ANNEX to CDP Europe's response to the public consultation on the revision of the Non-Financial Reporting Directive

CDP Europe's response

This document is an additional attachment to CDP Europe's response to the public consultation on the revision of the Non-Financial Reporting Directive. The full response to the European Commission's questionnaire can be found here.

Background

CDP Europe welcomes the European Commission's public consultation on the revision of the Non-Financial Reporting Directive and commends the Commission for conducting an over-arching revision of the corporate reporting legislation in Europe. Given recent developments in Europe, such as the Green Deal, which provides the roadmap for making the EU's economy sustainable and the Climate Law, which proposes a legally binding target of net zero greenhouse gas emissions by 2050 for all EU countries, it is crucial to take European companies on board and work together towards achieving those ambitious targets.

More transparency about companies' impact on the environment, and the risks they face, is the foundation for driving the urgent action science dictates must happen. This initiative shows that the EU has recognised that better information from companies is the cornerstone of their strategy. Increasing investment is key, but better data is required to "*guide investors towards sustainable investments and steer changes in the behaviour of companies*".

Since pioneering the global environmental disclosure system, CDP has driven corporates, cities and regions around the world to understand and act on the business case for reducing their negative impact. Central to CDP's mission is communicating the progress made in addressing environmental issues and highlighting where risks may be unmanaged. To this end, we score disclosers on the information they provide, assessing not only tangible impacts such as emission reduction activities, but also how climate change, water risk and deforestation issues are integrated into governance, strategy and risk assessment processes.

To increase transparency and drive sustainable investments, CDP provides a critical source of global data that delivers evidence and insights to a wide audience, including investors, companies, policymakers and their advisors, public sector organisations, government bodies, academics and the general public. Also tracking companies' performance against the goals of the Paris Agreement, CDP data enables our network to link environmental integrity, fiduciary duty and public interest to make better-informed decisions on climate action.

Section 1 - Quality and scope of non-financial information to be disclosed

Regarding the quality and scope of non-financial information we recommend the following key actions:

- Strengthen ‘inside-out’ disclosures by mandating all companies to disclose their long-term transition plans towards a temperature goal in line with the latest science (IPCC), water-secure and deforestation-free scenarios, as well as their dedicated strategies, approaches and timelines for pursuing climate and natural resources neutrality.
- Apply the TCFD’s recommendations to a broader perspective of natural capital and specify “environmental matters” to include climate change mitigation and adaptation, water security and pollution and commodity-driven deforestation and land use as a minimum, possibly referencing the environmental objectives of the EU Taxonomy Regulation.
- Strengthen ‘outside-in’ governance disclosures by incorporating TCFD recommended disclosures on Governance (describe the board’s oversight of climate- [and natural capital-] related risks and opportunities and describe management’s role in assessing and managing climate- [and natural capital-] related risks and opportunities) into the ‘corporate governance statement’ in Article 20 and in the non-financial statement in 19a and 29a of the Accounting Directive
- Strengthen linkages between non-financial and financial information and between the ‘inside-out’ and ‘outside-in’ perspective to ensure better disclosure of non-financial and financial impacts with a forward-looking perspective by incorporating TCFD recommended disclosures (climate and natural capital) on Strategy, Risk Management, Metrics and Targets into the NFRD.
- Make reporting in the management report mandatory by removing the exemption to allow the non-financial statement to be reported outside the management report.

Question 1: To what extent do you agree or disagree with the following statements about possible problems with regard to non-financial reporting?

Lack of comparability – the Directive allows non-financial information to be reported by companies outside the management report and up to 6 months later. This creates reporting inconsistencies, making it difficult for key audiences such as investors to perform comparative analyses and integrate this information into investment decisions. While the non-binding guidelines on non-financial reporting have been revised in 2019 to integrate the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD) and to stimulate companies to include their non-financial statements into the company’s management report, they are still non-exhaustive and non-binding. A 2018 report by CDP and CDSB found, that the guidelines have not found widespread adoption. Reporting material non-financial information in annual reports allows investors to assess the relationship between specific non-financial matters and an organisation’s overall strategy, performance and prospects. As a result, a more holistic picture of the inter-relationships between factors that affect their ability to create value is provided.

Inconsistencies between the national transpositions of EU law resulting in differences between EU Member States' ambition levels for regulation, are striking differences among companies' ambition levels and the implementation of actions towards EU and national climate and environmental objectives. Alignment of reporting obligations should reduce the overall reporting burden and create a level-playing field, while allowing for all necessary information to be disclosed by companies.

