

European policy briefing: From theory to practice, the role of supervisors in improving corporate reporting in the EU

As the European Union is currently revising its legal framework on sustainability reporting through the Corporate Sustainability Reporting Directive (CSRD), this paper aims to discuss the critical role supervision plays to strengthen corporate sustainability disclosures and prevent greenwashing. It also provides resources and practical recommendations to national supervisors.

Putting intentions to practice and improving the implementation of the regulatory framework

National supervision under European push for convergence

In the European Union, the supervision of sustainability information is performed by **National Competent Authorities (NCAs)**, which are either dedicated supervisory authorities or part of the roles and responsibilities of the Member State's central bank. Their activities are overseen by **the European Securities and Markets Authority (ESMA)** whose last enforcement report stated that during 2020, European enforcers undertook 729 examinations of non-financial statements. Such examinations led to 42 enforcement actions, causing an action rate of 5% (10% in 2019). The overwhelming majority of actions were to require the issuer to make a correction in a future non-financial statement in one, or several areas.¹

ESMA plays a critical role in **promoting supervisory convergence among NCAs**. Furthermore, the European supervisor has taken an increasingly active stance on corporate reporting since the release of a dedicated sustainable finance strategy in February 2020². Corporate reporting remains a central topic in both ESMA common enforcement priorities for 2021 annual financial reports³ and its 2022 work programme⁴.

A perfectible framework for supervision

To this date, supervision of sustainability information remains largely ineffective to ensure the disclosure of decision-useful, consistent and comparable information as the result of the implementation of the Non-Financial Reporting Directive (NFRD) due to of a lack of:

- **Clarity and specificity of the reporting requirements;**
- **Clear mandate** (when there is one) for NCAs to provide supervision and enforcement of corporate non-financial sustainability disclosures; and
- **Transparency over the procedural steps when a case of non-compliance is reported.**⁵

As stated in the Non-Financial Reporting Directive (NFRD) review reports issued by the European Commission (EC), "*the non-financial statement of companies with securities listed in EU regulated markets falls outside the scope of supervision of some national competent authorities due to the lack of coordination between the provisions of the NFRD and the Transparency Directive. Additionally, supervisory authorities themselves point out that the enforceability of the Directive is made harder by the flexibility of some of the disclosure requirements, for example in relation to the use of reporting frameworks, the location and timing of publication of the non-financial statement, and assurance. The situation regarding the disclosure of material non-financial*

¹ ESMA, Report on Enforcement and regulatory activities of European enforcers in 2020, available from : https://www.esma.europa.eu/sites/default/files/library/esma32-63-1101_enforcers_2020_activity_report.pdf

² ESMA, Sustainable Finance Strategy, available from: <https://www.esma.europa.eu/press-news/esma-news/esma-sets-out-its-strategy-sustainable-finance>

³ ESMA, European common enforcement priorities for 2021 annual financial reports, available from: https://www.esma.europa.eu/sites/default/files/library/esma32-63-1186_public_statement_on_the_european_common_enforcement_priorities_2021.pdf

⁴ ESMA 2022 Work Program, available from: https://www.esma.europa.eu/sites/default/files/library/esma20-95-1430_2022_annual_work_programme.pdf

⁵ EUKI 2020 research on enforcement activities, available from: [enforcement_activities_corporate_sustainability_reporting_summary_research_s.pdf](https://www.esma.europa.eu/sites/default/files/library/esma20-95-1430_2022_annual_work_programme.pdf) (frankbold.org)

information appears to vary to some extent according to **whether the non-financial statement is published as part of the management report or in a separate report**⁶

Taking supervision to the next level

The Corporate Sustainability Reporting Directive

Since 2014 and the publication of the NFRD, the sustainability reporting landscape has evolved significantly, moving away from **high level and voluntary requirements and standards towards more unified, mandatory and standardised requirements**. The recommendations from the Task Force on Climate-Related Financial Disclosures (TCFD) have been instrumental in these developments and are currently being embedded in EU legislation through the proposed CSRD.

