies within scope of CSRD (i.e., CSRD increases the number of companies within scope of its sustainability reporting requirements from approx. 11,000 under the NFRD to approx. 49,000).
- Many of the data points are subject to a materiality assessment, meaning that the reporting entity can omit those data points if they do not deem them to be material to the reporting entity's business.
- Firms are also not required to disclose intellectual capital, intellectual property, know-how or the results of innovation that would qualify as trade secrets under the provisions of the Directive on the Protection of Trade Secrets ((EU) 2016/943). For these purposes, a 'trade secret' means information meeting all of the following requirements:
  - It is secret in the sense that it is not, as a body or in the precise configuration and assembly of its components, generally known among or readily accessible to persons within the circles that normally deal with the kind of information in question;
  - It has commercial value because it is secret; and
  - It has been subject to reasonable steps under the circumstances, by the person lawfully in control of the information, to keep it secret

Source: PIMCO EMEA Regulatory Counsel, Dechert, Willkie Farr & Gallagher, K&L Gates

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CSRD Content Requirements*

Under CSRD, these sustainability requirements must be identified within the management report:

Business model and strategy

- The resilience of the company's business model and strategy in relation to risks related to sustainability matters
- The opportunities for company related to sustainability matters
- The plans of the company, including implementing actions and related financial and investment plans, to ensure that its business model and strategy are compatible with: (i) The transition to a sustainable economy , (ii) The limiting of global warming to 1.5°C in line with the Paris Agreement , (iii) The objective of achieving climate neutrality by 2050 as and where relevant
- The exposure of the company to coal, oil and gas-related activities
- How the company's business model and strategy take account of the interests of the company's stakeholders and the impacts of the company on sustainability matters
- How the company's strategy has been implemented with regard to sustainability matters

Time bound targets, administrative, management and supervisory roles, policies

- A description of the time-bound targets related to sustainability matters set by the company, including where appropriate absolute greenhouse gas emission reduction targets at least for 2030 and 2050, a description of the progress the company has made towards achieving those targets, and a statement of whether the company's targets related to environmental factors are based on conclusive scientific evidence
- A description of the role of the administrative, management and supervisory bodies with regard to sustainability matters, and of their expertise and skills in relation to fulfilling that role or the access such bodies have to such expertise and skills
- A description of the company's policies in relation to sustainability matters
- Information about incentive schemes linked to sustainability matters which are offered to members of the administrative, management and supervisory bodies

See EU and UK Appendix I for sample structure of ESRS sustainability statement

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CSRD Content Requirements (cont.)

Under CSRD, these sustainability requirements must be identified within the management report:

Due Diligence and value chain, actual/potential adverse impacts and risks

- A description of the due diligence process implemented by the company with regard to sustainability matters, and where applicable in line with EU requirements imposed on companies while conducting a due diligence process
- The due diligence process concerns the whole value chain of the company including its own operations, its products and services, its business relationships and its supply chains
- In line with the UN Guiding Principles on Business and Human Rights, an actual or potential adverse impact is to be considered a principal impact where it ranks among the greatest impacts connected with the company's activities based on: the gravity of the impact on people or the environment; the number of individuals who are or could be affected, or the scale of damage to the environment; and the ease with which the harm could be remediated, restoring the environment or affected people to their prior state
- For the first three years of the application of CSRD, if not all the necessary information regarding the value chain is available, the company may explain the efforts made to obtain the information about its value chain, the reasons why this information could not be obtained, and the plans of the company to obtain such information in the future
- A description of the principal risks to the company related to sustainability matters, including a description of the company's principal dependencies on those matters, and how the company manages those risks

CSRD sustainability information included in the management report should:
- specify whether data is related to short, medium and long-term horizons
- Where applicable, contain references to and explanations regarding the amounts reported in the annual financial statements

The sustainability reporting standards should promote a more integrated view of all the information published by the company within the management report, in order to provide users with a better understanding of the development, performance, position and impact of the company.

