Climate Disclosure Standards Board

CDSB

Summary for policymakers: The state of EU environmental disclosure in 2020

In our report The State of EU disclosure in 2020 the Climate Disclosure Standards Board (CDSB) has taken a deep dive into the environmental disclosures of the largest listed companies in the EU. The third in the series, we pick up where our previous report 'Falling Short?'[1] left off, comparing where we were then, and what progress has been made.

Supported by the LIFE programme of the European Union, CDSB reviewed the 2020 environmental disclosures of 50 of Europe's largest listed companies, with a combined market capitalisation of US$3.5 trillion, under the EU Non-Financial Reporting Directive (NFRD) and the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD). Our analysis assesses the effectiveness of environmental disclosures in meeting the NFRD's purpose of increasing the relevance, consistency and comparability of company reporting to support informed stakeholder decision-making on sustainable development. It also supports the corporate reporting process by identifying good practice case studies and tips.

This briefing provides a summary of the report's key findings and recommendations for policymakers.

Key findings of the review

Our latest review shows signs of improvement in the completeness and quality of aspects of environmental disclosure. However, the core challenges identified in our previous research, relating to TCFD adoption, risk disclosures and the application of materiality, must still be addressed to provide investors with the consistent, coherent and comparable disclosure needed.

Overall, our analysis indicates that those aspects which were already well disclosed by companies in 2019 continued to be well reported, whilst those previously found to be weakest are unchanged, as indicated in the key strengths and weakness below. The graph below shows the percentage of companies included in the 2020 review that disclosed key aspects assessed in the methodology. Notably, our 2020 analysis assessed the provision of information on deforestation and forest degradation, and on biodiversity, finding that these issues are disclosed by far fewer companies than climate change and water-related issues.

Strengths ★★★	Weaknesses ★★★
1. Policies and due diligence	1. TCFD
2. Business model	2. Principal risks
3. KPIs	3. Materiality

[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

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The state of EU environmental disclosure in 2020

Topic	Disclosure requirement	2019	2020
Business model	Clear and specific disclosure provided on business model environmental aspects	34%	52%
Policies and due diligence	Environmental policies and due diligence both disclosed	94%	94%
	Board and management level responsibilities disclosed	64%	70%
Outcomes	Quantitative targets used to disclose environmental policy outcomes*	N/A	74%
Principal risks	Environmental risks disclosed	90%	86%
	Transition and physical climate risk types considered	54%	74%
KPIs	Scope 1, 2 and 3 Greenhouse gas emissions disclosed	54%	74%
TCFD	Impacts of risks over short, medium and long-term time horizons disclosed	6%	4%
	Scenario analysis used to disclose strategic resilience to climate change	14%	18%
Materiality	Double materiality approach applied to environmental disclosure	8%	38%
Location and format	Respond to NFRD in the mainstream report	84%	82%
Environmental topics	Provided disclosure on deforestation or forest degradation*	N/A	22%
	Provided disclosure on biodiversity*	N/A	46%

*Aspect first assessed in 2020, therefore 2019 data unavailable

Recommendations for policymakers and regulators

With the European Commission's finalised proposal for revision of the NFRD forthcoming, this important opportunity to improve the effectiveness of the Directive must achieve enhanced access for investors and other stakeholders to the environmental information they need. In response to the above findings we have six key recommendations for policymakers.

1. Remove the exemption allowing the non-financial statement to be reported outside the mainstream report, to support accessibility, consistency and comparability of disclosures

The European Commission has previously observed that "It is hard for investors and other users to find non-financial information even when it is reported"[2]. This aligns with CDSB's findings, in that non-financial disclosures provided outside of the mainstream report were often fragmented in nature and not readily referenced from the mainstream report. In 2020, 82% of companies provided their disclosure within the mainstream report, showing this continues to be the norm for most companies, with 84% doing so in 2019. Increasingly, those providing disclosure within the mainstream report, are also choosing to integrate the information within the relevant sections of the management report (61%, compared to 55% in 2019).

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.

2. Define key terms used in the Directive, including 'policies', 'due diligence' and 'policy outcomes' to ensure consistent and comparable application of the 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, with companies appearing to interpret these terms differently. For example, policies often lacked business-specific detail, and 30% of due diligence disclosures failed to include board and management-level accountabilities in accordance with the Directive's non-binding guidelines[3]. Outcomes reporting was not clearly linked to stated policies in 14% of disclosures and few were able to provide balanced disclosure that fully addressed areas of weakness in policy progress. The significant variation in interpretation of these content categories shows that key terms should be defined within the Directive to ensure common understanding and application of these requirements.

