CDSB response to Inception Impact Assessment on the Revision of the Non-Financial Reporting Directive

The Climate Disclosure Standards Board (CDSB) would like to thank the European Commission for the opportunity to provide comments on the Inception Impact Assessment as regards the Revision of the Non-Financial Reporting Directive.

The Climate Disclosure Standards Board (CDSB) works to provide decision-useful environmental information to markets via mainstream corporate reports. Our mission is to create the enabling conditions for material climate change and natural capital information to be integrated into mainstream reporting.

CDSB is an international consortium of business and environmental NGOs. We are committed to advancing and aligning the global mainstream corporate reporting model to equate natural capital with financial capital.

We do this by offering companies a framework for reporting environmental information with the same rigour as financial information. In turn this helps them to provide investors with decision-useful environmental information via the mainstream corporate report, enhancing the efficient allocation of capital. Regulators also benefit from compliance-ready materials.

Recognising that information about natural capital and financial capital is equally essential for an understanding of corporate performance, our work builds the trust and transparency needed to foster resilient capital markets. Collectively, we aim to contribute to more sustainable economic, social and environmental systems.

The CDSB Framework is used by large listed companies globally and is referenced in government guidance to reporting regulation in the EU Commission Guidelines on Non-Financial Reporting, the UK Companies Act 2006, and stock exchange guidance in London, Australia, Singapore, Egypt, Santiago de Chile and elsewhere. CDSB has also contributed to the work of the UN Sustainable Stock Exchanges Initiative through its working groups on disclosure, green finance and financial regulators. CDSB also hosts the TCFD Knowledge Hub on behalf of the G20 Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD), which helps report preparers to find the resources they need to understand and implement the TCFD recommendations.

Our comments in full are provided below. Please do not hesitate to contact us for further information.

With kind regards,

Michael Zimonyi
Policy & External Affairs Director
Climate Disclosure Standards Board

T: +44 (0) 203 818 3939
www.cdsb.net

4th Floor, Plantation Place South
60 Great Tower Street
London EC3R 5AD

Appendix: Detailed response to consultation

Option 1.

We refer the Commission to the extensive evidence of the implementation of the Directive's requirements by companies, such as (but not limited to):

- CDSB's own review of reports in 2018 (available at https://www.cdsb.net/first-steps-corporate-climate-environmental-disclosure-under-eu-non-financial-reporting-directive);
- A review of corporate reports in the same year by the Alliance For Corporate Transparency for the same year (available at https://www.allianceforcorporatetransparency.org/assets/2018_Research_Report_Alliance_Corporate_Transparency-66d0af6a05f153119e7cffe6df2f11b094affe9aaf4b13ae14db04e395c54a84.pdf);
- A follow-up review by the Alliance For Corporate Transparency of reports in 2019 (available at https://www.allianceforcorporatetransparency.org/); and
- And CDSB's preliminary results from a review of 20 companies' reports also from 2019.

Based on this empirical evidence, it is clear that the current Non-Financial Reporting Directive does not fulfil its intended aims and outcomes and option 1. to continue the continue the current approach is not a viable option.

Option 2.

The current uncertainties of the Directive have also contributed in part to the concerns raised by business associations as regards too many approaches to reporting and increased reporting burdens. At the same time, it is also clear that investors do not find the reported information of sufficient quality, find it hard to locate, as well as the other issues that the Commission has highlighted in the Problem definition of this inception impact assessment. In addition, the low quality and level of reporting disincentivises good practice by those companies that have implemented an adequate level of reporting, by creating an uneven playing field where non-reporters incorrectly appear to be more suitable for investment that those who do report.

Following the more than 2 decades of experimentation and development, the time has come to move from learning to quality reporting. This means quality reporting that reliably informs decisions, stands up to scrutiny, directly influences the movement of financial capital and supports the transition and transformation necessary for our survival. The climate emergency and the material risks to business, the financial system and society at large from the alarming rates environmental degradation demands that we fast track the implementation path to quality reporting. There is no more time to be on the journey. Europe needs to be at the destination, including high-quality non-financial disclosure in mainstream reports.

