Climate Disclosure Standards Board

Summary for policymakers

CDSB's review of environmental and climate-related disclosures under the EU Non-Financial Reporting Directive

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The Climate Disclosure Standards Board (CDSB) has reviewed[1] the 2019 environmental and climate-related disclosures of Europe's 50 largest listed companies, with a combined market capitalisation of US$4.3 trillion, under the EU Non-Financial Reporting Directive, 2013/34/EU (NFRD). This review also assessed progress in implementing the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD) following the publication by the European Commission of NFRD's non-binding guidelines on reporting climate-related information[2]. The findings of the review were published in the "Falling Short?" report. The purpose of the paper is to inform policymakers of the changes needed to improve environmental disclosures under the Directive, to ensure it meets its purpose of increasing the relevance, consistency and comparability of company reporting. It also aims to support corporate report preparers in enhancing their disclosures under the Directive by identifying good practice case studies and tips, drawn from the findings of CDSB's review.

This summary for policymakers provides a brief overview of the key findings and policy recommendations contained within the report.

Key findings

Overall, our findings highlight that substantive improvements are still required in the quality, comparability and coherence of disclosures in order for the Directive to achieve its objective of providing investors and wider stakeholders with relevant, consistent and decision-useful disclosures.

Disclosure location
4 in 5 companies included their non-financial statement in their mainstream report

Materiality
1 in 3 companies failed to clarify how the materiality of environmental and climate-related information in the mainstream report had been determined

Business model
Only **3 in 10** companies fully disclose the environmental and climate-related aspects of their business model

Policies and due diligence
Companies demonstrated confusion over key terms from the Directive and often **failed to provide context-specific information** on their policies and processes

Outcomes
All companies reported some types of outcomes, however, **variations in disclosure** format limit the comparability of information, both between companies and over time

Principal risks
9 in 10 disclosed their principal environmental and climate-related risks, but **1 in 5** disclosed no related operational, strategic or financial impacts

Key performance indicators
Less than **1 in 3** companies reported metrics directly linking environmental and financial activities and performance

TCFD
While companies in the financial and energy sectors showed progress in aligning to the TCFD, **few disclosed their overall resilience** to different climate scenarios

More detailed findings from our review, relating to each of the aspects highlighted above, can be found in the full report.[3]

In response to the above findings we have six recommendations for policymakers, which are detailed below Please contact Michael Zimonyi, Policy & External Affairs Director (michael.zimonyi@cdsb.net) with any questions.

[1] CDSB (2020) Falling Short? Why environmental and climate-related disclosures under the EU Non-Financial Reporting Directive must improve. [PDF]. Available from: https://www.cdsb.net/falling-short
[2] https://ec.europa.eu/finance/docs/policy/190618-climate-related-information-reporting-guidelines_en.pdf
[3] CDSB (2020) Falling Short? Why environmental and climate-related disclosures under the EU Non-Financial Reporting Directive must improve. [PDF]. Available from: https://www.cdsb.net/falling-short

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Policy recommendations

Remove the exemption allowing non-financial reporting outside the mainstream report

The European Commission[4] 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. Non-financial statements reported outside of the management report are also not required to be filed in the Officially Appointed Mechanisms (OAMs) designated by Member States pursuant to Article 21(2) of the Transparency Directive, further hindering accessibility of this information. CDSB's review found that 84% of companies already provided their disclosure within the mainstream report; indicating this is already common practice. Requiring this as standard would better facilitate comparability of disclosures and foster stronger linkages across non-financial and financial disclosures.

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.

Review the principle risk requirements of the directive to ensure emphasis is placed on risk and impacts to the business, as well as by the business

Of the five core content categories of the Directive, principal risk disclosures relating to environmental and climate-related matters were generally found to be the weakest in our review.

