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TRADESCAPE

Wave of new regulatory measures set to raise the bar on sustainability for exporters

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Tradescape: Wave of new regulatory measures set to raise the bar on sustainability for exporters

- ***Increasing sustainability regulations, particularly in Europe, will require a shift in business practices for Western Cape exporters***
- ***Increasing pressure to report on sustainability across global supply chains will increase the need for global suppliers to monitor and audit sustainability practices***

In recent years, the global business landscape has witnessed a paradigm shift towards sustainability, driven by increasing environmental concerns, social consciousness, and regulatory pressures. As a result, businesses are under increasing pressure to integrate sustainability practices into their operations, with increasing transparency required across value and supply chains. This shift has been precipitated by a combination of international climate agreements, corporate climate targets, the rise of ESG (environmental, social, governance) disclosures in corporate governance, and sustainability-related laws.

The past two years have brought an increase in regulatory measures requiring due diligence of sustainability practices across supply chains, as well as a shift from voluntary reporting disclosures towards legislated, mandatory disclosures. This means that an increasing number of companies, including retailers, are being mandated to start reporting, not only on their climate risks, but also on the impact of their business, including upstream and downstream, on environmental and social conditions. This will have far-reaching impacts on global value chains and supply chains and is already influencing international sourcing decisions at company level.

In 2023, the Western Cape exported goods to the value of R37.57 billion to the European Union (EU), almost 20 percent of the province's global exports. To maintain and grow market share in Europe, local exporting producers and manufacturers are going to have to be increasingly vigilant across all aspects of their supply and value chains from a sustainability point of view. An inevitable outcome of this shift will be a further increase in the need for data collection and auditing. In certain instances, Western Cape industries are well acquainted with a high level of supply chain scrutiny from a social and environmental point of view. The fruit and wine exporting industries have, for example, set high standards for ethical labour and environmental practices and have the ability to provide third party assurance to international buyers that the standards applied in the production of their products can be trusted.

New regulations in export markets will, however, intensify the need for supply chain data and assurance across a broader scope of activities. Pressure to report on carbon emissions will increase, along with the ability to show emissions reduction efforts over time. Reporting requirements will be much broader than just emissions though, and will include other areas of sustainability, such as nature, water and social impacts. While this will bring new challenges and costs, it may also present opportunities to leverage investment into climate resilience including water security and biodiversity protection.

Examples of new regulations influencing corporate behaviour and implicating supply and value chains

Within the context of the European Green Deal, the EU has passed, or is in the process of passing, a number of new regulatory measures that have implications beyond the borders of the EU. These new measures are enforcing scrutiny over value and supply chains and their impacts in relation to climate and social conditions. In particular, the EU Corporate Sustainability Reporting Directive (CSRD) and Corporate Sustainability Due Diligence Directive (CS3D) will, over the next two to five years, impose strict new duties upon thousands of companies falling within the ambit of the directives.

While similar, there is a distinction between reporting disclosures and supply chain due diligence. Reporting disclosure standards refer to frameworks or guidelines that outline how companies should disclose information related to their ESG practices. These have been largely voluntary but are increasingly becoming mandatory. Supply chain due diligence regulations, on the other hand, are regulatory frameworks that place a legal duty of care upon companies, requiring them to conduct thorough assessments and take preventive measures to address potential adverse impacts within their supply chains.[i]

Within this context, there is increasing pressure on companies to account, not only for their direct and indirect greenhouse gas (GHG) emissions, but also for emissions occurring elsewhere in their supply chain, both upstream and downstream. These are typically referred to as "scope 3" emissions,[1] and can include, for example, purchased goods and services, upstream and downstream transportation and distribution, and the end-of-life treatment of sold products.[ii]

The scope of mandatory disclosures are, however, set to be much broader than just GHG emissions, and, depending on the business, include, for example: pollution, water, biodiversity and ecosystems, circular economy and waste, workers in the value chain, affected communities and end-users.

While these are not unique to Europe, the EU is leading the charge in various areas. An increasing number of jurisdictions around the world are however implementing mandatory climate related reporting requirements for listed or large companies, including the United Kingdom, Canada, Australia, Singapore and the United States.

