CDP EUROPE POLICY BRIEFING: CORPORATE SUSTAINABILITY DUE DILIGENCE DIRECTIVE

CDP's policy recommendations for the proposed due diligence law

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OVERVIEW

The Corporate Sustainability Due Diligence Directive (CSDDD) is an important cornerstone of the EU regulatory framework on company law and corporate governance. CDP Europe welcomes the Commission's initiative to establish a coherent framework of due diligence rules to make companies accountable for human rights and environmental harm as well as require them to develop plans to mitigate these risks and impacts.

The requirements for large companies to adopt a plan to ensure that their business model and strategy are compatible with the transition in line with 1.5 °C is a major step, next must be to align their business with the nature positivity goal. The integration of these requirements in the due diligence and directors' duties elements of the directive is necessary to make this a mandatory requirement for companies.

KEY RECOMMENDATIONS

- Policymakers should strengthen the role of directors in pursuing their company's long-term interests and improving the accountability of directors concerning the sustainability of their business conduct.
- An accountability mechanism is needed to raise the bar to align with halving emissions, shifting towards nature positivity by 2030 and achieving net-zero emissions and full nature recovery by 2050.
- Companies should set nature positivity targets to ensure their operations are contributing to the full nature recovery by 2050.

Directors' Duties and Long-Term Objectives

The requirements for directors' duties in the proposed directive set out overarching principles yet fail to define in more depth the required detail needed to define science-based and measurable targets. Policymakers should focus on strengthening the role of directors in pursuing their company's long-term interests and improving the accountability of directors concerning the sustainability of their business conduct.

- In 2020, 73% of European companies responding to CDP's disclosure request for climate reported that the responsibility for climate change oversight lies with the senior management. In 57% of companies, the top-level management (CEO, COO or CFO) bears responsibility for climate-related issues.

Policy Recommendation

- Corporate directors should be required to set measurable, science-based targets to ensure that possible risks and adverse impacts on climate and the environment can be identified and mitigated.

In a keynote speech entitled 'What does the European Commission want to achieve with the Sustainable Corporate Governance initiative' Didier Reynders, Commissioner for Justice said:

> "It is important that directors have a clear obligation to identify sustainability risks and opportunities and to integrate this in the corporate strategy. Directors would also need to set science based and measurable sustainability targets. They would need to set a trajectory or transition plan to reach those targets. They would also need to ensure that such a strategy is implemented with the necessary risk assessments and due diligence procedures. We want to ensure that corporate decision-making changes to a sustainability mindset at all levels." (February 2021)

Companies must set emissions reduction targets that cover at least two-thirds of scope 3 emissions. For many companies, most of their scope 3 emissions will be concentrated in their supply chain and so being able to track and reduce emissions in the supply chain is often key to enabling a company to meet their science-based emissions reduction target.

With the environmental crisis needing immediate attention, the necessary strengthening of corporate governance and due diligence rules will bring more accountability for achieving progress against EU and global goals by requiring large companies to set targets and implement actions to achieve those targets. Yet the primacy of both target setting and the accomplishment of those targets is neglected in many companies:

For example, CDP data shows just 1 in 20 listed companies have strong targets to reduce emissions, water use and deforestation impact, and around 50% of emissions reported aren't covered by science-based targets to align with 1.5 degrees.

Corporates are not moving fast enough to ensure that their operations align with the planet's limits. The European Commission's proposed requirements for company target setting is a key step towards measuring corporate impact.

Almost 2513 companies (as of May 2022) have committed to aligning their near-term emissions reduction targets with the goals of the Paris Agreement (science-based targets) – out of which 1415 companies (56%) had these targets checked and verified by the Science-Based Targets Initiative (SBTi).

The CDP Science-Based Targets (SBTs) Campaign offers CDP investor signatories the opportunity to play a key role in accelerating the adoption of science-based climate targets in the corporate sector by collaboratively engaging companies on this matter. In 2021, 220 financial institutions holding $29.3 trillion in assets across 26 countries requested over 1600 companies worldwide to set SBTs[1], representing 25% of global emissions, globally to set an SBT.

Expand Article 15 to Cover Nature

CDP Europe welcomes the requirements for companies to: 'adopt a plan to ensure that the business model and strategy of the company are compatible with the transition to a sustainable economy and with the limiting of global warming to 1.5 °C in line with the Paris Agreement.

[1] Financiers with $29 trillion ask 1600 companies for science-based targets ahead of COP26 – CDP

In line with the proposed CSRD and European Sustainability Reporting Standard E4 exposure draft on biodiversity and ecosystems[2], companies should also be required to adopt plans to ensure that their business model and strategy are compatible with the transition to achieve 'no net loss by 2030, net gain from 2030 and full recovery by 2050', in accordance with the first draft of the post-2020 Global Biodiversity Framework[3].

Align businesses not only with climate change mitigation but ensure their alignment with nature-recovery

Nature generates at least $44 trillion in economic value every year, yet losses to nature continue at unprecedented rates, with three quarters of land and sea altered by people and over a million species threatened with extinction[4].