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CSRD Formatting Requirements

Digitization of sustainability information	▪ Companies are required to tag reported information in accordance with a digital taxonomy which is in the process of being developed. ▪ Under this digital taxonomy, companies are required to digitize and identify their sustainability information to make it accessible with the EU's European Single Access Point (ESAP) database. This is intended to improve the accessibility of sustainability data for users and assist in promoting transparency and comparability.
Limited assurance	▪ All companies within scope of CSRD are required to seek limited assurance of sustainability reporting from a third-party verifier in their first reporting year. This includes digital tagging and the indicators to be reported in the management report under Article 8 of the Taxonomy Regulation (i.e., "green" turnover, capital expenditure and operating expenditure for corporates). ▪ The EC will carry out an assessment to determine whether moving from limited to reasonable assurance is feasible for auditors and for companies. Following this assessment, the EC will adopt assurance standards for reasonable assurance no later than 1 October 2028. The assurance can be carried out by the company's financial statement auditor. To note, limited assurance has a lower assurance threshold than reasonable assurance, therefore the verification/assurance process under the latter should be less time consuming and less extensive. ▪ CSRD amends the Audit Directive to include requirements regarding the educational qualifications and professional competence that demonstrate that statutory auditors have the necessary involvement, skills and knowledge to perform assurance over sustainability reporting ▪ Member States will have the option to require that the opinion is included as a separate section of the audit report. Member States will also have the option to allow an auditor that is not the statutory auditor or an independent assurance services provider (IASP) to provide assurance on undertakings' sustainability reporting, as long as they are subject to requirements that are equivalent to those applicable to auditors in the Audit Directive when providing assurance on sustainability reporting. Their opinion will need to be published with the annual financial statements and the management report

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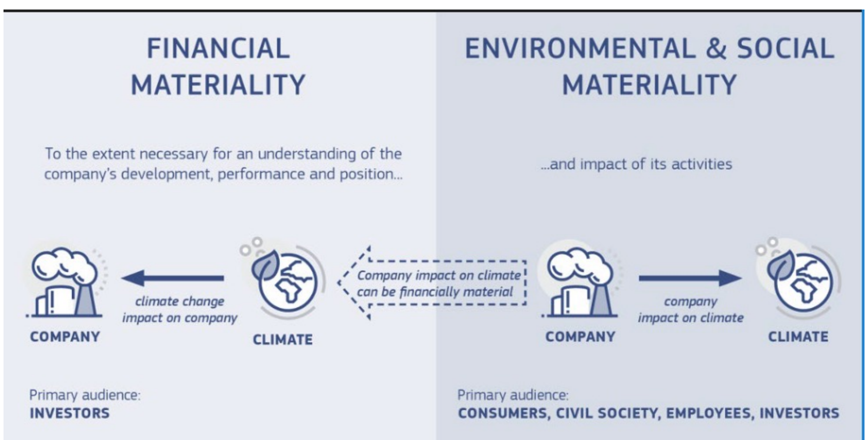
ESRS – Double Materiality Approach

Companies are required to report on their impacts on people and the environment, as well as how social and environmental issues pose financial risks and opportunities. (See EU and UK Appendix I for more detail)



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CSRD metrics that may present legal and/or reputational risk for U.S. firms

Potentially Problematic Requirements

Social

- Percentage gap in pay between its female and male employees and the ratio between the remuneration of its highest paid individual and the median remuneration for its employees (S1-16)
- Percentage of employees with disabilities (S1-12)
- Number of work-related incidents and/or complaints and severe human rights impacts, and any related material fines, sanctions or compensation for the reporting period (S1-17)
  - Including work-related incidents of discrimination on the grounds of gender, racial or ethnic origin, nationality, religion or belief, disability, age, sexual orientation, etc. This includes incidents of harassment as a specific form of discrimination

Environment

- When conducting a materiality assessment on environmental subtopics, the undertaking shall assess the materiality of resource use and circular economy in its own operations and its upstream and downstream value chain (materiality assessment)

Governance

- Political influence and lobbying activities (means financial or in-kind support provided directly to political parties, their elected representatives or persons seeking political office) (G1-5)

Discussion Topics – Regulatory Interpretation By Firms

- Remuneration metrics
- Demographic data (gender, disability, etc.)
- Discrimination and harassment incidents
- Treatment of 3rd party AUM for environmental metrics
- Materiality assessments: own balance sheet (i.e., proprietary assets) or 3rd party assets
- "In-kind" political contributions

Source: ESRS; https://eur-lex.europa.eu/legal-content/en/TXT/?uri=CELEX:32023R2772

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Appendix I – Further EU and UK climate disclosure materials

