European Sustainability Reporting Standards (ESRS)

Comment from CDP

July 2022

Overall ambition

Nicolette Bartlett, Chief Impact Officer, CDP

"The EU has shown leadership in creating sustainability standards covering companies' impacts on people and planet, as well as environmental-related risk information – what the EU calls double materiality.

With the environmental crisis needing immediate attention, this much needed strengthening of EU disclosure rules will bring more accountability, a better understanding of risks and opportunities and of the progress against EU and global goals, and will raise the bar on what is expected from 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 they do align with our planet's limits. That's why these standards' requirement that companies report a wide range of relevant science-based environmental data is so key.

With 13,000 companies currently disclosing environmental data to CDP, we are committed, through mainstreaming reporting against the European standards and other emerging global standards at scale through our disclosure system, to providing global capital market actors with a one-stop shop to access comparable, high-quality sustainability data."

Maxfield Weiss, Executive Director, CDP Europe

"CDP is delighted to see the first drafts of the EU sustainability reporting standards launched. These ambitious standards will require companies to report widely on sustainability information and cover their impacts on people and planet. The EU standards are the only ones currently going beyond climate and recognising the importance of a holistic response to our environmental challenges. As the global environmental disclosure system, CDP is committed to mainstreaming ESRSs and other emerging global and jurisdictional-level standards at scale in our disclosure system, to support disclosing and newly joined companies with their reporting and ensure global capital markets and policymakers have access to comparable, high-quality sustainability data produced under different incoming global standards in one place.

Companies disclosing through CDP are well prepared for regulations mandating disclosure. We have always evolved and adapted our questionnaires in light of emerging new standards, priorities or regulations, and will continue to do so. As more companies will be required to report under the Corporate Sustainability Reporting Directive and the European Sustainability Reporting Standards from 2024 onwards, we will continue to ask the right questions so that the data we collect, distribute and analyze is meaningful for companies to ensure their business is on top of regulatory expectations. Through its guidance documents, its workshops and dedicated teams, CDP offers support on every step of the disclosure journey and through its transparent scoring and benchmarking methodologies, CDP ensures that responding companies not only provide a complete and consistent dataset but also drive change through insight and action."

Key recommendations

- A double-materiality approach in sustainability reporting is the correct approach, and the climate and nature crisis dictate that we need it to be applied globally. With reference to the impact on people and planet, the definitions should be fully aligned with the GRI Standards. With reference to the financial materiality, EFRAG expands the notion of financial materiality in the context of sustainability reporting to include potential financial effects of the risks and opportunities likely to influence the company in the short, medium, or long term. CDP supports such an expansion and considers there to be scope to bring the language used closer to the one adopted by the International Accounting Standards Board (IASB) and used by ISSB when referring to the materiality of sustainability-related financial information.

- Oversight of companies' double materiality assessments needs to be kept at the level of the EU sustainability reporting standard setter. How materiality assessments will work in practice is critical for the implementation of the ESRSs and only the experience of the first years will show if the right balance has been reached. Therefore, analysis and public documentation will be essential.

- TCFD and ESRS structures are different, but compatible. However, the differences in the structure may pose challenges to practical implementation, may lead to confusion, and inevitably cause unnecessary costs to preparers and users alike. The ESRS structure can be easily improved to better correspond with the TCFD (and ISSB).

- EFRAG and disclosing companies, as well as users of information wanting to assess targets, should continue to actively reference the work of the Science Based Targets initiative and network, which allows users to put company targets into the necessary global and local sustainability context.

- Structuring disclosures is essential for greater data comparability and dissemination. XBRL is a great technological platform to achieve this.

- Specifying sector and activity disclosure, and guidance to generic ESRS disclosures will help further enhance data comparability.

- The lessons learned from financial reporting show that, at a minimum, country-by-country reporting is essential for full transparency and CDP's long-term practice shows it is possible to do it without over-burdening companies.

- Consider creating links between the environmental ESRSs based on a holistic approach. They are currently presented almost as a stand-alone environmental issue. The TNFD Framework's 'Why nature matters' section provides an example of a clear narrative on how the various environmental issues fit and interact with one another.