Lack of clarity and relevance – the Directive does not require companies to disclose enough relevant information. Board oversight of environmental information such as climate change and natural capital as well as scenario analysis, climate-related financial risk and opportunity criteria around governance, strategy, risk management, and metrics and targets are not disclosure obligations under the NFRD. While the NFRD's intention is to cover climate under the auspices of "environmental matters", this ambiguity has created uncertainties for preparers and inconsistences in reporting practice when comparing disclosures, as shown throughout the findings in CDP and CDSB's "First steps" report.

Additional Information on Key Performance Indicators (KPIs)

There is a need to guide companies in reporting against clearly defined climate change metrics and key performance indicators (KPIs) at European level. Italy and France have specified what information should be reported in relation to the various ESG factors, whereas the UK and Germany as well as most other Member States have implemented a word-for-word transposition of the basic general requirements of the NFRD. There is a risk, as a result, that a multitude of KPIs are used across companies in different countries, complicating comparative analysis.

While more specificity in KPIs would make comparative analysis significantly easier, it is important to strike a balance between specificity and flexibility. Given that each business is unique and comprises of a multitude of business activities with varying ESG risks and opportunities, it is important to ensure that companies have the ability to report a true and complete picture of their business. As such, it is important to take into considerations specific to each sector or industry.

In line with the existing and emerging climate change and environmental regulation, established corporate disclosure frameworks such as CDP, climate change metrics and KPIs are readily available and are already being used by investors today. At a minimum, a set of metrics and KPIs that are key to measure and track corporate performance against the Paris Agreement should be implemented into reporting requirements for companies.

KPIs on GHG emissions target

For the EU to achieve its 2030 and 2050 climate targets, it will be fundamental to maintain an accurate picture of GHG emissions by European companies. Even more important will be to understand how corporate GHG emissions are likely to evolve in the medium to long-term. A key component in this regard is to have information on corporate GHG absolute emissions targets. However, as evidence suggests, this data is currently not sufficiently available.

An initial review following the adoption of the NFRD was carried out by the Climate Disclosure Standards Board (CDSB) and CDP in 2018 in the “First Steps Report”. The information contained in the management reports of a core sample of 80 companies from the UK, France and Germany was analysed and, where possible, compared with the information provided by a control group of 500 companies. The report found that only 39% of core sample companies fully reported their Scope 1, 2 and 3 GHG emissions and only 41% stated emissions targets.
An analysis of the 2019 CDP responses of 882 companies from 25 European countries reveals that from 704 companies who reported active targets, 34% had an absolute reduction target, 37% an intensity target and 29% reported both intensity and absolute targets. The data further revealed that 65% of absolute targets were short-term (expiring between 2020-2025), and 35% of companies with absolute targets had in place long-term targets beyond 2025.

Setting a science-based target means companies adhere to the SBTi criteria, which require them to disclose of a full GHG emissions inventory (Scope 1, 2 and 3 GHG emissions) along with detailed target information and to set ambitious medium-term targets that lead to absolute emissions reductions. The recent SBTi status report shows a relatively strong adoption of SBTs by European companies compared to their global peers: 409 companies headquartered in Europe (out of the 840 total) had joined the SBTi by March 2020, of which 170 had already had their targets approved by the initiative.

A new mandatory disclosure of GHG emissions targets under the NFRD might not automatically lead to more companies setting targets in line with climate science. However, the strength of the SBTi in Europe means that European companies can already draw on many existing best-practice examples and expertise to help them along this important path. Moreover, public scrutiny on high impact companies’ transition planning is set to increase. Mandatory target setting could create a stronger incentive for them to consider setting ambitious science-based targets.

CDP Europe recommends the Commission to consider amending the NFRD in the following regards to allow for the development, by means of delegated acts, of binding measures providing for:

- key general principles underpinning high-quality non-financial information, including guidance on the assessment of materiality and on the provision of forward-looking ESG information over a reasonably extended time horizon, and
- a limited set of specific disclosure requirements, including indicators and relevant targets to address the different requirements for each of the non-financial matters envisaged by the NFRD.

