Regulation by Disclosure: Expanded EU Corporate Social Responsibility Reporting

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Reporting as an alternative to regulation is a growing trend in corporate social responsibility initiatives. New or proposed EU disclosure rules include:

- Transparency: payments to governments by oil, gas, mining and logging companies
- Conflict minerals: tantalum, tin, tungsten and gold from civil war zones
- Social, human rights, environmental and anti-corruption reporting
- Diversity in management and supervisory boards
- Deferred action on country by country reporting of tax payments.

1. Transparency

The Extractive Industries Transparency Initiative (EITI), Transparency International, and Publish What You Pay (PWYP) call for extractive industries to disclose payments made to governmental authorities. Constituents in resource-rich countries should know what is paid for access to resources, and make governments accountable for how moneys are spent.

2013 EU Accounting and Transparency Directives[1,2] require disclosure in business registries in EEA countries and stock market repositories for companies engaged in extractive industries or logging of primary forests. Reporting is country-by-country and project-based, including:

- production entitlements

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[1] DIRECTIVE 2013/34/EU OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC, 2013 O.J. L 182/19 (Text with EEA relevance).

[2] DIRECTIVE 2013/50/EU OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 22 October 2013 amending Directive 2004/109/EC of the European Parliament and of the Council on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market, Directive 2003/71/EC of the European Parliament and of the Council on the prospectus to be published when securities are offered to the public or admitted to trading and Commission Directive 2007/14/EC laying down detailed rules for the implementation of certain provisions of Directive 2004/109/EC, 2013 O.J. L 294/13 (Text with EEA relevance).

- taxes
- royalties and dividends
- signature, discovery or production bonuses
- license, rental, entry of concession fees
- infrastructure payments

Amounts below €100 000 in a financial year are exempt. Non-listed companies subject to the Directive are those above two of three criteria: €40 million turnover, €20 million total assets, or 250 employees. Companies filing equivalent reports in a third country, e.g. to the US SEC, are also exempt.[3]

Transparency requirements may be extended to other industry sectors in the future.

2. Conflict Minerals

Conflict minerals are natural resources whose revenues fuel armed civil conflict, such as in the African Great Lakes region. Key minerals are tantalum, tin and tungsten (vital for computers and other products); gold; and diamonds.

The *US Wall Street Reform and Consumer Protection (Dodd-Frank) Act*, Section 1502, implemented by the Securities and Exchange Commission (SEC), requires *users* of conflict minerals that are listed on US stock exchanges to declare the origin of such minerals and comply with OECD Due Diligence[4] or comparable standards to ensure minerals only come from responsible sources. The rules thus affect global supply chains involving these companies.[5]

The EU draft directive[6] is designed to complement US requirements. It calls on *importers* to volunteer as responsible suppliers by certifying to the OECD Due Diligence standard. Voluntary self-certification by importers would be enforced by Member States. Infringement will trigger a notice of remedial action to be taken by the EU importer. If the response is inadequate, the authority will issue a non-recognition notice for the 'responsible importer' certificate. The importer, as well as the smelters and refiners in its supply chain, will be removed from the EU list of 'responsible

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[3] A US court said companies could report on a confidential basis and did not have to report if prohibited by the host country. This significantly weakens transparency. *American Petroleum Institute et al. v. SEC*, No. 12-cv-1668, 2013 WL 3307114 (D.D.C. July 2, 2013).

[4] OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas, http://www.oecd.org/investment/mne/mining.htm

[5] On April 14, 2014 the US Appeals Court for the District of Columbia Circuit vacated the SEC requirement that companies report that products had <u>not</u> been certified conflict free. Other requirements in the SEC rule were upheld. *National Association of Manufacturers et al. v. Securities and Exchange Commission* (No. 13-5252).

[6] Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL setting up a Union system for supply chain due diligence self-certification of responsible importers of tin, tantalum and tungsten, their ores, and gold originating in conflict-affected and high-risk areas {SWD(2014) 52}, {SWD(2014) 53} COM(2014) 111 2014/0059 (COD).

smelters and refiners'.

The draft Regulation contains a definition of 'conflict-affected and high-risk areas', but does not list specific countries. In contrast, Section 1502 of the US Dodd-Frank Act is directed to the Democratic Republic of Congo and neighbouring countries.

The EU and the OECD will also publish annually a global list of responsible smelters and refiners. Smelting (refining in the case of gold) is the last stage where information is known about the origin of the minerals. The Commission estimates that only a minority of smelters and refiners now carry out supply chain due diligence.

The EU requirements also add an additional step to OECD procedures: importers must provide the due diligence information to downstream purchasers, so they have a clear tool to identify responsible smelters or refiners.