- Iterate, clarify and change disclosure recommendations as needed; the time window to address the climate and environmental emergency is short and this requires prompt identification and addressing of problems. We can restart the global financial system after financial crises, but **we cannot restart the planet after a global environmental breakdown overshooting planetary boundaries**.

- Further reading:
  - CDP's response survey 1 & 2: overall ESRS exposure draft's relevance and implementation
  - CDP's response survey 3: adequacy of disclosure requirements

Highlights from the ESRS disclosure requirements

Highlight #1: Value creation, business model and value chain disclosures

Considerable focus is given within the ESRS 2 on aspects related to value creation, business model and value chains. These aspects are critical for the transformation of businesses in the long term and for the creation of a sustainable economy. Relevant disclosures considered in the ESRS 2 include:

- ESRS 2-GR 3 – Key features of the value chain
- ESRS 2-GR 4 – Key drivers of the value creation
- ESRS 2-SBM1 to 4 – On strategy and business model, expectation of stakeholders, impacts and business mode and risks and opportunities

These narratives on how the business creates value, as well as critical dependencies and impacts along the value chain, get to the core of what double materiality should be. How relevant these disclosures will be in practice is yet to be seen. Having transparency on a company's own assessment of their business model impacts and dependencies, and if and how they are willing to transform them, will enable greater accountability of sustainability outcomes or lack of ambition in relation to sustainable performance.

This is certainly an area where significant evolution of the role of a company will occur and significant interaction should happen between companies, their stakeholders, as well as analysts and sustainability ratings.

With the Assessing low-Carbon transition initiative, CDP and ADEME began to address aspects related to the business alignment and transformation towards a net-zero economy. CDP's ambition is to be able to integrate such thinking across different environmental dimensions into its own ratings and contribute to the analysis of this information to drive companies towards a truly sustainable transformation of their business models.

Value creation, business models and value chains

- The World Benchmarking Alliance published The Climate & Energy Benchmark, using ACT methodologies, as well as data and analysis by CDP. Its Oil & Gas analysis from 2021 produced five key findings that relate to the lack of ambitious business model change of companies within this sector:
- Staying within 1.5°C means companies must keep oil and gas in the ground, but the most influential companies in the sector are purposefully going in the opposite direction pursuing a 'take what you can while you can' approach.
- The greatest contributors to climate change show a limited recognition of emissions responsibility through targets and planning. Analysis finds a systemic lack of scope 3 accountability, with only three companies having comprehensive emissions reduction targets.
- Empty promises: companies' capital expenditure in low-carbon technologies are not nearly enough. Only 30 companies reported on capital expenditure (CapEx) for low-carbon and mitigation technologies in 2019. And the CapEx companies are allocating to low-carbon technologies is insufficient to decarbonise at the scale and pace required.
- National oil companies: big emissions, little transparency, virtually no accountability. Companies with state ownership are slower to transition than the 'Majors' and 'Independents'. This poor performance is an even bigger risk to climate ambition than that of publicly listed and private companies. Companies with state ownership account for the majority of current and expected emissions in the sector. Many of the states involved have made no commitment to net-zero emissions and there is limited ability for non-government stakeholders to push for change.

Spotlight: Materiality assessment

A double-materiality approach in sustainability reporting is the right way to go and the climate and nature crisis dictates that we need it globally.

European efforts to assert a multi-stakeholder perspective on company reporting are essential for a truly sustainable transformation of companies' business models that reverses the environmental and climate crises, contributes to economic and financial stability, and protects a company's ability to generate value for investors. Value creation needs to embrace the careful act of constantly balancing positive and negative impacts across capitals and stakeholders in a "full world" (Daly, 2015). This wider view of value creation, pioneered by the GRI, is also a way of reiterating core EU values: democracy – all stakeholders should be represented and have a view on what is "valuable"; human rights – no discrimination in assigning and recognizing "value"; and equality – equal participation of all in the process of defining "sustainable value creation".