The IPCC and the Intergovernmental Science-Policy Platform on Biodiversity and Ecosystem Services (IPBES) jointly agree that addressing the climate crisis cannot be achieved without simultaneously equitably addressing the nature crisis. This includes conserving, protecting and restoring ecosystems, adopting more sustainable agriculture and forestry practices, and ensuring a circular economy[5].

Overall, the global goal of net carbon neutrality by 2050 needs to be matched by an equally clear global goal of net positivity for nature. This requires measures to eliminate nature loss, with restoration well underway by 2030, moving us to a nature positive economic system by 2050.

An organization that commits publicly to implementing a nature – including biodiversity – policy sends investors and other data users a strong signal that it wishes to be held to account for its biodiversity stewardship. Organizations disclosing this information can benchmark their commitments against their peers and so drive change within their industries.

Policy Recommendation

- Companies should ensure there is board-level capacity and oversight of climate and nature-related impacts, risks and opportunities.
- Consider whether the board, board committees and/or executive management consider biodiversity-related issues when reviewing and guiding the business strategy, major plans of action, risk management policies, annual budgets, and future financial planning, or when setting the organization's performance objectives, monitoring implementation and performance, and overseeing major capital expenditures, acquisitions, and divestitures.

[2] First Draft of the post-2020 Global Biodiversity Framework
[3] The First Draft of the Post-2020 Global Biodiversity Framework (2021) states "by 2050, biodiversity is valued, conserved, restored and wisely used, maintaining ecosystem services, sustaining a healthy planet and delivering benefits essential for all people" and "to take urgent action across society to conserve and sustainably use biodiversity and ensure the fair and equitable sharing of benefits from the use of genetics resources, to put biodiversity on a path to recovery by 2030 for the benefit of planet and people".
[4] Accelerating the rate of change CDP strategy 2021 – 2025
[5] IPBES-IPCC. Scientific Outcome of the IPBES-IPCC co-sponsored workshop on biodiversity and climate change

Raising ambition and accountability with transition plans

Setting GHG reduction targets aligned with demanding decarbonization scenarios should not be just another brick in the company's GHG disclosure wall. It should lead to actual strategic shifts toward a low carbon economy.

Quantifying GHG emissions and setting GHG reduction targets should be the stepping stone to supporting and developing a relevant decarbonization strategy with an associated detailed transition plan and roadmap.

- Accountability is needed to raise the bar to align with halving emissions, shifting towards nature positivity by 2030 and achieving net-zero emissions and full nature recovery by 2050. In line with CDP's 2021-2025 strategy, the climate change questionnaire and scoring will be evolving to further encourage and support companies to set targets and create tangible transition plans and measure their performance against them.

Policy Recommendation

- Large companies should develop and adopt their transition plans as per the recommendations of ACT (Assessing Low Carbon Transitions) – an initiative founded by CDP and ADEME (French State Agency for Ecological Transition)

Eighty-three per cent of companies headquartered in EU27 countries and reporting to CDP in 2021 indicate that climate-related risks and opportunities have influenced their organization's strategy and/or financial planning, of which 52% report having developed a low-carbon transition plan.

CDP's briefing on transition methodologies[6] shows how the work of ACT (Assessing Low Carbon Transitions) – an initiative **founded by CDP and ADEME (French State Agency for Ecological Transition) to recognize and support companies to align their climate transition strategies with low-carbon pathways – can support European policymakers to design a uniform methodology for assessing transitions.**

- ACT recognizes the role of governance in the climate transition and includes indicators on remuneration linked to emissions reductions or growth
- ACT identifies best practice elements in climate transition plans, including the use of scenario or stress testing, and assesses against them
- Transition risk is included in the scope of the assessment

A comprehensive assessment of how the proposed article 18 could be enhanced by ACT's transition methodology is presented in the table below.

[6] CDP Fact Sheet: Transition plans in line with 1.5°

CSDDD Article 15 – combatting climate change	ACT transition methodology
Companies adopt a plan to ensure that the business model and strategy of the company are compatible with the transition to a sustainable economy and with the limiting of global warming to 1.5 °C in line with the Paris Agreement.	Assessment of a company's transition plan using qualitative indicators to assess the integration of low-carbon activities in current and future business models, for each sector. ACT methodologies identify best practice elements which should be included in the transition plan. These include but are not limited to: - Financial projections; cost estimates or other assessments of financial viability; - Quantitative estimates of how the business will change in the future; - Potential "shocks" or stressors (sudden adverse changes); - Relevant region-specific considerations; - Targets or commitments with timescales to implement them; - Details of actions the company realistically expects to implement; - Measures of success. In terms of strategy, ACT is using a comprehensive forward-looking approach to assess the alignment of companies' strategies and actions with a 1.5°C compatible pathway.
This plan shall identify, on the basis of information reasonably available to the company, the extent to which climate change is a risk for, or an impact of, the company's operations.	ACT asks whether a company has engaged in scenario and/or stress testing to calculate its value-at-risk due to climate-related impacts. The results of this testing should be communicated to management, incorporated into strategic planning and made public.
The company should include emission reduction objectives in its plan.	An ACT assessment evaluates a company's targets across a number of areas. - Is there sufficient ambition and alignment with the company's decarbonization pathway? - Achievement of current and past targets - How much the target timeline covers the lifetime of the company's assets - Are the targets frequent enough to deliver the necessary emission reductions? - Is the scope of the target(s) sufficient? ACT analysis can determine the gap between the company's targeted pathway and the company's low-carbon pathway at a given time horizon.