Taking the above into account, it is clear that the cost of inaction is too high and the purely voluntary approach of option 2. is also insufficient to result in improvement at the scale and pace required.

Option 3.

Based on the above, it is clear that option 3. to revise and strengthen the provisions of the NFRD is the only viable path forward. It is also important to note that this option is still not sufficient on its own to achieve the transformation needed to ensure sustainable business practices and allocation of capital and that significant improvements are needed on all aspects of the European Green Deal.

Our specific comments on this option are outlined below:

Specifying in more detail what non-financial information companies should report.

It is important for thee completeness of the reported information as a result of the revision that the Directive explicitly states the word climate in the Directive. While climate change is not explicitly referred to in the NFRD under environmental matters, the Guidelines refer to the UN SDGs, the Paris Agreement and TCFD. Therefore, despite the absence of the term climate from the language of the Directive, the NFRD's intention appears to cover climate under the auspices of "environmental matters". This ambiguity, however, has created uncertainties for preparers and inconsistences in reporting practice when comparing disclosures, as shown throughout the findings in this review.

The approach outlined in the TCFD recommendations should also be applied to the disclosure of all ESG information in the management report, so that there is a unified approach, ensuring consistency and connectivity of information. ESG information in the management report should cover all four elements of the TCFD (i.e. Governance, Strategy, Risk Management, Metrics & Targets). Risk Management and Governance of ESG matters should be disclosed irrespective of materiality.

The Directive should also more clearly set the investor as primary audience, while recognising that information may satisfy other stakeholder needs Investors require information presented in a way that is suitable to their decision making. Having multiple audiences with varying information needs can result in less clarity of the reported information and lengthy disclosures that contain information that is immaterial for investors. The Commission has also recognised this, stating that "Investors cannot take sufficient account of sustainability-related risks and opportunities, or of the social and environmental impacts of their investments. As a result, there are systemic risks to the economy from investments that do not adequately price in sustainability-related risks, and there are inadequate capital flows to companies that contribute to resolving sustainability-related problems." It is important to note that other forms of reporting outside the management report might be better suited for other stakeholders and more work needs to be done to address this.

Linkages between non-financial and financial information must also be strengthened, in line with the TCFD recommendations, because the financial impacts of non-financial matters are missing from corporate management reports.

In addition, governance disclosures must also be strengthened by incorporating TCFD recommended disclosures a) and b) on governance into the 'corporate governance statement' in Article 20 and in the non-financial statement in 19a and 29a of the Accounting Directive. Board oversight of environmental and climate change matters is not a disclosure obligation under the NFRD, although the Directive does provide that companies include a corporate governance statement in their management report under Article 20. This approach has worked for diversity, so it would be prudent to adopt the same approach to other ESG issues. CDSB's review of corporate reports[1] found that almost half of companies (49%) disclosed both board oversight and management's role in assessing and managing environmental or climate matters. There were higher disclosures of board oversight of environmental (60%) than climate-related information (15%). Similarly, 58% of companies provided information on management's role on environmental matters, but only 20% for climate-related matters. In both cases, this may be attributable to the mandatory obligation for environmental matters in the Directive compared to the voluntary approach of the TCFD.

Modifying the scope, either to add certain categories of company not currently covered by the NFRD and/or by excluding certain categories of company that are currently covered.

Increase scope by changing business size to >250 employees, as by definition of PIEs in Accounting Directive as opposed to >500 WHY: Recognising the need to avoid the overall regulatory burden on SMEs, ESG matters may pose material risks and opportunities to businesses irrespective of their size. As Accountancy Europe states: "Expanding the NFRD's scope should capture all those companies that significantly impact the environment due to their sector's environmental and social profile. Stakeholders are interested in non-financial

[1] CDSB (2018) First Steps Corporate climate and environmental disclosure under the EU Non-Financial Reporting Directive. [PDF]. Available from: https://www.cdsb.net/sites/default/files/cdsb_nfrd_first_steps_2018.pdf

T: +44 (0) 203 818 3939
www.cdsb.net

4th Floor, Plantation Place South
60 Great Tower Street
London EC3R 5AD

information to better understand a company's performance, its future developments and impact on society. Reporting on non-financial matters make businesses better assess, measure and manage their risks and performance on specific ESG-metrics. That could lead to lower funding costs, fewer and less significant business disruptions, strong consumer loyalty and better relations with stakeholders."[2]

Clarifying and further harmonising provisions regarding where non-financial information should be reported, in particular with regard to publishing such information in the management report and/or in a separate report.

