CLIENT MEMORANDUM

Changes Ahead for Corporate Sustainability Disclosures Following Publication of New EU Directive

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The European Union Council adopted and published Directive 2014/95/EU (the "2014 Directive") on the disclosure of non-financial and diversity information (a/k/a Corporate Social Responsibility ("CSR") matters) on September 29 and November 15, 2014, respectively. The new Directive, which has the force of law, amends the 2013 Accounting Directive (Directive 2013/34/EU) and establishes new environmental, social, and governance ("ESG") (a/k/a sustainability) reporting requirements for covered enterprises, including companies based in the United States. Accordingly, companies should evaluate the 2014 Directive's potential applicability and change their practices as necessary to come into compliance before enforcement commences in 2017. This briefing is intended to help companies determine whether they will be subject to regulation under the new directive, and if so, what is required.

Background

The 2014 Directive marks the most recent action by EU regulators determined to spur broader sustainability transparency by corporations. The new rules set forth in the 2014 Directive build on two prior resolutions of the European Parliament (78/660/EEC and 83/349/EEC) highlighting the importance of disclosures on sustainability factors, in particular, social and environmental matters, as well as matters relating to anti-bribery and corruption. These resolutions were formally adopted in June 2013 as the 2013 Accounting Directive on the preparation of annual and consolidated financial statements. The

2013 Accounting Directive included a requirement that certain companies include CSR disclosures in their annual reports. The 2014 Directive now provides additional clarity regarding the nature and scope of such disclosures.

Directive 2014/95/EU

Applicability Determination

The 2014 Directive is applicable to all companies incorporated in EU Member States that meet the criteria set out below. The new directive will also impact U.S. companies that are EU exchange-listed and, potentially, U.S. companies with a presence in an individual Member State significant enough for that Member State to designate the company as an entity subject to the reporting requirements.

The 2014 Directive specifically targets “large” companies, defined by reference to the number of employees, balance sheet total, and net turnover. The European Council had previously called for the regulatory burden for small- and medium-sized enterprises (“SMEs”) to be reduced, and as such SMEs are exempt from certain regulatory requirements, including the obligation to file a non-financial statement. For the purpose of the 2014 Directive, “large” companies are defined as those that:

- Have more than 500 employees;
- Are “public-interest” organizations, which are defined to include EU exchange-listed companies as well as some unlisted companies, such as credit institutions, insurance undertakings, and other businesses selected by Member States (based on size, number of employees, and/or activities); and
- Have a balance sheet total of at least EUR$20 million (approximately USD$25 million) or a net turnover of at least EUR$40 million (approximately USD$50 million).

What are the reporting requirements?

Large companies will be required to submit ESG disclosures (a/k/a “non-financial statement(s)”) either within the annual corporate report or as a separate filing. Where a separate filing is made, it should either be published with the management report or be made publicly available on the company’s website (within six months of the balance sheet date) and referred to within the management report. The non-financial statement can be filed by the group/parent company, rather than individually by all affiliate companies. Covered enterprises must be prepared to provide information relating to, at a minimum:

- Environmental matters (including, but not limited to, current and foreseeable impacts on environment, health, and safety issues, the use of renewable and/or non-renewable energy, greenhouse gas emissions, water use, and air pollution);

- Social and employee-related matters (including, but not limited to, gender equality, implementing fundamental conventions of the International Labor Organization, trade union rights, health and safety at work, and engagement with local communities);
- Human rights (specifically, "respect for human rights");
- Anti-corruption and bribery issues; and
- Diversity in the company's board of directors.

The 2014 Directive provides companies with significant flexibility in tailoring ESG disclosures, including through the use of recognized international, European, or national guidelines, such as the United Nations Global Compact,[1] ISO 26000,[2] the OECD Guidelines for Multinational Enterprises,[3] or the Global Reporting Initiative.[4] Although no official guidelines for preparing a non-financial statement currently exist,[5] the following elements must be included in the company's ESG analysis:

- The company's business model;
- The company's policies, as well as information about its due diligence process, including, but not limited to, the supply chain;
- Outcomes of the company's policies and risks associated with its operations; and
- Non-financial key performance indicators relevant for the business.