The objective of sustainability-related financial materiality is to maximize the stock value of a listed company – which, currently, does not necessarily price in the costs of climate change mitigation, and nature safeguarding and restoration. In light of the climate and nature crisis, we need corporate reporting rules, including materiality assessment, that are fit for driving environmental action within companies. The EU's double materiality approach is therefore the right way to go.

Financial materiality is a well-established and generally accepted accounting principle that, in its application, requires judgements about what information to include and how to present it. This judgement is not straightforward and often results from a dialogue between the preparers of information, its auditors and investors.

Double materiality, which seeks to establish an impact on value creation for the company and other stakeholders, will be even less straightforward. Preparers of information, assurers, users of information, impacted communities, and academia will have different views on what should be included under a double materiality lens. In this sense, double materiality is a socially constructed concept and differences of opinion about it should be agreed upon among stakeholders. Double materiality should not be looked at as a static exercise but as a process that evolves with time considering factors such as the financial risks to companies, the social perception of its impacts and different societal priorities and the physical limits of the environment (at local and global scales). Companies' reassessment of materiality should be done regularly against these factors. The risk is that companies just keep doing repeated single financial materiality assessments. Therefore, the EU's approach to request a double materiality lens from the start is sensible and will help companies understand better what is already or becomes financially material over time. Double materiality assessment will need to be practiced and its practice evaluated and evolved at pace to provide a reasonable response to the emergent environmental crisis. To allow consistent application globally, it would be beneficial to fully align the elements of the double materiality to the global definitions provided by GRI Standards and the ISSB.

As double materiality evolves, the impact of ESG factors on the financial accounts might also evolve – and might require new interpretations of financial standards or even new financial standards to accommodate this new reality. With the pressure from all stakeholders and the pressure of new financial realities, maybe it will be possible to radically transform companies' business models to guarantee the economy works within a planetary safe space.

This is also why CDP has adjusted its questionnaires over time to allow for more sector and sometimes activity-specific questions, and this is why the sector-specific ESRSs drafts still to be published - should be seen as an opportunity to highlight and clarify specific material topics for key sectors and activities.

Also, our process through which CDP, on behalf of its network of capital market signatories, selects companies to request to respond to the climate change, water security and forests questionnaire, can help inform materiality assessment at the standard-setter level. We apply factors such as market capitalization and environmental impact. **Reflecting on CDP's experience of 20 years, our point is that disclosure needs practice, constant oversight and**

evolution. In this sense, the draft ESRSs are a great effort but not a destination, rather they represent the beginning of a new, essential journey.

Highlight #2: Disclosures on transition plans

ESRS E1-1 requires the disclosure of transition plans for a climate-neutral economy and limiting global warming to 1.5 °C in line with the Paris Agreement; and ESRS E4-1 requires the disclosure of transition plans in line with the targets of no net nature loss by 2030, net gain from 2030 and full recovery of nature by 2050.

CDP considers the inclusion of these two requirements as a fundamental contribution to the successful transformation of companies' business models.

CDP first introduced a question for high-impact sectors on climate transition planning in 2018, as a result of the work done in the ACT – Assessing low-Carbon Transition project during 2016, with ADEME. Transition plans enable an organization to outline how it will deliver on its strategy to align with the latest and most ambitious climate science recommendations and keep itself in line or ahead of relevant policy goals for the organization.

How CDP supports best-practice implementation and can scale EU ambition globally

Transition plans will be fundamental in catalyzing action needed to achieve a sustainable economy and are therefore at the heart of CDP's strategy. We want to do more to encourage and support companies to establish credible transition plans, underpinned by science-based targets. CDP is continually working to refine and develop guidance on transition plans, based on the companies' disclosures, as well as measure performance against them. It is our ambition to broaden the scope of our existing work to fully integrate nature.