More specifically, CDP Europe recommends that the specific disclosure requirements of the amended NFRD include the following Key Performance Indicators (KPIs) and further guidance from the Commission’s guidelines on non-financial reporting (supplement on reporting climate-related information):

Recommended KPIs
1) **GHG absolute emissions target (in metric tons CO_2e achieved or % reduction), from base year**, including - a requirement to set targets for 2025 or 2030 and to review them every five years, and - a description of whether their target(s) relate(s) to their Scope 1, Scope 2 and/or Scope 3 GHG emissions either in full or in part.
2) Direct GHG emissions from sources owned or controlled by the company (Scope 1, in metric tons CO_2e), including - the % of emissions for which reliable data have been collected and the % of emissions that have been estimated, - the reasons why reliable data could not be collected for a proportion of the emissions and - the methodology used to estimate the proportion of emissions for which reliable data could not be collected. - a breakdown of Scope 1 GHG emissions by country or region (including the EU), by business activity, and by subsidiary.
3) Indirect GHG emissions from the generation of acquired and consumed electricity, steam, heat, or cooling (collectively referred to as "electricity") (Scope 2, in metric tons CO_2e), including - whether there are any sources (e.g. facilities, specific GHGs, activities, geographies, etc.) of Scope 2 GHG emissions within their selected reporting boundary for which GHG emissions could not be collected or estimated, and the reasons for this. - a breakdown of Scope 2 GHG emissions by country or region (including the EU), by business activity, and by subsidiary.
4) All indirect GHG emissions (not included in Scope 2) that occur in the value chain of the reporting company, including both upstream and downstream emissions (Scope 3, in metric tons CO_2e) including - a requirement not to exclude any activity that would compromise the relevance of the reported Scope 3 GHG emissions inventory.

CDP Europe believes that a mandatory disclosure of these KPIs under an amended NFRD will lead to more complete and accurate data on corporate GHG emissions and emissions targets. With further innovation currently under way, it will soon be possible to translate this data into medium and long-term temperature trajectories. This will enable companies, financial markets, policy makers and other stakeholders to better measure their expected degree of future alignment with EU climate goals and to continuously monitor their progress.

Five specific benefits can arise from a mandatory disclosure of GHG emissions and targets. Taken together, these can significantly increase the likelihood of achieving EU climate targets:

- **Improving the impact of the Disclosure Regulation:** Only complete and accurate data on corporate GHG emissions and related targets will allow investors to fully integrate climate risk factors into investment processes. Meaningful disclosure by investors on climate risks of financial products will rest on high quality, past and forward-looking data.
- **More ambitious target setting by European companies:** Companies and their stakeholders will be better able to benchmark corporate emissions reduction ambitions. The higher peer pressure can incentivise companies to set more ambitious emissions targets as the business case for doing so will strengthen. Already today, companies report multiple business cases from setting science-based targets, ranging from improved risk management, better sustainability communication, a stronger supply chain engagement process and higher employee satisfaction.
- **Strengthening low-carbon transition financing:** More comparable, forward-looking data is often seen as a barrier to sustainable investing. High quality data on GHG emissions and targets will close this gap and create transparency over the longer-term transition planning of companies. This is particularly important across high impact sectors, where companies with ambitious goals need substantial amounts of private capital to manage the transition to a low-carbon business model.
- **Supporting more effective climate policies**: Accurate data on corporate GHG emissions allows policy makers to better assess the actual and expected effects of carbon pricing policies across economic sectors. Furthermore, information on corporate ambition for reducing emissions and the ability to track progress against targets enables policy makers to identify transition gaps and to better design appropriate policies, particularly across high impact sectors.
- **Improving the impact of the Taxonomy Regulation**: Information on economic sustainable activities is more decision useful if viewed in context of a GHG emissions target. For example, data users can better assess capital expenditures in economic sustainable activities if the expected temperature pathway based on reported emissions target data is also known.

Question 2: Do you consider that companies reporting pursuant to the NFRD should be required to disclose information about other non-financial matters in addition to those currently set-out in Article 19a?

Please specify which other non-financial matters	
Other non-financial matter #1	Climate change mitigation and adaptation, water security and pollution and commodity-driven deforestation and land use should be specified as a minimum and a reference could be made to the environmental objectives defined in the EU Taxonomy Regulation.

Other non-financial matter #2	Suggested wording option 1: [… i environmental impact and dependencies across all natural capitals, in particular regarding climate change, water security and quality, and commodity-driven deforestation and land use]
Other non-financial matter #3	Suggested wording option 2: [… i environmental impact and dependencies across the climate and environmental objectives defined in the EU Taxonomy Regulation]

Question 3: Are there additional categories of non-financial information related to a company's governance and management procedures, including related metrics where relevant, (for example, scenario analyses, targets, more forward-looking information, or how the company aims to contribute to society through its business activities) that companies should disclose in order to enable users of their reports to understand the development, performance, position and impacts of the company?