3. Explicitly embed the TCFD recommendations into the Directive, as non-binding guidelines are not driving uptake at the necessary pace and scale to support investor decision-making

Whilst 68% of companies referenced or provided some disclosure aligned to TCFD in 2020 in their reports, adoption of the recommendations was found to be inconsistent and complete. The vast majority have still only partially adopted the recommended disclosures, with just 4% clearly defining risks over short, medium and long-term time horizons and 18% providing clear disclosure on their resilience to different climate scenarios. Given the TCFD recommendations were integrated into the Directive's 2019 Guidelines on reporting climate-related information[4], it could have been expected that TCFD disclosures would have seen greater improvement in 2020 reports. The continued challenges in the quality and completeness of disclosures however indicates that voluntary adoption of the TCFD by Europe's largest companies, through its inclusion in non-binding guidelines, is not achieving the levels of disclosure required to fully inform investor decision-

[2] European Commission (2020) Inception impact assessment - Ares (2020)580716. [PDF]. Available from: https://ec.europa.eu/info/law/better-regulation/initiatives/ares2020-580716

[3] European Commission (2017) Communication from the Commission – Guidelines on non-financial reporting (methodology for reporting non-financial information) (2017/C 215/01). [Online]. Available from: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52017XC0705(01)

[4] European Commission (2019) Communication from the Commission – Guidelines on non-financial reporting: Supplement on reporting climate-related information (C/2019/4490). [Online]. Available from: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52019XC0620(01)

making. It is therefore evident that the TCFD recommendations must be embedded into the revision of the Directive itself.

4. **Emphasise in the revision of the Directive the importance of ensuring that the different content elements provide a connected overall view on how companies ensure sustainable long-term value creation**

Whilst disclosure of information under individual content categories of the Directive has shown some improvement, such as business models and KPIs, coherent and connectedness across environmental disclosures is critical to ensuring it is decision-useful for investors. Our 2020 review found that information across content categories was not always well linked; for example 14% disclosed policy outcomes that did not clearly relate to their stated policies, and 36% did not indicate any explicit management actions being taken to address their principal risks.

In order to drive disclosure that provides a complete and consistent picture on the organisation's overall approach to sustainable long-term value creation, it is therefore key that the revision of the Directive places greater emphasis on ensuring companies' disclosure across content categories tells a clear overall story regarding its approach to environment, social and governance issues.

5. **Incentivise companies to do more to tackle environmental and climate issues, through ambitious policies and rigorous due diligence processes, by ensuring policy coherence between the NFRD review and the upcoming EU initiative on corporate governance**

Whilst due diligence disclosures under the NFRD are expected to provide information on board and management level responsibilities of relevance from a corporate governance perspective, 30% of companies did not provide this information relating to environmental matters in their 2020 reports. Additionally, where governance information was provided, the level of detail and specificity it included on how environmental risks were managed, and in particular climate risk as requested under the TCFD recommendations, was often limited. The revision of the NFRD therefore presents a timely opportunity to ensure that companies disclose information on their internal processes and responsibilities over environmental issues, while the EU also takes legislative action to boost responsible business conduct through the upcoming initiative on sustainable corporate governance.

6. **Ensure that environmental issues beyond climate, including biodiversity, water and forests, are clearly integrated and addressed in the revision of the NFRD, to support wider EU policies.**

Our review found a clear disparity in the level and quality of disclosure on different environmental aspects. Whilst all companies referenced climate change in their reporting and 94% mentioned water-related issues, only 46% made reference to biodiversity and 22% for deforestation and forest degradation. When considering the inclusion of quantitative KPIs specifically, practices become increasingly divergent across environmental topics. Only 10% provided quantitative metrics on biodiversity, and 4% deforestation and forest degradation, compared to over 90% for water and climate.

The revision of the directive must therefore ensure environmental issues beyond climate are clearly integrated and addressed, to ensure company disclosure supports the wider EU policy agenda through reporting information on all material environmental matters.

For any questions relating to this report or our recommendations, please contact our **Policy and External Affairs Director, Michael Zimonyi. E-mail:** Michael.Zimonyi@cdsb.net.

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With the contribution of the LIFE Programme of the European Union
Hosted by CDP Europe

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