The CSRD, which revises the NFRD, introduces several changes to the regulatory framework, both on the format and content of the required information, to make it more specific and answer the needs of investors and other stakeholders. It aims to address the shortcomings in the implementation of the NFRD, including on supervision, by ensuring that **all NCAs have a legal mandate to supervise sustainability information** and requiring **ESMA to issue guidelines to promote supervisory convergence among NCAs**.

As a result of the implementation of the CSRD, supervision of sustainability information should improve based on **a single location of the information** within the management report, **more detailed and specific disclosure requirements** and **the implementation of common sustainability reporting standards**. At the same time, the CSRD extends the number of companies covered by the requirements of the Directive beyond listed companies, which might increase the challenges of supervision for NCAs.

Other relevant European and global developments

Beyond the CSRD, there are a number of initiatives looking at how supervisors can i) **improve their supervisory practices** and ii) **better take climate and environmental risks into account**. They are predominantly focusing on the financial sector, for which the European System of Financial Supervision and the three European Supervisory Authorities were created in the aftermath of the financial crisis.

It is interesting to note that:

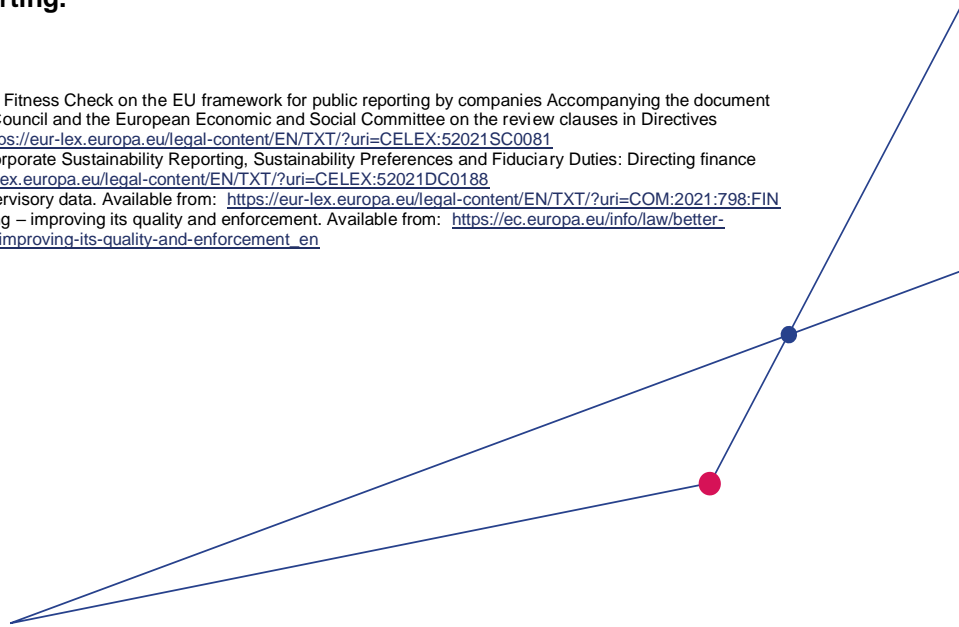
- Many of the materials listed below are recent, showing that this is **a field where work and reflections are ongoing**;
- These materials are often **industry-specific** looking at the banking, investment or insurance sectors climate and environmental-related risks;
- Climate and environmental risks are more and more embedded into sectorial legislations related to fiduciary duties, investment and insurance advice;⁷ and
- Further regulatory developments are expected following the release by the EC of **a strategy on supervisory data in EU financial services**.⁸ The EC will also present in 2022 **a horizontal initiative looking at the governance, audit and supervision of corporate reporting to improve the enforcement of corporate reporting**.⁹