The current NFRD disclosure requirements do not yet serve the needs of financial sector companies to integrate evidence-based sustainability and risk criteria into their decision-making processes. Corporate reporting on sustainability issues needs to serve investors and stakeholders by assessing companies' long-term value creation and their exposure to long-term risks. Only high-quality, consistent disclosure of long-term sustainability risks across the entire investment and lending chain enables investors to engage with company boards on sustainability issues and to drive sustainability in business operations. To be useful, disclosures must systematically account for the actual contribution of investments and capital allocation decisions in achieving environmental and societal goals, set out by the European Green Deal and the Paris Agreement. Investors with fiduciary duties that require them to ensure long-term, low-risk investment strategies do not encounter sufficient information on long-term climate and environmental-risk mitigation and adaptation strategies of the companies they invest in. Climate and environmental risks or opportunities that are unlikely to materialize over the next few years, but could be significant over longer horizons, tend to be under-priced or underappreciated by investors.

To make the information usable for investors and to hold companies' boards accountable for their performance regarding environmental matters, there needs to be a requirement that all financially material climate and other natural capital information is published in mainstream financial reports, as recommended by the TCFD, and not in separate non-financial reports. Also "consideration should be given to the linkage between scenario analyses performed to assess the resilience of an organisation's strategy to climate-related risks and opportunities (as suggested in the TCFD recommendations) and assumptions underlying cash flow analyses used to assess asset (e.g., goodwill, intangibles, and fixed assets) impairments".

The TCFD recommendations provide valuable guidance on effective and efficient reporting of material information associated with climate change in particular. Implementing the TCFD recommendations within the NFRD would support an appropriate level of reporting on these matters.

Please specify additional categories of non-financial information	
Additional category of non-financial information #1	**Targets**: including a quantitative and qualitative description, with special focus on dedicated strategies, approaches and timelines for pursuing climate and natural resources neutrality (for GHG emission reduction targets, see the new EU Commission non-binding guidelines for reporting climate-related information (KPI section).
Additional category of non-financial information #2	**Investments & expenditures**: forward-looking CapEx/OpEx and/or R&D expenditures on activities that contribute to sustainable development (incl. EU Taxonomy).
Additional category of non-financial information #3	**Scenario analysis** (stress testing) of medium to long term sustainability issues on business performance. (Note: This will likely result in unbalanced information as companies feel disincentivized to disclose risks / negative information. This issue should be considered either through the NFRD or other means). Companies need to be incentivized to disclose negative results from scenario analysis.

Question 6: How do you find the interaction between different pieces of legislation?

Lack of interaction between different pieces of legislation – all existing requirements, notable under the NFRD regarding environmental issues, are necessary. However, they are not yet fully "fit for purpose". This is due to shortcomings that prevent investors from being able to link the information reported by companies under the NFRD to their own new disclosure requirements. For example, investors are not able to assess whether a company's business model and impact contribute to the environmental objectives that will be set out in the EU framework to facilitate sustainable investment (EU Taxonomy), while not harming any of the objectives. For the NFRD to serve as the disclosure requirement for companies, it is important it also covers the six environmental objectives of the EU Taxonomy Regulation.

In a mapping of the 'Actions' under the Sustainable Finance Action Plan and CDP's disclosure system and the data analysis, tools, metrics and initiatives offered by CDP to implement, and go beyond, the regulatory requirements, CDP shows how to spearhead sustainability leadership. The document provides information to CDP stakeholders on policies under the 'Actions' of the Action Plan, describing the purpose, scope, disclosure requirements and place of reporting, among other information, in a consistent structure that can allow disclosing entities to interconnect their disclosure requirements and develop synergies in reporting under several policies. It also supports policymakers in understanding the gaps, overlaps and how to improve interaction.

Section 2 - Standardisation

In regard to its proposal to develop a European standard and clearly define what information companies should report and how such information should be prepared and presented, the European Commission is right to be proactive. A public standard is important for ensuring that the long-term risks and impacts of climate change and environmental degradation – both economic and societal – are as universally measured and managed as possible. And achieving public consensus over the key information needed to deliver a climate neutral, resource-secure economy will ensure that the long-term, complex and systemic non-financial risks are well-priced by the market, and that the societal benefits of mitigation and adaptation can be well-judged.

Question 10.2: Please specify which other standard(s) or framework(s) you consider, applied on their own, would resolve the problems identified while also enabling companies to comprehensively meet the current disclosure requirements of the NFRD, and to what extent.