While 90% of companies did disclose at least one principal risk relating to climate or environment showing improvement from 2018, where 79% disclosed at least one risk, only half considered both transition and physical risks as outlined in the TCFD recommendations. Only 6% of companies defined the short, medium and long-term time horizons over which the identified risks would impact the organisation. It is therefore clear that the Directive's existing risk disclosure requirements are not delivering the information investors require on the financial, operational and strategic risks companies face, necessary to inform their decision-making

Incorporate 'climate' into the wording of the Directive to ensure companies consider climate-related matters explicitly in their disclosures, including the associated financial impacts

While climate change or biodiversity are not explicitly referred to in the NFRD under environmental matters, the European Commission's June 2019 Guidelines on reporting climate-related information, which integrated the TCFD recommended disclosures and supplemented its Non-Binding Guidelines on Non-Financial Reporting published in July 2017. Despite the absence of the terms 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, with a lack of disclosures on climate. Our evidence on the lack of TCFD aligned disclosure, points to the fact many sectors are failing to address climate-related risk effectively in their disclosures, with only 6% being able to clearly describe the impacts of risks over the short-term, medium and long-term.

Define key terms used in the Directive, such as 'policies' and 'due diligence' to ensure a common understanding and application of the Directive's content categories

Although our review found that almost all companies disclosed these content categories, significant variation in the extent and quality of disclosures was observed. As 'policies' and 'due diligence' are not defined within the Directive, the way companies interpreted these terms also varied.

In addition, due diligence arrangements and policies were often not explicitly linked. For example, many companies stated their policies on environmental and climate-related matters within a dedicated sub-section

[4] European Commission (2020) Inception impact assessment - Ares (2020)580716. [PDF]. Available from: https://ec.europa.eu/info/law/better-regulation/initiatives/ares-2020-580716

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of their mainstream report, however, due diligence disclosures were often made separately within the corporate governance report, without direct linkage to the policy description.

The significant variation in interpretation of this content category suggests that it is important to define key terms within the Directive. This will contribute towards a common understanding and application of these requirements. The importance of policies in providing the basis for a coherent and connected disclosure must also be emphasised.

Embed the TCFD recommendations into the Directive to drive stronger linkage of non-financial and financial reporting and a more unified, harmonised and convergent approach

Overall, progress in implementing the TCFD recommendations was found to be lacking in our review, with many sectors failing to address them effectively in their disclosures. The most progress was seen among companies in the energy and financial sectors. However, in other sectors, such as healthcare and consumer goods, limited progress was observed. The synergies in subject matter between the NFRD and TCFD represent an opportunity to facilitate more harmonised, streamlined and consistent reporting. However, in practice few companies are achieving the full potential of more integrated and efficient disclosure, by considering the requirements in tandem, for example;

- There were very few instances where companies provided TCFD-aligned disclosure in an integrated manner alongside their environmental matters' content aligned to the NFRD;
- Commonly, limited reference was made to the TCFD recommendations within the mainstream report, with readers signposted to external resources, such as a sustainability or standalone climate risk report;
- Where TCFD-aligned disclosure was included in the mainstream report, it was often a standalone section, in addition to NFRD disclosure. This led to duplication, unnecessarily increasing reporting efforts and hindering usefulness for the reader; and
- Due to the overlapping aspects of the two reporting requirements, this was observed to cause inconsistencies and confusion within reporting, for example in relation to principal risks.

Ensure that supervision of non-financial information is at the same level as for financial information, in order to provide authoritative feedback to corporate report preparers

Non-financial information should be subject to the same level of supervision as financial information if it is embedded within corporate management reports. In addition, corporate report preparers do not receive authoritative feedback that can guide them towards effective disclosure in line with legal requirements. Our review found that substantive improvements are required in the quality, comparability and coherence of disclosures, suggesting that the current limited feedback provided limits the incentive for companies to produce more effective disclosures that go beyond basic compliance with the Directive.

Separate reports that include non-financial information, as were used for NFRD disclosure by 16% of the companies in our review, also hinder appropriate supervision because they are out of the legal mandate of the National Competent Authorities, whose mandate over periodic reports is limited to the annual and semi-annual financial reports (which include the management report). Supervision by NCAs should be strengthened and is already overseen by ESMA whose last enforcement report stated that during 2019, European enforcers undertook 937 examinations of non-financial statements. Such examinations led to 95 enforcement actions, causing an action rate of 10%. The overwhelming majority of actions were requiring the issuer to make a correction in a future non-financial statement on one or several areas.

It is important to note that further clarification within the issues to be disclosed on within the text of the Directive will help strengthen and improve further supervision and enforcement activities.

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