

# The era of environmentally & socially conscious entities: ESG in Cyprus

Elena Georgiou | Senior Associate



Today's world calls for businesses which are not merely entities serving an economic purpose, but conscious beings whose decisions shape the world we live in. The 2021 26<sup>th</sup> United Nations Climate Change Conference, COP26, gathered together world leaders and delegates who were tasked with, *inter alia*, producing solutions to reverse climate change. Launched as a movement initiative in the United States, ESG, which stands for Environmental, Social, and Governance ("**ESG**") was a focal point of COP26 aiming to provide direction for the corporate world in establishing ESG guidelines.

This article will provide an overview of EU legal obligations on entities to report and disclose information on issues which relate to society and the environment with the added colour of ESG and how these have been applied in Cypriot law and in the practices of Cypriot corporate culture.

The EU embraced the concept of business transparency and accountability on social and environmental matters through the adoption of the Directive on the disclosure of non-financial and diversity information (Directive 2014/95/EU) (the “**Directive**” also known as “**NFRD**”). The Directive applies to large public interest entities with over 500 employees (listed companies, banks, insurance companies, other companies designated by national authorities as public-interest entities) requiring them to disclose certain non-financial information.

As stated in the Directive:



**Indeed, disclosure of non-financial information is vital for managing change towards a sustainable global economy by combining long-term profitability with social justice and environmental protection. In this context, disclosure of non-financial information helps the measuring, monitoring and managing of undertakings’ performance and their impact on society...”**

Cyprus as an EU Member State transposed the aforesaid Directive into Cyprus law by amending the Cyprus Companies Law, Cap. 113 (the “**Law**”), through Law N. 51(I)/2017.

In June 2017 the European Commission (the “**Commission**”) published its guidelines to help companies disclose environmental and social information. These guidelines are not mandatory and companies may decide to use international, European or national guidelines according to their own characteristics or business culture. Further, in June 2019 the European Commission published guidelines on reporting climate-related information, which in practice consist of a new supplement to the existing guidelines on non-financial reporting, which remain applicable.

A Cyprus entity, which is considered a “large undertaking” under section 141A(1)(c) of the Law and/or “large group” in section 141A(2)(c) of the Law, embarks on the journey of non-financial reporting through the obligation imposed by section 151A(1) of the Law to produce a non-financial report, with specific elements and information as per section 151A(2) of the Law. The relevant entity discharges its obligation for the production of the non-financial report set out in section 151A(1) of the Law, if pursuant to section 151A(9)(b) the non-financial report of the company is made publicly available, within six (6) months of the balance sheet date, in the company’s website and referred to in the management report. Alternatively, as per section 151A(9)(a) the non-financial report can be published along with the management report of the company, according to the provisions of sections 118 to 122 and section 152 of the Law; thus, the non-financial report is included in the management report and financial statements of the company which will accompany the annual return of the company (form HE32) for the respective year and filed with the Cyprus Registrar of Companies.

Additionally, the EU Regulation 2019/2088 on Sustainability-Related Disclosures in the Financial Services Sector (“**SFDR**”) lays down harmonised rules for financial market participants and financial advisers on transparency with regard to the integration of sustainability risks, including the consideration of adverse sustainability impacts in their processes and the provision of sustainability-related information with respect to financial products provided for therein. This regulation aims to reduce information asymmetries in principal-agent relationships with regard to the integration of sustainability risks, the consideration of adverse sustainability impacts, the promotion of environmental or social characteristics, and of sustainable investment. The SFDR requires financial services professionals, to make pre-contractual and ongoing disclosures to end investors, when they act as agents of those end investors (principals). The sustainability disclosures required under the SFDR apply in addition to the pre-contractual and ongoing disclosures already required under the applicable sectoral legislation. The SFDR is already in force and directly applicable since March 2021.

The supervision of non-financial reporting does not currently fall under the Cyprus Securities and Exchange Commission’s (“**CySEC**”) competence at national level. However, at EU level non-financial reporting falls under the competence of the European Securities and Markets Authority (“**ESMA**”), where CySEC participates in the relevant working streams. To this end, CySEC is monitoring non-financial reporting at national level in the context of conforming to its EU duties.

Non-financial reporting is becoming increasingly more sophisticated with the introduction of ESG, which also reached the shores of our island. ESG has grown to represent a metric of evaluation and assessment of a company’s consciousness towards society and the environment compared to their peers. “Environmental” covers water usage, waste production and general environmental behaviour, that is how efficient a company is with managing its resources, while respecting the environment around them. “Social” covers attitude towards clients, employees and diversity elements in the structure of the management of the workforce. “Governance” focuses on share class and governance structures within the company. Thus, stepping away from an examination of a company’s balance sheet, one examines a company’s impact on society at large.