Name of other standard or framework		Please rate from 1 to 4
Other standard or framework #1	**To a reasonable extend for disclosure requirements of the NFRD in regard to climate change, water security and commodity-driven deforestation.** CDP's global disclosure system facilitates the above-mentioned standards and other frameworks regarding environmental information plus TCFD as CDP questionnaires reflect the double-materiality perspective: Information necessary for understanding impacts of the company («inside-out») on the environment and information necessary for understanding position, performance and development of the company regarding climate change and environmental degradation («outside-in»). Among CDP's key capacities are global consistency and comparability of data as well as mainstreaming reporting requirements among companies representing over 50% of global market capitalization and 75% of European market capitalization. This enables financial market participants to make evidence-based decisions of integrating environmental criteria into their investments. Moreover, CDP is widely used among SMEs through the Supply Chain Programme.	3

Question 13: In your opinion, would it be useful for there to be a simplified standard and/or reporting format for SMEs?

CDP provides simplified versions of its standardised questionnaires for SMEs. The threshold for eligibility for the minimum questionnaire at "*annual revenue of less than EUR/US$250 million"*. The exact layout of the minimum vs standard questionnaire can be derived from CDP's Question Changes and Map document (page 20 onwards). Similar documents exist for the water and forests questionnaires.

The general principles by which the questionnaire gets slimmed down from full to minimum version are:

- Lower level of granularity
- No sector-specific questions
- No ask for external verification

Questions 17 and 18: Which key stakeholder groups should have an interest in and contributing to the elaboration of nonfinancial reporting standards?
While different stakeholder groups should be involved, we see a need for and benefit of differentiating each stakeholder group's involvement in the process of developing the European non-financial reporting standards along:

- Expertise on the issues and consequently involvement on specific aspects in the standards development process
- Input driven by private interest versus public interest (for-profit entity or charity)

Investors: The main audience of the NFRD is financial market actors. They are key users of non-financial information in order to invest in line with the European Green Deal and the Paris Agreement and need non-financial information from companies to comply with investor disclosure requirements in interconnected regulations. Investors' view should be given extra emphasis when it comes to location and presentation, accountability framework, and assurance of non-financial information.

Preparers: The sustainability departments, but also other departments such as risk management, research and development and purchasing need to ensure that the reporting standards enable and drive internal strategic integration of sustainability and transitioning the business model. Preparers should be given extra emphasis when it comes to the accountability framework, the use value of different indicators for internal management, and on the design of simplified standards for SMEs from a value chain/client (purchasing department) perspective.

Auditors / accountants: These stakeholders need to ensure that non-financial information is provided in a way that allow assurance and audits to drive high-quality and efficient verification of non-financial information. Accountants should be given extra emphasis when it comes to enabling preparers via the standards to assess and assign the real costs to negative impact of corporate activities on the environment and to identify ways to reward sustainability and factor it into business decision making.

Civil society representatives / NGOs: This stakeholder group represents the public interest across environmental, social and governance issues. Expert organizations on the different matters should be given extra emphasis when it comes to the principles and the content of European standards on non-financial reporting. NGOs should also be involved in the governance of the European non-financial reporting standard(s) in order to uphold the public interest and non-financial reporting leading to private sector activities that serve the public good.

Academics: Representatives from academia need to ensure that the content and in particular the methodology and metrics that might be specified in the non-financial reporting standard enable science-based measuring of corporate impact against limits of natural resources from a holistic and interdependency perspective.

Section 3 - Application of the principle of materiality

The materiality perspective of the Non-Financial Reporting Directive covers both financial materiality and environmental and social materiality.
CDP questionnaires reflect this double-materiality perspective: Information necessary for understanding impacts of the company («inside-out») on the environment and information necessary for understanding position, performance and development of the company regarding climate change and environmental degradation («outside-in»).

We suggest clarifying the concept of 'material' non-financial information along the following considerations:

1. Non-financial and financial materiality are different, complementary concepts, especially regarding audience and time-horizons.
2. Materiality needs to be explicitly linked to scientific limits of natural resources from a holistic and interdependency perspective. This could be done by reflecting non-financial materiality in the set of forward-looking indicators developed in the standard setting process. (see 'Please provide any comments or explanations to justify your answers to questions 8 to 20', suggestion for involvement of NGOs and academia).
3. For achieving the goal of 'shifting the trillions', there are three main aspects: (i) recognizing financial market actors as a primary audience of non-financial information, (ii) clarifying that the concept of financial materiality needs to stem from the 'inside-out' materiality perspective (see point 2), and (iii) strengthening linkages between non-financial and financial information and reporting.
4. Clarifying that financial materiality needs to build on non-financial materiality can help to avoid that financial materiality does negatively influence the assessment of non-financial materiality; and help preparers to better reflect financial risks and opportunities occurring from non-financial matters.