Transition plans

Based on existing CDP data and current research into established frameworks, CDP considers a credible climate transition plan to:

- Support a strategy for the transition that needs to occur for an organization to pivot towards a net zero future, with five-to-ten-year near-term science-based targets (SBTs), and then long-term SBTs for 2050 at the latest.
- Contain verifiable and quantifiable key performance indicators (KPIs) which: (a) measure the success of an organization's climate transition; and (b) are tracked regularly.
- Be succinctly integrated into an organization's existing mainstream filings (in annual financial reporting/sustainability reporting/overall business strategy); serving the purpose of being an accountability mechanism.
- Further reading:
  - CDP Climate Transition Plan discussion paper
  - CDP Factsheet: Transition plans in line with 1.5

Highlight #3: Measurable targets

The inclusion of targets for all sustainability dimensions related to the environment is a considerable contribution by the EU regulator to ESG reporting and a critical element of meaningful corporate reporting. The following requirements for targets are present in the 5 topical environmental ESRS:

- E1-3 – Measurable targets for climate change mitigation and adaptation
- E2-2 – Measurable targets for pollution
- E3-2 – Measurable targets for water and marine resources
- E4-3 – Measurable targets for biodiversity and ecosystems
- E5-2 – Measurable targets for resource use and circular economy

CDP has asked for structured target information on mitigation of greenhouse gas emissions and deforestation, and water security since at least 2010 and has done considerable work on climate mitigation targets (founding partner of the science-based targets initiative) as well as planetary boundaries targets (through the science-based targets network). We strongly encourage EFRAG and disclosing companies, as well as users of information wanting to assess targets, to actively reference the work of these initiatives, which allows a user to put company targets into the necessary global and local sustainability context.

How CDP supports best-practice implementation and can scale EU ambition globally

We believe that in the future, the assessment of the ambition of the different targets will need to consider the best scientific knowledge and make use of standardized approaches, which will facilitate their audit and assurance.

CDP will continue to facilitate the implementation of science-based targets by their inclusion in our questionnaires and our scoring, acknowledging that the adoption of SBTs is a feature of companies leading in addressing sustainability challenges.

We will continue the work to date with our partners on developing methodologies relevant to all sectors and environmental topics and promote them through our system.

Measurable targets

- Since 2015 the adoption of science-based GHG emission reduction targets (SBTs) has considerably increased, encompassing today more than 1000 companies, with1.5b t tCO2, according to the Science Based Targets initiative. This considerable increase in the adoption of SBTs demonstrates that companies were eager to find guidelines and adopt best practices to align their emission reduction efforts with what is necessary to meet global environmental goals.
- Collaboration and alignment with other initiatives where relevant will ensure that target setting rules and methodologies are complementarily building on and referring each other, leading to consistent and meaningful target-setting by companies.
- SBTN are setting methodologies for identifying targets on land, freshwater, oceans and biodiversity. The TNFD are developing recommendations on how companies should use metrics and targets when disclosing on impacts and dependencies on nature. The Global Biodiversity Framework will be setting global goals on biodiversity and ecosystems and national targets and plans will follow. CDP is actively participating in all these processes.
- Further reading:
  - Mind the Science
  - The sectoral decarbonization approach
  - SBTi progress report 2021
  - https://sciencebasedtargetsnetwork.org

Recommendations for improvement of the ESRS

Improvement #1: Country breakdown of GHG emissions and water use metrics

Multiple breakdowns are allowed but not required under ESRS 1, namely, it does not require the breakdown of Scope 1 & 2 emissions nor water withdrawals, consumption or discharges by country. Country breakdown of this data is important because climate and water risk is not only a global risk but also driven by regulations defined at the country level. Likewise, country breakdown of this data allows for further scrutiny and linkage of corporate reporting to assets and an understanding of how corporate inventories contribute to country reporting (to the UNFCCC and SDGs) and information and data can be made available to regions, states and sub-national bodies to help guide the development of emissions and water-related legislation. It adds transparency to climate and water reporting and avoids fudging with numbers – just like country reporting of revenues has helped combat tax avoidance. CDP has been requiring country breakdowns for more than 10 years. Although initially companies complained, the practice is now well established. For that it has been fundamental to allow for some flexibility – companies do not need to report all emissions by country but should breakdown at least 90% of their global Scope 1 & 2 by country, with the additional 10% being able to be reported under a category "Rest of the World". Similarly, for water, companies do not need to report water withdrawals, consumption and discharges for all countries and facilities, but should report this data for sites that they identify as being at risk and/or those located in water-stressed areas.