[1] GHG emissions are classified into three different "scopes". In addition to scope 3, scope 1 emissions are direct emissions from sources owned or controlled by a company, and scope 2 emissions are indirect emissions from the generation of purchased energy.

Listed below are some examples of new regulations impacting corporate behaviour and supply chains:

- **French Supply Chain Law**
    - In 2017, France was the first country to adopt a law obligating large companies to carry out human rights and environmental due diligence (HREDD) and publish a Vigilance Plan annually.[iii]

- **German Supply Chain Due Diligence Act**
    - Entered into force in 2023.
    - For the first time, thousands of German companies, as well as foreign companies with German branches, are obliged to address human rights-related and environment-related due diligence obligations in their supply chains in an appropriate manner.[iv]
    - The application of the law expands to more companies in 2024.

- **Swiss Ordinance on Due Diligence Obligations and Transparency**
    - Effective since 2022 with reporting obligations from financial year 2023.
    - Companies of a certain size are required to provide annual reporting on their supply chain activities relating to environmental and social issues, respect for human rights and combating corruption. Where risks are identified, companies need to implement management systems and supply chain policies.[v]

- **EU Corporate Sustainability Due Diligence Directive (CS3D)**
    - Adopted 24 May 2024.
    - The CS3D establishes a corporate due diligence standard on sustainability issues for businesses operating in the EU, including environmental concerns, climate change, and human rights.
    - The new due diligence requirements apply not only to the direct actions of the company, but also to their subsidiaries and supply chain, meaning that EU based companies could become liable for the actions of their suppliers.[vi]
    - “In scope” companies will need to integrate environmental and human rights due diligence into their policies and risk management systems; identifying and assessing actual or potential adverse human rights and environmental impacts, and prioritising those that are most severe or likely.
    - The CS3D will apply to large EU companies (with more than 1,000 employees and a worldwide turnover of more than €450 million) and non-EU companies doing significant business in the EU.
    - This directive essentially ensures alignment of Member State due diligence laws.
    - Obligations will begin to apply from 2027 onwards.[vii]

- **EU Corporate Sustainability Reporting Directive (CSRD)**

    - Adopted in 2022. Member states have until July 2024 to transpose the Directive into their laws.
    - The CSRD relies on the new **European Sustainability Reporting Standards (ESRS)** reporting framework, which aims to standardise and harmonise existing voluntary frameworks.[viii]
    - The Directive marks a pivotal shift in sustainability reporting, extending its reach beyond immediate operations to the entire value chain. Companies not only have to disclose information about their own activities, but also about their upstream and downstream value chain**.**[ix]
    - The CSRD expands the scope, sustainability disclosures and reporting requirements of its predecessor, the Non-Financial Reporting Directive (NFRD). It more than quadruples the number of companies to which the requirements apply, thus setting the standard by which nearly 50,000 EU companies and those with operations in the EU will have to report their climate and environmental impact.
    - The CSRD will apply to:
        - Large EU companies;[2]
        - Most businesses with operations or securities in Europe, including small and medium-sized enterprises (SMEs) (exemptions apply);
        - Non-EU parent companies with a cumulative group turnover in the EU greater than €150 million.
    - This will include many large manufacturing companies and other companies with extensive value chains (e.g. assembly or food).[x]
    - The CSRD requires a concept known as “double materiality” – which means businesses will have to disclose not only the risks they face from a changing climate, but also the impacts they may cause to the climate and to society.
    - Sustainability reporting under the CSRD will be presented as part of a company’s annual report or management report. This is a key feature of the CSRD: It incorporates environmental disclosure into financial reporting.[xi]
    - The CSRD rules will start applying between 2024 and 2028.
    - Under the proposed value chain sustainability reporting, companies will be required to report scope 3 emissions.[xii]

- **EU Deforestation Regulation**

    - Entered into force in 2023.
    - Companies trading in cattle, cocoa, coffee, oil palm, rubber, soya and wood, and certain derived products, are required to conduct extensive value chain due diligence to ensure the goods do not result from recent deforestation, forest degradation or breaches of local environmental and social laws.[xiii]

[2] Companies (including EU and non-EU subsidiaries) that exceed two of the following three criteria: (1) 250 employees, (2) net revenue of €40 million, or (3) total assets of €20 million.