On consideration 2:

Rationale for a strong focus on the inside-out perspective: For many companies, particularly SMEs and inexperienced report preparers, the term "non-financial" statement does not imply disclosing information that is financially material. After all, financially material information must be disclosed separately in financial accounts and management reports. In line with this, evidence from recent disclosures under the NFRD shows that, by and large, companies DO NOT connect non-financial information in their non-financial statements to their current financial performance or position. In 2019, over 700 stock-listed companies in Europe disclosed to CDP have identified inherent climate-related risks with the potential to have a substantive financial or strategic impact on their business.

The NFRD in its current form should not be regarded as an appropriate or even effective tool to strengthen disclosure of non-financial performance on a company's bottom line. To achieve that objective, the Commission needs to consider changing the Accounting Directive to include references to financially material environmental matters over the short and medium term. After all, a double materiality perspective is best considered by preparers of integrated reports, which, in the absence of a regulatory move towards integrated reporting in the EU, most companies in Europe are not.

Therefore, the reporting obligation under the NFRD could be clearer and avoid any form of implied double materiality perspective. Instead, and to implement the double-materiality perspective effectively, the materiality definition of the NFRD should clearly focus on the inside-out perspective, i.e. a company's impact on environmental matters, while the materiality definition in the Accounting Directive should be extended to specify the outside-in perspective in regard to financially material environmental matters over the short and medium term. Companies should be incentivized to voluntarily connect financial and non-financial information in their non-financial statements. See more details below.

In the NFRD, the materiality concept should focus on the inside-out perspective (also see Q24 for further details) and must be extended:

Companies should disclose information **"to the extent necessary for an understanding of the development, performance, position and impact of [the company's] actions and activities on non-financial matters in the short, medium and long term."**

The word "actions" should be added to differentiate from "activities", which could be interpreted as economic activities only (EU Taxonomy Regulation definition). However, companies can take other actions, e.g. introduction of a policy for management incentives to achieve environmental goals, to foster sustainable development. The time periods "short, medium and long term" should be added to support long-term strategic planning and disclosure, and avoid unnecessary short termism in the face of long-term sustainability risks and opportunities.

Further guidance should be provided on:

- What is meant by "development, performance, position and impact" with regard to non-financial, i.e. for environmental matters. For example, that "performance" means performance against environmental objectives, or "position" means a company's current level of greenhouse gas emissions etc.
- That non-financial matters include EU environmental policy objectives such as EU climate goals, mid- and long-term. Corporate misalignment to these public policy objectives could put a company's license to operate at risk and present a material risk for investors (see the EU guidelines on reporting climate-related information where KPIs are linked to EU climate and energy policies).
- As to when to report financial information, particularly revenue and expenditures relating to environmentally sustainable actions and business activities, including EU Taxonomy activities. See further details below.

On consideration 3:

Certain financial information is relevant in the NFRD. Still, some financial information will be necessary for report readers to understand and compare a company's (future) impact and should be mandatory to disclose. For example, it is important to know the revenues generated from EU Taxonomy activities or related capital or operational expenditures.

The NFRD already makes that connection under Article 1: *"The non-financial statement referred to in the first subparagraph shall also, where appropriate, include references to, and additional explanations of, amounts reported in the annual financial statements.".*

This existing linkage should be strengthened, for example: *"The non-financial statement referred to in the first subparagraph shall also include references to, and additional explanations of, amounts reported in the annual financial statements. This shall apply to revenues from or expenditures in actions or activities related to non-financial matters".*

On consideration 4:

Such negative influence is that the financial materiality concept can be used by companies for avoiding reporting on issues which are not considered "material". For example, some companies do not report on the deforestation-risk commodities they source as they consider the financial risks to be negligible, however, the volumes they source are big enough to have a detrimental environmental impact. If they were to correctly apply the double materiality principle, i.e. also taking into account in similar fashion the impact of their activities on the environment as stand-alone determinator, they would probably not come to this conclusion.

For this reason, CDP guidance for companies e.g. tells them not to exclude emission sources just for the reason of "immateriality": Relevance of emissions should not be limited to sustainability topics that have a significant financial impact on your organisation, or "materiality" (see CDP guidance to companies).

Section 4 - Assurance

Question 26: Should EU law impose stronger assurance requirements for non-financial information reported by companies falling within the scope of the NFRD?

CDP encourages the verification/assurance of information disclosed in the questionnaire. CDP-accredited third-party verification and assurance providers can help companies to disclose accurate data and improve internal processes. Because of the widespread use of CDP corporate scores on financial markets, companies within CDP's highest level of scoring must submit external verifications for their data on GHG emissions.
To ensure that the third-party verification activities undertaken by companies are broadly comparable, CDP requires verification to be completed in accordance with recognised verification standards. These standards must have a common set of attributes which are set out in the criteria below. Any third-party verification standard referenced in a company's submission to CDP will be assessed against these criteria to determine acceptability. Note that "Agreed upon procedures", "pre-assurance" or internal verification is not accepted as verification under the CDP scoring methodology.