Crucially, CDP´s questionnaire makes it possible for companies to break up metrics on water-related detrimental impacts, fines and engagement with stakeholders per river basin. This hydrological boundary is as important as country data enabling companies and data users to identify local impacts and engage with stakeholders.

CDP considers that the lessons learned from financial reporting show that at least, country-by-country reporting is essential for full transparency and that CDP's long-term practice shows it is possible to do it without over-burdening companies.

Improvement #2: Structuring disclosures

To facilitate data exchange and use, the ESRSs disclosures must be easily available in a structured format. The European Commission has already flagged that this is the intention and for that purpose has created an Expert Working Group for the digitization of sustainability information. However, there is ample scope to capture the same disclosures in a variety of ways and CDP recommends careful consideration of these options in groups that involve not only data experts but also domain (climate and environmental reporting) experts and users of information.

CDP has a wealth of experience in the structuring of climate change and environmental data and its digitization. CDP began structuring climate and environmental disclosures in 2009, and in 2012 started working on a climate change reporting taxonomy (in XBRL) with XBRL International, Fujitsu and others.

Further reading: The role of XBRL in overcoming climate-related reporting challenges

ESRS E1 on climate change – recommended improvements

- Climate change mitigation target data: climate change mitigation target data should be clearly structured requiring the provision of a base year, base year value, target year, and target year value, GHG scope (if applicable), target type (absolute/intensity/other), etc. CDP has been collecting structured target data for more than 10 years and provides target data for multiple analysis, including the UNFCCC Global Climate Action Portal (GCAP).

- Breakdown of Scope 1 & 2 emissions: there are multiple possible breakdowns of Scope 1 & 2 emissions which can be relevant for users of information. Having clear structures and lists of values to report on them in a standardized fashion, will be particularly relevant for users of information. Dimensions to consider are gas type (CO_2, CH_4, etc), country (not required in current version), source, operating segment, etc.

- Scope 3 emissions: ESRS E1-10 requires breakdown in 5 categories (AG50); the GHG Protocol offers 15 categories and ISO 14064-1 gives 4 categories. There are a number of ways companies can report indirect emissions and ESRS is requiring an additional one. It would be important to provide a structure and mapping of how ESRS E1-10 categorization matches with companies common practice related to the use of the GHG Protocol and ISO 14064-1. Digitalization can help making life easier to companies in mapping these different ways of categorizing their emissions.

- Comparability: there is an expectation of comparability of GHG emission disclosures between companies, which does not correspond to current practice. This stems largely from flexibility on the consolidation approach of the organizational boundaries. ESRS 1 states that "reporting boundary … is the one retained for its financial statements" and that "associates and joint ventures accounted under the equity method are considered as part of the upstream or downstream value chain" and that "entities accounted for under the proportional consolidation method are considered as part of the boundary for the consolidated portion". There is little about consolidation of operated assets that are not financially controlled or with no financial stake, although in the EU space, responsibility under the EU Emissions Trading System is attributed to the operator of assets. ESRS E1 does not mention the issue of consolidation of organizational boundary. Many companies report their GHG emissions based on an operational control boundary. CDP considers that reporting of consolidated GHG emissions should be done according to the one retained in financial statements, but that for transparency and comparability purposes, a breakdown should be provided between GHG emissions from financially controlled and operated items, financially controlled but not operated items, associates and joint ventures (either using the equity or proportional consolidation method) and operated but not financially controlled items. For a historical comparability point of view, such breakdowns will be indispensable to understand companies' historical contributions and they will also be relevant to enhance comparability between companies' disclosures.

ESRS E3 on water and marine resources and E2 on (water) pollution – recommended improvements

- CDP has been operating the world's only global corporate water disclosure mechanism since 2009. CDP now holds the world's largest corporate water dataset, with more companies reporting than ever before. This dataset provides evidence that **voluntary corporate disclosure of water-related data is normalizing for most data points**. Of the 171 water-related data points analyzed by CDP, 92 (54%), achieve disclosure rates greater than 80%.