- **EU Carbon Border Adjustment Mechanism (CBAM)**

    - Adopted May 2023.
    - Levies a charge on the carbon embedded in certain carbon-intense products imported into the EU.
    - Currently, the EU CBAM only has relevance for cement, iron and steel, aluminium, fertilisers, electricity, and hydrogen.
    - Designed in conjunction with the EU Emissions Trading System (EU ETS), the CBAM aims to preserve the competitiveness of EU exports and prevent carbon leakage through equalising the price of carbon levied against locally manufactured European products and non-EU imports from certain sectors.[xiv]
    - This takes the form of a charge levied on the carbon emissions embedded in certain products imported into the EU from non-EU countries. The CBAM will be phased in gradually and in parallel to a phasing out of free allowances afforded through the EU ETS, a process expected to be completed in 2034.
    - The CBAM applies to a limited number of carbon intensive product categories, all of which currently fall within the ambit of the EU ETS.
    - The product scope will be reviewed by the end of the transitional period to assess the feasibility of including other goods that are included in the EU ETS. The European Parliament have signalled that they aim to expand the scope to include plastics and chemicals by 2026 and to all sectors covered by the EU ETS by 2030.[xv] The EU ETS does not currently cover the agricultural sector, however there are discussions regarding the potential inclusion of the sector in carbon pricing schemes in future.

- **EU Greenwashing Rules**

    - The Empowering Consumers for the Green Transition ("EmpCo Directive") was approved in March 2024 and amends the Unfair Commercial Practices Directive. This Directive will have application from September 2027.
    - The proposed EU Green Claims Directive ("Green Claims Directive") was tabled by the European Commission in March 2023.
    - Both Directives aim to bridge the gap caused by the current varying standards for validating environmental claims and the lack of clear criteria to tackle their unreliability.
    - Together, these directives will prohibit “greenwashing”, for example, the use of generic or vague environmental and sustainability claims and create a regime for environmental labelling.

- **Packaging and Packaging Waste Regulation (PPWR)**

    - The rules, which have been provisionally agreed on with the European Council, include packaging reduction targets and require EU countries to reduce the amount of plastic packaging waste.
    - Certain kinds of single-use plastic packaging would be restricted, including plastic packaging for fresh fruit and vegetables.

- The proposal aims to make all packaging on the EU market recyclable in an economically viable way by 2030.
- The European Parliament adopted the provisionally agreed PPWR text on 24 April 2024. The PPWR will need to be formally adopted by the Council, which is expected to take place later in 2024, with entry into force expected in 2026.[xvi]

- **United Kingdom**

  - Mandatory climate-related financial disclosure requirements were introduced into UK legislation in 2022 for certain large companies and LLPs.[xvii]
  - The UK government has said it expects to set out new sustainability reporting standards, aligned to international standards, early next year, paving the way for new regulatory obligations.[xviii]
  - The UK is set to introduce a carbon border adjustment mechanism from 2027 on certain carbon intensive imported goods from the following sectors: aluminium; cement; ceramics; fertilisers; glass; hydrogen; and iron and steel.[xix]

- **United States**

  - On 6 March 2024, the US Securities and Exchange Commission (SEC) adopted final rules designed to enhance public company disclosures related to the risks and impacts of climate-related matters. The new rules include disclosures relating to climate-related risks and risk management as well as the board and management's governance of such risks.[xx]
  - The final rules exclude scope 3 emissions.[xxi]

- **China**

  - The Shanghai Stock Exchange (SSE), Shenzhen Stock Exchange (SZSE) and Beijing Stock Exchange (BSE) recently finalised guidelines on corporate sustainability reporting, which came into effect from 1 May 2024. The Guidelines lay out China's first set of mandatory sustainability reporting requirements for public companies listed on SSE and SZSE.[xxii]
  - According to a recent Government proposal, China will also seek to introduce basic regulations for corporate sustainability disclosure and climate-related disclosure by 2027, with the aim of establishing a nationwide standard by 2030.[xxiii]

Global Convergence of Climate Change Disclosures

In the past, businesses have had to make sense of a variety of disjointed climate reporting frameworks, resulting in confusion for both investors and business. Reporting rules and standards from different jurisdictions are now beginning to converge around shared principles, following a deliberate effort by international standard setters and regulatory bodies to harmonise reporting requirements. These rules are set to further crystalise as core principles are mandated into corporate governance regulations in jurisdictions around the world.[xxiv]

Increasing recognition for the importance of nature in climate resilience

It is evident from various of these regulations that businesses will face growing pressure to account for their impacts on nature, ecosystems and water security along their supply chains.