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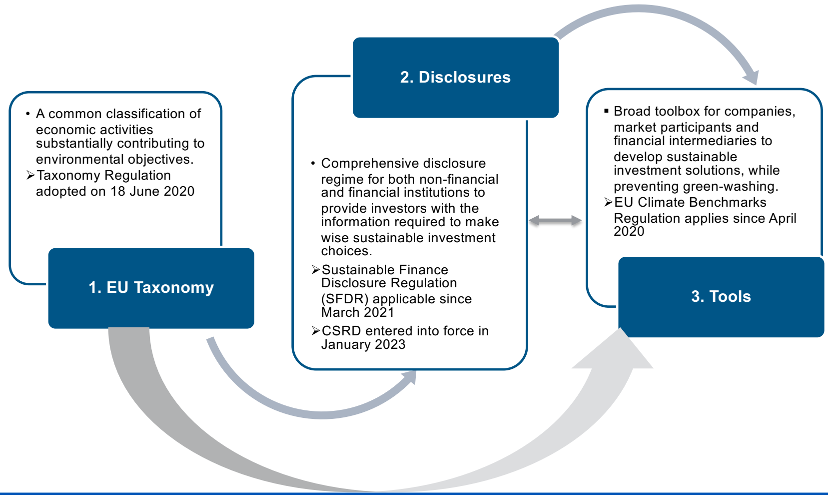
Macro Outlook: EU's sustainability policies framework

There are three Key Foundations under the EU's sustainability policies framework:



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Macro Outlook: Current Landscape of Sustainability Disclosure (high level comparison of different disclosures)

International sustainability Board (ISSB)	Corporate Sustainability Reporting Directive (CSRD)	UK Sustainability disclosure framework (including FCA Disclosures and TCFD)	EBA ESG Pillar 3 Framework
▪ Created in 2021 by the International Financial Reporting Standards Foundation (IFRS) and aims to develop a comprehensive global baseline for sustainability disclosure standards. ▪ Two standards published in June 2023: general sustainability-related disclosure standards & climate-related disclosure standards. ▪ Countries such as the UK, Australia, Canada, Japan, New Zealand and Singapore are working toward requiring disclosures aligned	▪ CSRD will apply in a phased way to different entities. It entered into force in January 2023. ▪ EFRAG published its 1st set of draft reporting standards 'ESRS' under CSRD in November 2022. ▪ The European Commission adopted the European Sustainability Reporting Standards (ESRS) in July 2023. ▪ ESRS effective dates vary for different entities, with first reporting starting from ranging from FY 2024 to 2028. ▪ EU Member States have 18 months from January 2023 to transpose CSRD to mandatory requirements for fiscal year on or after.	▪ UK FCA disclosure requirements are included in the Financial Conduct Authority (FCA) Environmental, Social and Governance Sourcebook (ESG Sourcebook). ▪ Pre-existing Task Force on Climate Related Financial Disclosure Recommendations (TCFD) are referenced within the ESG Sourcebook. (For more on TCFD, see EU and UK Appendix I). ▪ On 6 April 2022, The Companies (Strategic Report) (Climate Related Financial Disclosure) Regulations 2021 (the Regulations) came into force, amending the Companies Act 2006. The Regulations make sustainability reporting in accordance with the TCFD compulsory for a number of U.K. companies as part of their strategic reporting. (similar to CSRD)	▪ Disclosure on ESG risks incurred by listed banks. ▪ Templates to be completed: 10 quantitative and 3 qualitative. ▪ Allow market participants to compare sustainability performance of institutions. ▪ Supporting the aims of the EU Green Deal, providing transparency for ESG risk management. ▪ Public consultation on two draft Implementing Technical Standards launched in December 2023. This public consultation closes in April 2024. There are no effective rules as of yet.