⁶ European Commission, Commission Staff Working Document Fitness Check on the EU framework for public reporting by companies Accompanying the document Report from the Commission to the European Parliament, the Council and the European Economic and Social Committee on the review clauses in Directives 2013/34/EU, 2014/95/EU, and 2013/50/EU. Available from : <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52021SC0081>

⁷ European Commission, Communication on EU Taxonomy, Corporate Sustainability Reporting, Sustainability Preferences and Fiduciary Duties: Directing finance towards the European Green Deal. Available from : <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52021DC0188>

⁸ European Commission, Communication on a strategy on supervisory data. Available from: <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=COM:2021:798:FIN>

⁹ European Commission, Public consultation Corporate reporting – improving its quality and enforcement. Available from: https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/13128-Corporate-reporting-improving-its-quality-and-enforcement_en



On investor and asset manager supervision

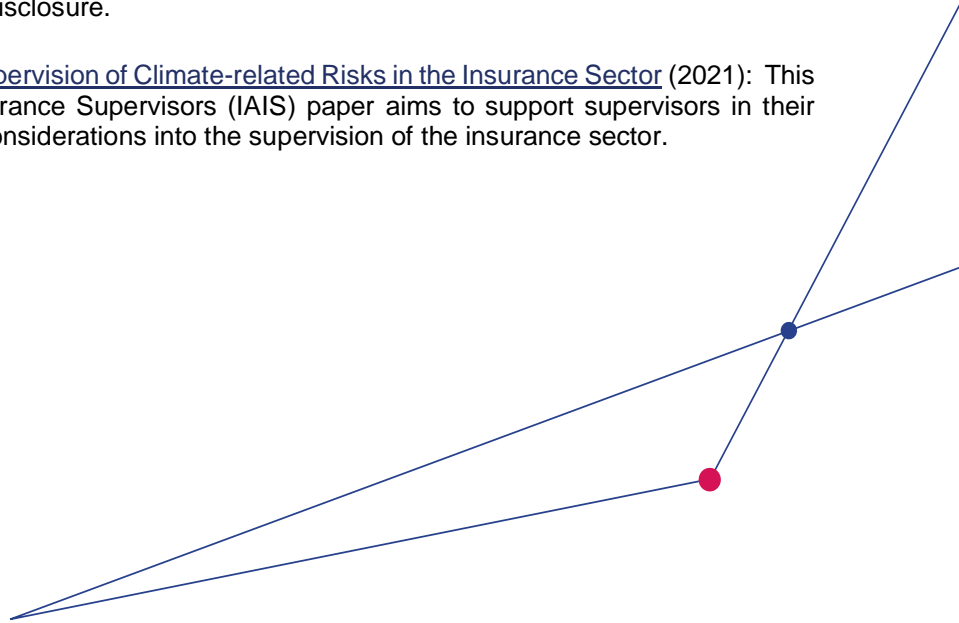
- [IOSCO Recommendations on Sustainability-Related Practices, Policies, Procedures and Disclosure in Asset Management](#) (2021): This report was developed by the IOSCO Task Force on Sustainable Finance established in 2020. It aims to improve sustainability-related practices, policies, procedures and disclosures in the asset management industry through recommendations for securities regulators.