Make reporting in the management report mandatory by removing the exemption to allow the non-financial statement to be reported outside the management report WHY: The European Commission's Inception Impact Assessment on the Revision of the Non-Financial Reporting Directive found that "It is hard for investors and other users to find non-financial information even when it is reported" and that reported non-financial information is not sufficiently reliable.

Ensuring that non-financial information is available in a digital format.

As already stated in CDSB's response to consultation document on fitness check on the EU framework for public reporting by companies already in 2018, it is crucial that financial and "non-financial" information is treated the same throughout the implementation of digital reporting to ensure consistency and comparability.

The Commission should work with the European Securities and Markets Authority (ESMA) to ensure that the Regulatory Technical Standard for the European Single Electronic Format contains taxonomies for financial and "non-financial" information as well. Currently, financial and so-called non-financial information is considered separately by ESMA when it comes to digital reporting, which is a hindrance to the integration of non-financial information into mainstream reporting. While making corporate reporting digital is a very useful development, it only applies to the financial information reported by companies. This means that non-financial information will be continued to be reported in the same way as before. This does not only hold back progress on non-financial reporting, but also separates information that is intended to be used in conjunction with each other. Given that the future direction of reporting is clearly laid out in Europe and was re-affirmed by Executive Vice President Dombrovskis in his recent remarks, it is imperative that all forms of reporting move in the same direction. This is especially important to ensure policy stability and avoid multiple, incremental changes in the EU legislative framework later on. There is therefore a strong need in Europe to ensure equivalence in technological advances and developing financial and non-financial reporting at the same pace using the same reporting platform.

Strengthening the enforcement regime and promoting greater supervisory convergence.

It is clear that a lack of supervision and enforcement of non-financial reporting in Europe has contributed to the shortcomings of the NFRD's implementation. As already stated in CDSB's response to the public consultation on the operations of the European Supervisory Authorities in 2017, enforcement is a crucial element of the successful implementation of the Non-Financial Reporting Directive. To this end, CDSB welcomes ESMA's recently published sustainable finance strategy.

Based on ESMA's founding regulation, as well as evidence by ESRB, the Financial Stability Board and many others on the potential impacts of climate change and wider environmental matters on financial stability, ESMA must have the necessary enabling environment to incorporate such matters into its core activities. ESMA has a responsibility to contribute the establishment of common regulatory and supervisory standards in its position to promote supervisory convergence.

[2] Accountancy Europe (2019) Sustainable Finance: Achieving High Quality & Consistent Reporting. [PDF]. https://www.accountancyeurope.eu/wp-content/uploads/191015-Call-to-action-SF-final-version.pdf

ESMA develops draft regulatory or implementing technical standards, issues guidelines and recommendations, provides opinions to the Union institutions to contribute to the establishment of high-quality common regulatory and supervisory standards and practices. ESMA may also organise and conduct peer review analyses of competent authorities, including issuing guidelines and recommendations and identifying best practices, to strengthen consistency in supervisory outcomes. ESMA has a duty to identify best practices to strengthen consistency and establish common high-quality standards to facilitate a smooth transition to a sustainable economy. A shared and consistent regulatory approach by national competent authorities will be fundamental and ESMA can play a key role in shaping a race to the top between Member States. In doing so it will also prevent fragmented EU markets and enable policy makers to see where risk lies across EU markets and take corrective actions where needed so the whole EU can transition to a sustainable economy.

The Commission should also address the lack of enforcement and supervision by National Competent Authorities in Europe to ensure that there is comprehensive supervision and enforcement, providing a much needed authoritative and constructive feedback loop to companies on the appropriate level needed for compliance with the NFRD's requirements.

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4th Floor, Plantation Place South
60 Great Tower Street
London EC3R 5AD