Member States shall ensure that companies duly take into account the fulfilment of the obligations listed above when setting variable remuneration, if variable remuneration is linked to the contribution of a director to the company's business strategy and long-term interests and sustainability.	An ACT assessment reviews whether the Board's compensation committee has included metrics for the reduction of GHG emissions in the annual and/or long-term compensation plans of senior executives. For relevant sectors, an assessment of whether incentives exist in executive remuneration could incentivize emissions growth is conducted.

ACT presents policymakers with the elements that make up a sound and effective transition planning framework that is long-term, science-based, holistic and action-oriented. Developed in partnership with ADEME and already used by companies who lead the transition globally, ACT has set the foundation for what is becoming mandatory in the EU. Whereas transition planning in line with 1.5°C and a nature recovery will be introduced across EU initiatives, the CSDDD must mandate companies to disclose their transition plan. ACT goes beyond driving transition plans; it provides the tools to assess their quality.

- EU policymakers should introduce a uniform methodology for measuring an undertaking's low-carbon transition in relation to the disclosure requirements defined under article 15 of the directive, which mandates disclosure of business plan alignment with the Paris agreement.

SUMMARY – POLICY RECOMMENDATIONS

- **Strengthen the role of directors in pursuing their company's long-term interests** and improving the accountability of directors concerning the sustainability of their business conduct.
- **Corporate directors should be required to set measurable, science-based targets** to ensure that possible risks and adverse impacts on climate and the environment can be identified and mitigated as part of a wider transition plan.
- **Large companies should adopt transition plans** in line with net-zero emissions and full recovery of nature by 2050 (in line with latest science from IPCC and IPBES) and disclose them under the CSRD.
- Companies should ensure there is board-level capacity and oversight of climate and nature-related impacts, risks and opportunities.**Consider whether the board, board committees and/or executive management take into account biodiversity-related issues when reviewing and guiding the business strategy**, major plans of action, risk management policies, annual budgets, and future financial planning, or when setting the organization's performance objectives, monitoring implementation and performance, and overseeing major capital expenditures, acquisitions, and divestitures.
- **Companies should adopt plans to ensure that their business model and strategy are compatible with the transition to achieve 'no net loss by 2030, net gain from 2030 and full recovery by 2050'**, in accordance with the first draft of the post-2020 Global Biodiversity Framework.

For further information

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CDP Europe and the CDP global system

CDP Europe is a charitable organization registered in Brussels and Berlin and on the EU Transparency Register since 2012. It is part of the CDP Global System, a global non-profit that runs the world's environmental disclosure system for companies, cities, states and regions. Founded in 2000 and working with over 680 investors with $130 trillion in assets, CDP pioneered using capital markets and corporate procurement to motivate companies to disclose their environmental impacts, and to reduce greenhouse gas emissions, safeguard water resources and protect forests. Over 14,000 organizations around the world disclosed data through CDP in 2021, including more than 13,000 companies worth over 64% of global market capitalization, and over 1200 cities, states and regions. Fully TCFD aligned, CDP holds the largest environmental database in the world, and CDP scores are widely used to drive investment and procurement decisions towards a zero carbon, sustainable and resilient economy. CDP is a founding member of the Science Based Targets initiative, We Mean Business Coalition, The Investor Agenda and the Net Zero Asset Managers initiative. Visit cdp.net or follow us @CDP and on LinkedIn to find out more.

In Europe, CDP Worldwide (Europe) gGmbH is a charitable limited liability company headquartered in Berlin, Germany, registered on the EU Transparency Register since 2012. It is a wholly owned subsidiary of CDP Europe AISBL, a charity based in Brussels, Belgium (together: "CDP Europe"). CDP Europe is part of the non-profit CDP Global System ("CDP"), which refers to three legally separate organizations: CDP Europe (BE), the CDP Worldwide Group (UK), and CDP North America, Inc. (US).

CDP Europe's annual report is available **here** and its regular policy newsletter can be joined here.

CDP Government Partnerships

CDP Government Partnerships are designed to help governments analyse the impact of policies and regulation to achieve carbon-neutrality and resource efficiency by 2050. CDP's global disclosure system equips national, EU and international policymakers and governmental bodies with the data they need to track and measure the impact of policies, identify gaps, trends and best market practice that can be tackled and incentivized through policymaking to create positive impact and drive the transition.

By endorsing the CDP disclosure system, governments can actively drive the increase in quantity and quality of climate and environmental data of corporates and local governments as well as action on climate change, water insecurity and deforestation.

CDP Europe in European and international media

Les Echos FINANCIAL TIMES Bloomberg euronews.

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