On banking supervision

- [NGFS guide for supervisors about integration of climate and environmental risks into prudential supervision](#) (2020): This guide was issued by the Network for Greening the Financial System (NGFS), a group of central banks and supervisors set up back in 2017 at the One Planet Summit. The guide aims to develop common international approaches to prudential supervision.
- [BCBS Principles for the effective management and supervision of climate-related financial risks](#) (consultative document, 2021): The Basel Committee on Banking Supervision (BCBS) has opened in November 2021 a public consultation on a set of principles for the management and supervision of climate-related financial risks. These principles should help address climate-related financial risks to the global banking system and promote a principle-based approach to improving both banks' risk management and supervisors' practices in this area.
- [Bank For International Settlements \(BIS\) and Banque de France Report, "The Green Swan Central Banking and financial stability in the age of climate change"](#) (2020): This report discusses the impacts of climate change for financial stability. It highlights the challenges, options and tools to integrate climate-related risk analysis into financial stability monitoring and prudential supervision.
- [ECB guide on climate-related and environmental risks](#) (2020): This guide outlines how the European Central Bank (ECB) expects institutions to consider and disclose climate-related and environmental risks with a set of recommendations and best practice examples. It serves as a basis for the supervisory dialogue the ECB has with directly supervised banks.
- [EBA Report on management and supervision of ESG risks for credit institutions and investment firms](#) (2020): This report issued by the European Banking Authority (EBA) assesses how to include ESG risks into the supervisory review and evaluation performed by competent authorities based on common definitions of ESG risks as well as arrangements, processes, mechanisms and strategies to be implemented by credit institutions and investment firms to identify, assess and manage ESG risks.

On insurance supervision

- [SIF Report on implementation of TCFD Recommendations by insurance supervisors and regulators](#) (2021): This paper from the Sustainable Insurance Forum (SIF) provides insights and examples of best practices on how supervisors and regulators take supervisory action to strengthen climate risk assessment, management and disclosure.
- [IAIS Application Paper on the Supervision of Climate-related Risks in the Insurance Sector](#) (2021): This International Association of Insurance Supervisors (IAIS) paper aims to support supervisors in their efforts to integrate climate risk considerations into the supervision of the insurance sector.



- IAIS [Issues Paper on Climate Change Risks to the Insurance Sector](#) (2018): This paper provides an overview of the climate change risks the insurance sector might or is exposed to before discussing supervisory approaches to climate change risks through a series of case studies.
- [Turning up the heat – climate risk assessment in the insurance sector \(bis.org\)](#) (2019): This paper from the Financial Stability Institute (FSI) hosted by the BIS and the BCBS discusses how supervisors can assess climate risks, through stress testing and scenario analysis.
- [EIOPA Opinion on the supervision of the use of climate change risk scenarios in own risk and solvency assessment](#) (2021): In this opinion, the European Insurance and Occupational Pensions Authority (EIOPA) sets out expectations on the supervision of the integration of climate change risk scenarios by insurers in their own risk and solvency assessment.

What can supervisors do to improve their supervisory practices?

Building on the recommendations included in the resources listed in this paper and considering the regulatory framework and the supervisory mandate they operate in, supervisors can consider the following actions to improve their supervision of climate and environmental disclosures:

- **Take an active role on sustainability disclosures** by:
 - ✓ Adopting a dedicated strategy on sustainable finance and sustainability disclosures (e.g.: ESMA sustainable finance strategy);
 - ✓ Developing specific recommendations or supervisory priorities/strategies/policies on sustainability information (e.g., specific sustainability disclosure [theory](#) developed by the French supervisor AMF);
 - ✓ Creating dedicated enforcement units (e.g., such as [the Danish supervisor FSA](#)); and
 - ✓ Publishing an annual report on enforcement activities and results (e.g., ESMA [Annual Report on enforcement and regulatory activities](#)) or dedicated reports on specific issues (e.g., the [report](#) from the Dutch supervisor AFM on the implementation of the Sustainable Finance Disclosure Regulation).
- **Ensure that they have the relevant internal organisation in place** with dedicated resources and internal trainings;
- **Engage in a strong and constructive dialogue with supervised entities** to define and implement a clear set of supervisory expectations;
- **Strengthen exchanges with European Supervisory Authorities (EBA, ESMA and EIOPA)** to promote supervisory convergence. For example, ESMA has announced as part of its 2022 work program that it would release a supervisory convergence roadmap with specific actions to better identify and tackle greenwashing; and
- **Discuss with their peers** to exchange best practices and learnings, share information and strengthen cooperation and coordination in dedicated forums such as the IOSCO Sustainable Finance Task Force and the Network for Greening the Financial System.