In relation to anti-bribery and corruption issues, the 2014 Directive provides that the non-financial statement could include information on instruments a company has in place to fight bribery and corruption. Given that the United Kingdom ("UK") Bribery Act,[6] the primary anti-bribery and corruption legislation in the UK, and the Foreign Corrupt Practices Act (the

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1 https://www.unglobalcompact.org/

2 http://www.iso.org/iso/home/standards/iso26000.htm

3 http://www.oecd.org/corporate/mne/

4 https://www.globalreporting.org/

5 Non-binding guidelines are scheduled to be published, following a consultative process with stakeholders, by December 6, 2016.

6 Section 7 of the UK Bribery Act provides that a company will be guilty of an offense if any person associated with the company bribes another person with the intention of obtaining, retaining, or gaining an advantage in business unless the company can show that it had "adequate

"FCPA"),[7] the equivalent U.S. legislation, provide powerful incentives for companies to establish and maintain strong anti-bribery and corruption polices and procedures, it would be prudent for a company to include information in its non-financial statement on any anti-bribery and corruption instruments it has in place.

Compliance

The 2014 Directive adopts the "comply or explain" principle; if a company fails to pursue policies relating to anti-bribery and corruption, environmental, or other non-financial matters, it will have to explain why in its annual report. Because Member States have until December 6, 2016, to transpose the 2014 Directive into national law, specific penalties for failure to comply have not yet been determined. However, the directive does instruct Member States to "ensure that adequate and effective means exist to guarantee disclosure of non-financial information . . ." and to that end, that "effective national procedures are in place to enforce compliance with the obligations laid down by this Directive. . . ."

Plan Ahead

Trends show that many companies already recognize the potential relevance and importance of non-financial disclosures to key stakeholders. Of the world's 250 largest corporations, 95% currently produce CSR reports.[8] Among the largest U.S. corporations, 86% file such reports, which represents a 12% increase (up from 74%) over the past five years (between 2008 and 2013).[9] Although CSR reporting of some kind or another is now commonplace in most enterprises, the efficacy of such disclosure will remain "in the eye of the beholder" until mainstream consensus emerges around fundamental areas such as content and scope.[10]

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procedures" in place to prevent people from engaging in such conduct. Section 7(5) of the Bribery Act provides that this offense extends to both companies incorporated in the UK and companies incorporated elsewhere, which carry on a business, or part of a business in the UK.

7 The U.S. Department of Justice (the "DOJ"), the agency tasked with enforcing criminal violations of the FCPA, considers the existence and effectiveness of a company's pre-existing compliance program in making charging decisions and in determining proper sanctions. *See* United States Attorneys' Manual, Title 9-28.300 – Prosecution of Business Organizations; *see also* United States Sentencing Guidelines Manual, § 8C2.5(f).

8 Carol Casazza, *Oversight of Corporate Sustainability Activities*, DIRECTOR'S HANDBOOK SERIES 2014: EXECUTIVE SUMMARY (National Association of Corporate Directors & Ernst & Young LLP), at 3; *see also Corporate Sustainability Reports Reach 86% of US Largest Companies*, SUSTAINABLEBUSINESS.COM, Dec. 9, 2013, http://www.sustainablebusiness.com/index.cfm/go/news.display/id/25389.

9 *Id.*

10 KPMG ranked the "quality" of CSR reports for "demonstrating a superior understanding of the impact of social and environmental issues on their business, and reporting on their strategy, performance and interaction with stakeholders[,]" and out of a possible score of 100, the 250 largest global companies and the largest U.S. companies received scores of only 59 and 54, respectively, indicating significant room for improvement on sustainability reporting. *Corporate Sustainability Reports Reach 86% of US Largest Companies*, *supra* n.8.

To that end, companies should assess the applicability of the 2014 Directive and, if they are covered, begin factoring the elements of the new requirements into their internal policies and procedures. This should include measurement, monitoring, and reporting of ESG performance, so that covered companies are positioned to provide appropriate disclosures by the 2017 deadline. Subsidiaries or affiliates of entities covered by the 2014 Directive, as well as other companies along the parent's supply chain, should also anticipate data requests from related entities (especially parent corporations), and continue to monitor relevant ESG reporting initiatives of major stakeholders.

If you have any questions about this memorandum or would like additional information, please contact William Thomas (202 303-1210, wthomas@willkie.com), Annise Maguire (202 303-1162, amaguire@willkie.com), or the Willkie attorney with whom you regularly work.

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