This increased focus on nature and biodiversity can be linked to the adoption of the Global Biodiversity Framework (GBF) in 2022, then heralded as a monumental step in the recognition of the importance of biodiversity and ecosystems in climate mitigation and adaptation. For the first time in a multi-lateral agreement, governments explicitly committed to require all large and transnational companies and financial institutions to assess and disclose their risks, impacts and dependencies on nature, through their operations, supply and value chains, and portfolios. Under the GBF, governments are committed to take legal, administrative, or policy measures to “encourage and enable” all businesses and financial institutions to act on nature.[xxv] This has been aided by the first corporate science-based targets for nature being released this year.[xxvi]

This may present new opportunities. South Africa, and particularly the Western Cape, is among the most biodiverse places on Earth. South Africa is recognised as a world leader in systematic biodiversity planning and biodiversity management. The Western Cape is a leader in conservation agriculture, and in the wine industry, WWF South Africa works with over sixty “Conservation Champion” vineyards, who are dedicated to the conservation of the Cape Floral Kingdom’s unique biodiversity. The Western Cape is also a water scarce region, a situation set to be further impacted by climate change. Importantly, opportunities exist for local and/or international businesses based in the Western Cape or with supply chains in the province to invest in nature-based solutions, [3] such as the eradication of alien invasive plants to support water security and protect biodiversity. Examples where this is already happening include the Greater Cape Town Water Fund and Tesco’s water stewardship programme.[xxvii] Clearing alien invasive trees from priority catchment areas can reclaim up to 55 billion litres of water per year.[xxviii] The Western Cape Government has developed comprehensive and progressive policies that recognise the importance of biodiversity conservation and the role of nature-based solutions in economic and climate resilience, including the Western Cape Ecological Infrastructure Investment Framework, aimed at attracting and steering investments in nature.[xxix]

[3] Nature-based Solutions are interventions to use nature and natural functions of healthy ecosystems to address major challenges like climate change, disaster risk reduction, food and water security, biodiversity loss and human health.

Conclusion

ESG or sustainability reporting is not new, and many businesses in South Africa are advanced in the application of sustainability practices. Strict compliance with social and environmental standards are also not new for many of our exporting industries in the Western Cape. For example, the fruit and wine industries in the province represent international best practice regarding many of these aspects. However, the rise of mandatory regulatory measures brings new pressures and new areas of reporting and will require a change in business practices in order to maintain a competitive market share in Europe. Certain issues, such as carbon emissions pose very significant challenges, while others, such as biodiversity protection may present interesting opportunities.

The EU is a crucial export market for Western Cape industries. As a premium market with close on 20 percent of the province's total exports destined for this region it contributes significantly to jobs and livelihoods. It is therefore essential that exporters are equipped to maintain market share and are supported and enabled to meet the increasing demands related to implementing and reporting on sustainability across business activities. The ability to access renewable energy also becomes increasingly important for export competitiveness; not only for exporting companies, but for their suppliers as well.

While Europe is significantly shifting the bar, climate related regulations are set to proliferate around the world, including in South Africa, with the Climate Change Bill currently on the President's desk for signature.

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About Wesgro

Wesgro is the official tourism, trade and investment promotion agency for Cape Town and the Western Cape.

Ensuring Cape Town and the Western Cape is a sought-after source market, Wesgro's Trade unit is responsible for supporting businesses in the province with exporting their goods and services to the rest of the world. Key services offered by the Trade team include: export training and mentoring; trade and networking events; connecting exporters to the wider trade ecosystem (export councils and industry associations); trade research and intelligence; trade missions and exhibitions; B2B facilitation; supporting with trade barriers; and the management of the online Cape Trade Portal (www.capetradeportal.com).

If you require any further information, please feel free to reach out to us through the Cape Trade Portal or contact:

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