On 21 April 2021, the Commission adopted a proposal for a Corporate Sustainability Reporting Directive (CSRD), which would amend the existing reporting requirements of the NFRD. The proposal:

- extends the scope to all large companies and all companies listed on regulated markets (except listed micro-enterprises);
- requires the audit (assurance) of reported information;
- introduces more detailed reporting requirements, and a requirement to report according to mandatory EU sustainability reporting standards;
- requires companies to digitally 'tag' the reported information, so it is machine readable and feeds into the European single access point envisaged in the capital markets union action plan.

The CSRD envisages the adoption of EU sustainability reporting standards drafts of which would be developed by the European Financial Reporting Advisory Group (EFRAG). The standards will be tailored to EU policies, while building on and contributing to international standardisation initiatives. The first set of standards would be adopted by October 2022. It should be mentioned that before adopting any standards, the Commission will consult the Member States Expert Group on Sustainable Finance and seek the opinion of the European Securities and Markets Authority. It will also consult the European Banking Authority, the European Insurance and Occupational Pensions Authority, the European Environment Agency, the European Union Agency for Fundamental Rights, the European Central Bank, the Committee of European Auditing Oversight Bodies, and the Platform on Sustainable Finance. These consultations will help to ensure a broad consensus on the content of the standards, and coherence with relevant EU legislation and policies. The next step is for the European Parliament, and the Member States in the Council, to negotiate a final legislative text on the basis of the Commission's proposal. From then on, we will be expecting to see how these will be further translated into Cyprus legislation and/or regulation.

From a practical application view point, companies in Cyprus have been developing and applying ESG practices and policies in a very creative way. Training and educating company staff, thereof cultivating an ESG culture, funding staff's public transport, planting trees, cleaning sea coasts, funding charities and education initiatives are only a few ESG initiatives. It has been said that what you receive from this world, this planet, you have a duty to return to it. Cyprus companies have embraced this concept and this is evident through the creation of CSR Cyprus, the Cyprus Network for Corporate Social Responsibility, in 2016, an initiative of ESG sensitive companies which has played an important role in empowering the area of Corporate Social Responsibility. The Handbook on Corporate Volunteering represents an example of the action of CSR Cyprus, in terms of CSR and sustainable development in the country.

Having that ESG framework vibrate in the foundations of companies transforms them into better stewards for a cleaner environment and a healthier society. As a consequence, these companies produce good ESG scores, build a better reputation and attract more socially responsible investors; this can help create value and drive deal activity. Additionally, this enhances a company's ability against forthcoming challenges and crises. The ESG framework is important not only for stakeholders, like investors, but also for rating agencies, NGOs, governments and regulators. It should be stressed that the above initiatives resonate the notion of sustainable finance and encapsulate the process of including ESG considerations into corporate decision making and investment advice processes.

It has been argued that one of the challenges in ESG due diligence is the broad scope it can cover and, as a result, the spread of expertise and the time required to undertake it. Multiple specialist counsel may be required to report on different aspects of ESG, each producing its own, often very technical report.



From a project finance perspective, ESG ratings are growing in importance and are being introduced in the prospective stage of the loan transaction process. These ratings are provided by third party providers scoring a borrower's capacity to mitigate and manage key sustainability issues within their sector, indicating to lenders the performance of any potential borrower. Sophisticated lenders are developing an appetite in a borrower's internal policies on a wide range of key social issues and ethical investment policies, developing specific requirements in their facility documentation. The assessment of the presence of ESG policies, including their monitoring, functionality and effectiveness, is becoming a fresh element in project finance due diligence.

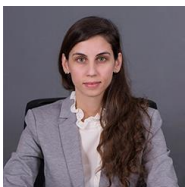
As a closing remark, the injection of ESG in corporate practices is a step towards the direction of leaving a better world to forthcoming generations and as veteran British broadcaster and documentary maker David Attenborough has stated in COP26,

**“We are, after all, the greatest problem solvers to have ever existed on Earth. If working apart, we are a force powerful enough to destabilize our planet. Surely working together, we are powerful enough to save it.”**



Patrikios Pavlou & Associates LLC is one of the largest law firms in Cyprus, highly recommended for its professional legal services and exceptional client service. With nearly 60 years of experience in the local and international legal market, we are renowned for our involvement in some of the largest cross-border transactions and regulatory work.

As a forward-looking law firm we remain dedicated in providing advice and guidance on the relevant ESG legal framework and on the implementation of ESG strategies and programmes.



Elena Georgiou | Senior Associate

[egeorgiou@pavlaw.com](mailto:egeorgiou@pavlaw.com)



Patrician Chambers  
332 Agiou Andreou str., 3035 Limassol, Cyprus  
P.O.Box 54543, 3725 Limassol, Cyprus

T +357 25871599 | F +357 25344548 |  
[info@pavlaw.com](mailto:info@pavlaw.com)

[www.pavlaw.com](http://www.pavlaw.com)