To be awarded Leadership points for verification in 2020, at least 70% of Scope 1 emissions and 70% of Scope 2 emissions must be verified. The 70% refers to the total emissions within the reporting boundary, and there must also be no relevant exclusions from the reporting boundary for Leadership points to be awarded. Leadership points for Scope 1 and Scope 2 verification must have been awarded for a company to get the highest score of "A" and be included in the "A list". To be awarded Management points for verification in 2020, the statement can cover any proportion of emissions within the reporting boundary. For Scope 3 verification in 2020 Management points will be awarded for any proportion of emissions verified. To ensure that the third-party verification activities undertaken by companies are broadly comparable, CDP requires verification to be completed in accordance with recognised verification standards.

Finally, through the nature of the CDP reporting system, investors are enabled to hold companies accountable for the correctness of their disclosures, including – in many cases – their disclosures of past years.

Question 27: If EU law were to require assurance of non-financial information published pursuant to the NFRD, do you think that it should require a reasonable or limited assurance engagement on the non-financial information published?

Currently, CDP does not differentiate between limited and reasonable assurance within the CDP scoring methodology. CDP wants to continue to allow the flexibility of both levels of assurance being accepted allowing companies to select what makes sense for their business, the purpose of the verification and previous practices in the company. CDP also accepts different verification standards and those can use different terminology in relation to levels of assurance, therefore limiting verification requirements to a particular level of assurance might not always be comparable. However reasonable and high assurance will always provide a higher level of assurance than limited and moderate assurance. CDP will continue to monitor and review its approach to different levels of verification in 2020.

Question 30: If assurance of non-financial information was required by EU law, do you think that assurance engagements should be performed based on a common assurance standard?

CDP requires companies' external emission verification to follow an accepted standard (see list of accepted standards). It needs to be ensured that external assurance follows a standard that has been assessed to be solid and trustworthy, but that it does not necessarily have to be only one and the same framework.

Section 5 - Digitalisation

Question 35. Please provide any other comments you may have regarding the digitalisation of sustainability information:

Improving the flow of non-financial information and reducing transaction costs through digitalization is highly important.

It would greatly reduce access costs for investors and ESG rating agencies, so that work could focus more strongly on interpreting the data and engaging with companies on non-financial issues.

In order to save time and costs and to build on existing work, the CDP disclosure system – as the only corporate environmental reporting system and operating under a charitable mission –, can be used to channel corporate environmental information to and/or to operate as part of the EU's single access point for non-financial information.

Digitalization would also allow other relevant stakeholders to access and use relevant corporate non-financial information easier. The opportunities are countless such as for:

- Cities (e.g. issuing green bonds)
- Statistical institutions (e.g. interconnecting with macro-economic indicators)
- Governments (e.g. using private sector information for national-level modelling and monitoring)
- Environmental agencies (e.g. comparing physical climate risk maps with similar risks reported by businesses in same region)
- Academia and NGOs (e.g. performing research projects)

Section 6 - Structure and location of non-financial information

Question 38.1 Please provide any comments regarding the location of reported non-financial information:

Irrespective of whether a company sees non-financial information as financially material or not, non-financial information should have the same status as financial information.

A switch in mindset is necessary. By creating a level playing field of information, corporate managers will learn and adopt the notion that business is embedded in society and nature and that sustainable development is a precondition for long-term business success.

To make the information usable for investors and to hold companies' boards accountable for their performance regarding environmental matters, there needs to be a requirement that all financially material climate and other natural capital information is published in mainstream financial reports, as recommended by the TCFD, and not in separate non-financial reports nor in internal management reports. Management reports can be used as an internal tool to demonstrate a company's performance for certain segments, yet it cannot replace the mandatory external financial reports, in which standards have to be kept and in which environmental matters should be integrated.

While reporting is necessary to support efficient and resilient markets, inconsistency can cause additional burden and therefore unnecessary costs to report preparers.

Reference to established frameworks and guidance can further increase consistency, as well as market best practice, to support the preparation of the reports.

To help investors make well-informed decisions, monitor and analyse relevant risks, and price long-term risks and consider opportunities - specifically those arising from the move towards a sustainable and climate friendly economy - a harmonisation of member states' non-financial ESG reporting requirements is crucial. The structure of the TCFD should be the mandatory frame to create more coherence and consistency on disclosure across the 4 components.