The EU aims to encourage a market in the EU for responsibly traded minerals from conflict zones. Risk aversive business decisions have led EU and US operators to source these minerals elsewhere, so local mining jobs are lost, trade has gone underground and legitimate minerals fetch lower prices. The EU accounts for about 35% of global trade in tin, tantalum, tungsten and gold though more than 400 importers.

The EU will promote implementation of supply chain due diligence by EU companies through Its own public procurement contracts; and funding to promote acceptance of the voluntary certification scheme among EU importers, and to promote transparency and due diligence among EU and non-EU smelters and refiners.

The European Commission also endorses the Kimberley Process (Kimberley Process Certification System Certification - KPCS). KPCS certifies that rough diamonds are not from conflict zones.

3. Broad-based CSR Reporting

EU Accounting Directives currently require non-financial reporting on employment and environmental matters in company annual reports. A Directive adopted by the European Parliament on April 15, 2014, and awaiting Council approval,[7] will mandate that public interest entities - about 6,000, mainly listed, EU companies - disclose in their annual reports policies, results and risks on environmental, social and employee-related matters, respect for human rights, anti-corruption and bribery issues, and diversity on boards of directors (see below).

These must be based on recognized national or international standards. International standards include the UN Global Compact, OECD Guidelines for Multinational

[7] http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-%2f%2fEP%2f%2fTEXT%2bTA%2b20140415%2bTOC%2bDOC%2bXML%2bV0%2f%2fEN&language=EN; Part 5, pp. 312-346.

Enterprises, the UN Guiding Principles on Business and Human Rights ("Protect, Respect and Remedy" Framework), and the ILO Tripartite Declaration of Principles concerning multinational enterprises and social policy. The German Sustainability Code illustrates a national voluntary standard. Denmark, France, Spain, Sweden and the UK have added CSR disclosure elements to company legislation. EU disclosure requirements are without prejudice to additional requirements at Member State level.

CSR/ESG reporting is already practiced by some large multinationals. There are detailed CSR reporting frameworks such as EFFAS/DVFA's *KPIs for ESG: A Guideline for the Integration of ESG into Financial Analysis and Corporate Valuation,* the Global Reporting Initiative (GRI)'s *G4 Sustainability Reporting Guidelines,* and the International Integrated Reporting Council (IIRC) *International <IR> Framework: Integrated Reporting.*

The Directive is framed on a "comply or explain" basis, i.e. companies can explain why a particular CSR element is not applicable to them.

The Directive contemplates 2 years for transposition of the requirements by Member States. It is expected the new CSR reporting will begin in 2017.

4. Management and Board Diversity

Public interest entities will also be required to disclose in their corporate governance statements what policies they have on diversity - age, gender, geographical diversity, educational and professional background - and the results achieved in representation in its administrative, management and supervisory bodies.

'Comply or explain' will similarly apply with respect to diversity reporting.

These requirements complement the objective set in 2012 of 40% women among non-executive board members in larger publicly listed companies.[8]

5. Country-by-country tax reporting

The Commission had proposed country-by-country reporting of tax payments by large multinational companies to EU governments. This has been deferred.

Country-by-country tax reporting would require more transparency in the use of low-tax jurisdictions to locate revenues and profits. There is concern that low tax payments mean multinational companies are not making a fair contribution to the countries in which they produce and sell, and where their operations use publicly funded education, health and other services.

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[8] Proposal for a Directive of the European parliament and the Council on improving the gender balance among non-executive directors of companies listed on stock exchanges and related measures, COM(2012) 614 final.

The *OECD Guidelines on Multinational Enterprises*[9] encourage enterprises to make a fair contribution by way of taxes to the jurisdictions in which they operate.

Comment

These new and proposed directives illustrate important an important trend: the expanding influence of 'voluntary' CSR codes. All adopt and thus implement standards developed by multi-stakeholder rather than legislative bodies: Extractive Industries Transparency Initiative (EITI), OECD, UNGlobal Compact, and International Labour Organization, for example.

However, general guidelines express only general principles. They are more and more supplemented, or superseded, by detailed standards to meet the exigencies of specific industries or subject matter. An example is the OECD Due Diligence Guidance, the referent standard for conflict mineral chains of custody in both the proposed EU and the US rules. Those are further supplemented by guidelines of mineral users (e.g. Electronics Industry Citizenship Coalition, Responsible Jewellry Council) and by mining organizations such as the World Gold Council and the International Tin Research Institute.

The EU transparency, conflict minerals, CSR and diversity initiatives put the EU in the forefront among jurisdictions encouraging the application of CSR standards in the private sector. It is to be expected such practices will be extended to a wider range of companies in the future.

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[9] 2011 Edition, chapter XI.