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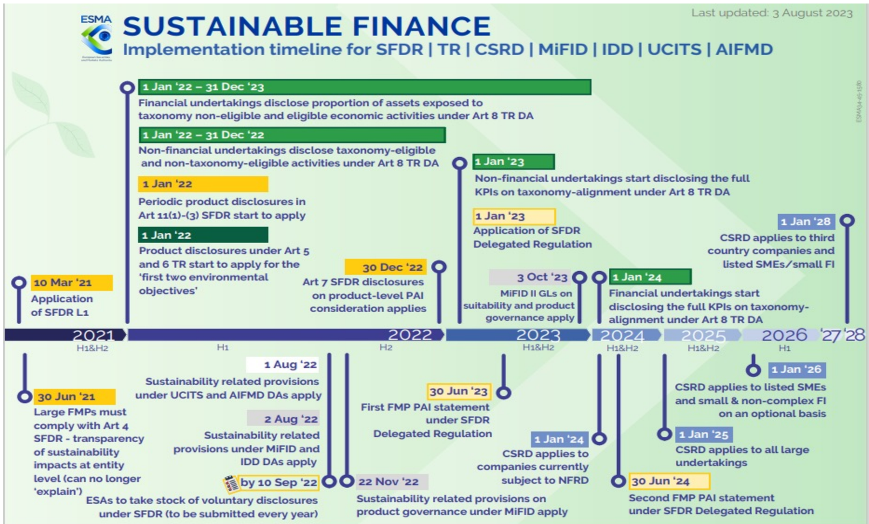
Implementation Timeline - Context of CSRD as part of the Sustainability Regulatory Framework under the EU



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Evolutionary Framework – Comparing NFRD (the old) and CSRD (the new)

	NFRD	CSRD
Policies and requirements	▪ Environmental Protection ▪ Social responsibility and treatment of employees ▪ Respect for human rights ▪ Anti-corruption and bribery ▪ Diversity on company boards	In addition to NFRD requirements, companies must report: ▪ Strategy, targets, and the role of the board and management ▪ Principal adverse impacts connected to the company and its value chain, intangibles, & how they have identified the reporting information
Double materiality	Not referenced/ applicable	Takes a double materiality approach, where companies report on how their business impacts the environment 'inside out' as well as how environment impacts business 'outside in' in addition to social matters
Detailed reporting disclosures	No reporting standards and lacks explicit comparability	New detailed mandatory standards via the ESRS
Audit/assurance	No requirement for third party assurance	EU wide requirement for limited assurance, with later movement toward reasonable assurance
Reporting format	Online or in pdf format	XTHML format according to the European Single Electronic Format (ESEF) regulation
Located reporting	No reference	Inclusion in the management report as a single document in a digital, machine-readable format

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TCFD Framework – UK Sustainability Disclosure Requirements

Governance

Disclose the organization's governance around climate-related risks and opportunities.

Strategy

Disclose the actual and potential impacts of climate-related risks and opportunities on the organization's businesses, strategy, and financial planning where such information is material.

Risk Management

Disclose how the organization identifies, assesses, and manages climate-related risks.

Metrics & Targets

Disclose the metrics and targets used to assess and manage relevant climate-related risks and opportunities where such information is material.

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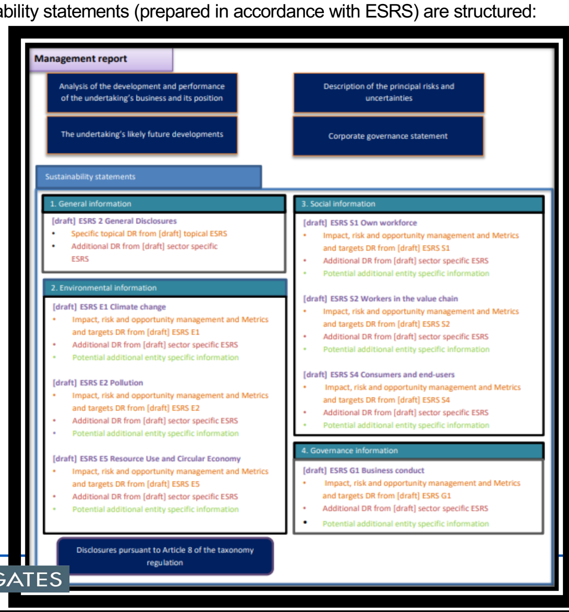
Sample structure of ESRS sustainability statement

Example of how sustainability statements (prepared in accordance with ESRS) are structured:



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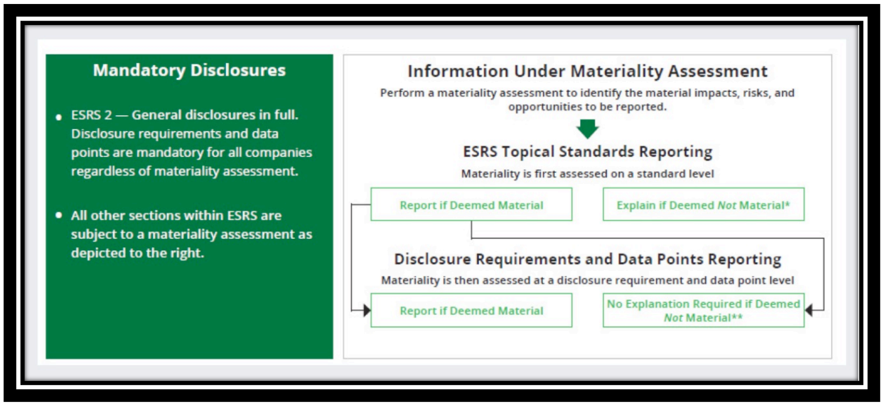
Double materiality approach – disclosing material vs non-material risks, impacts and opportunities under ESRS



- A detailed explanation is required when ESRS E1 climate change is deemed to be not material. For all other topical standards deemed not material, explanatory disclosures are optional.
- An explicit statement is required if the data point is "not material."

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Appendix II – U.S Climate Disclosure materials

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In some U.S. jurisdictions, climate laws are becoming more prevalent

Local

- **California recently passed the first mandatory climate reporting obligations**
- Goldman Sachs estimates California's Climate Accountability laws will likely impact roughly 4,000 public companies, almost half of which are likely already subject to CSRD
- Timing and practical implementation remains subject to change via further legislation in the next calendar year
- California has also enacted a **bill requiring disclosures by businesses buying, selling, or using voluntary carbon offsets**. The bill requires disclosures by entities making claims about the achievement of net zero emissions or that the entity or product has made significant reductions to emissions

Federal

- In March 2024, the SEC issued a final rule that requires registrants to provide climate-related disclosures in their annual reports and registration statements, **beginning with annual reports for the year ending 2025**
- **Disclosures will be subject to existing audit requirements for financial statements** and include:
  - **Material Scope 1 and Scope 2 GHG emissions, subject to assurance requirements that will be phased-in (no scope 3 emissions)**
  - Governance and oversight of material climate-related risks
  - The material impact of climate risks on the company's strategy, business model, and outlook
  - Risk management processes for material climate-related risks
  - **Material climate targets and goals**
  - **SEC voluntarily stayed rule in April 2024**

Source: GS Sustain, PIMCO Global ESG Regulations Overview, Deloitte

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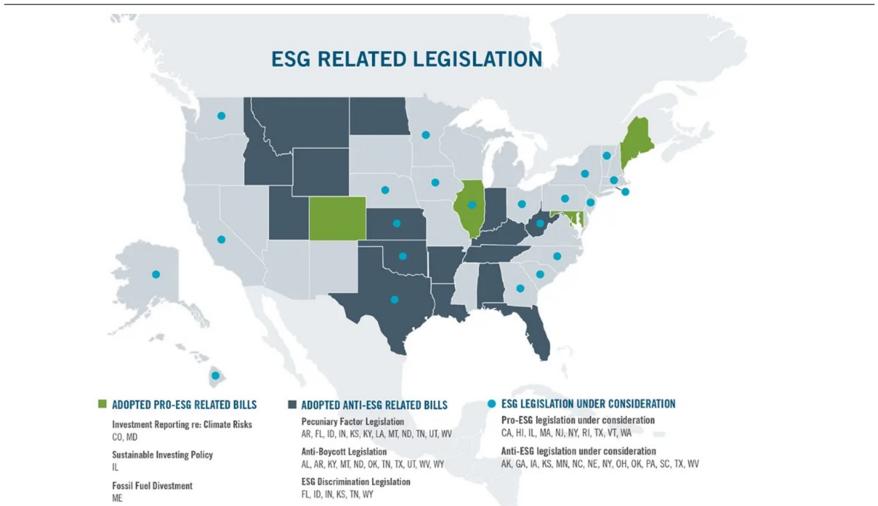
However, sustainability continues to be polarizing and U.S. firms are navigating diverging legislation and litigation on sustainability issues



As of 25 July 2024
Source: K&L Gates; https://www.klgates.com/2023-ESG-State-Legislation-Wrap-Up-7-19-2023

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