Section 7 - Personal scope (which companies should disclose)

Question 42.1 If you consider that there should be a specific competent authority in charge of supervising non-listed companies' compliance with the obligation of disclosing non-financial information, please specify who in your opinion should carry out this task (National Competent Authorities, European Supervisory Authorities, other...) and how.

Supervision of non-financial information by National Competent Authorities should be ensured at the same level as for financial information, in order to provide authoritative feedback to corporate report preparers.

Separate reports that include non-financial information 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 underline 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.

Section 8 - Simplification and reduction of administrative burdens for companies

While the question whether SMEs experience too high reporting burden through being asked to report to larger companies is understandable, it is not the right question to ask. Reporting is a necessity for companies for thorough internal management and an opportunity for companies to attract long-term investments by showcasing their transition to a more sustainable business model. Disclosure helps companies get ahead of regulatory and policy changes, identify and tackle growing risks, and find new opportunities for action that their investors and customers worldwide are demanding.

There are tangible business benefits to be gained from responding to investor and purchaser's requests for disclosure:

- Protect and improve a company's reputation – building trust through transparency and respond to rising environmental concern among the public
- Boost competitive advantage – gain in a competitive edge when it comes to performance on the stock market, access to capital and winning tenders
- Get ahead of regulation – preparedness for likely mandatory environmental reporting rules
- Uncover risks and opportunities – identifying emerging environmental risks and opportunities that would otherwise be overlooked, to inform data-driven strategy
- Track and benchmark progress - benchmark environmental performance against industry peers

CDP has identified $20.2bn worth of monetary savings associated with emission reduction activities by companies that respond to the climate change questionnaire through the supply chain program. Translated to the context of the NFRD, the rationale for leveraging corporate disclosure has a clear benefit. Concrete examples of the cost savings of reporting are most evident throughout supply chains. Confronted with the risks of disruption from climate change, water insecurity and deforestation, in 2019 more than 1.700 European companies disclosed data through CDP's climate, water and/or forest questionnaire after called upon by their clients (purchasing departments of corporates). The result was quite extraordinary: French and German suppliers alone report saving 50 million tonnes of CO2e and over $1 billion from initiatives implemented in 2017. Even without a direct request from investors or purchasing companies, almost 60 companies in Europe are disclosing data via CDP's disclosure platform voluntarily, to be able to attract investments and to improve their reputation.

Supply chain emissions on average are 5.5 times greater than operational emissions. It's clear that to take meaningful action, companies must leverage their purchasing power, and collaborate with their supply chains. Supplier's ambition often lags behind the buyers' ambitions. This inaction generates corporate risk. Thus, there is no alternative to tackling sustainability issues throughout entire supply chains and thus the questions that needs to be asked is how it can be ensured that suppliers benefit from climate and environmental reporting. Especially, suppliers benefit from reporting when they have a competitive and/or financial advantage. CDP data show that globally 52% of suppliers have already integrated climate change into their strategies. Further, 23% of suppliers are engaging with their own supply chain to reduce emissions. Not to mention the huge water footprint of manufacturing and extractive industries or impact on forests by agriculture.

With the global economy set to triple by 2050, supply chains are more important than ever to meet decarbonization targets. In most sectors, SMEs have multiple clients which means that the reporting is done once to respond to the reporting need of several large companies. In 2019, on average, one supplier company received the same disclosure request by 55 large companies through CDP. This is the result of harmonized reporting requirements – in this case the CDP climate change questionnaire that is the same for all companies, suppliers and stock-listed companies – which create competitive advantage for suppliers for a good climate performance which compensates the reporting effort.

A 2015 cost-benefit analysis by KPMG, on behalf of WWF and CDP, shows that while companies have a significant cost factor in resources, such as human resources, IT and alike to conduct environmental reporting, the benefits of disclosing weight out these costs. There are some sectors in which the benefits are higher than in other sectors, and also larger companies generally have higher benefits than smaller companies. However, the study also suggests, that reliable information and support on how to implement environmental reporting reduces the costs factor, as well as the learning effects over time. Also, clear signals from financial market participants and transparent communication risk analyses and the resulting pricing, can increase companies' direct benefits from reporting.

Brussels, 08/05/2020

For further information

Mirjam Wolfrum
Director Policy Engagement
+32 2 880 04 37
mirjam.wolfrum@cdp.net

CDP Europe
EU Transparency Register No.: 050269010212-72
c/o Finance Watch
Rue Ducale 67 b3, 1000 Brussels, Belgium

Supported by the LIFE programme of the European Union