- We welcome the introduction of comprehensive water-related disclosure requirements. By ensuring that relevant and comprehensive water-related information about corporate impacts, targets, risks and opportunities and their corresponding action plans and resources are made available by both financial and non-financial companies, the current proposals (accompanied by the ESRS1 General Principles) will advance corporate water reporting and action. While the current requirements represent a good start, we would like to point out some desirable improvements:

  Breakdown water metrics (water withdrawal, consumption and discharge data): there are multiple possible breakdowns of water metrics which can be relevant for users of information. Enterprise-wide water metrics are rarely of value for users of information lacking any context useful for judging the impact of the metric. In this regard, of greatest value to users of information is facility-level water data. Dimensions to consider are: water sources (renewable/non-renewable groundwater, surface water, third party utility etc), water discharge location (surface water, third party wastewater treatment etc), country and river basin (not required in current version), water stress status of location (scarce, stressed, abundant etc), comparison to last year and future forecast.

  Ensure supply chain transparency: In addition to ESRS1 and since ESRS E3 and ESRS E2 are currently focused on direct operations and do not consider performance across the supply chain, nor products and services, we would recommend requiring the provision of the following data:

  - % of suppliers incentivized for improved water performance;
  - % of suppliers assessed by the undertaking against their own water commitments;
  - % of suppliers that have achieved a water management certification (or an environmental management certification which covers water management); and
  - % of products and services categorised as low-water impact.

Enhance the context of financial information: we would recommend requiring non-financial undertakings to provide the proportion of their turnover generated per river basin and the water stress status of that river basin (e.g. scarce, stressed, abundant etc). In addition, requiring companies to provide data associated with the financial impact from water-related transition risks is recommended.

The indicators regarding access to safe, fully functioning water, sanitation and hygiene services in the social standards ESRS Ss could potentially be enhanced for workers in the value chain and affected communities: Access to safe, fully functioning water, sanitation and hygiene (WASH) services for employees and supply chain employees - WASH access - is a central tenant of SDG6 and requiring companies to disclose the proportion of employees and % of supply chain workforce that have WASH access will accelerate action on the issue and accelerate progress on SDG6.

Finally, whilst we welcome the inclusion of water intensity as an indicator for decoupling growth and water use, the proposed metric measures the economic impact of water resource use, but fails to capture any improvements in water use efficiency intended as "doing more and better with less". To measure the decoupling of economic production from water use, an indicator capturing resource use per unit produced would be more appropriate.

ESRS E4 on biodiversity and ecosystems – recommended improvements

- CDP began collecting data on the actions companies were taking to remove deforestation from their supply chains in 2012. The forests questionnaire focuses on entities producing or trading the key 'forest risk commodities' of palm oil, timber, cattle, soy, cocoa, coffee and rubber. Respondents are asked questions across 15 KPIs that are aligned with the broad reporting pillars of the TCFD, and with the principles of the Accountability Framework (a multistakeholder initiative that identifies the key steps required to remove deforestation from commodity supply chains).

- Growth in disclosure on deforestation has been rapid, but lags behind disclosure on climate and water. In 2021, 515 major investors and 19 large purchasing companies invited 2,552 companies to disclose through the CDP forests questionnaire. 865 responded, with respondents coming from across the globe but with the highest numbers in Europe. Most disclosures related to the use of timber, followed by palm oil, then soy. Respondents came from across the value chain, from producers to retailers.

- The results from 2021 show that, whilst most companies reporting to CDP are now taking some action on addressing deforestation, the actions taken lack scale, scope and rigour. Only 3% of respondents scored an 'A'. Whilst 66% of respondents had deforestation policies in place, only 13% were robust enough to meet CDP's KPI. Whilst 76% reported having some level of traceability system in place, only 8% could trace all of the commodity sourced to the production unit and less than 20% could even trace half. Whilst 70% employ certification, only 7% could say most of the commodity sourced came from certified deforestation free sources.

- Since 2020, CDP have also been asking financial institutions to disclose on progress with removing deforestation from their portfolios. 2020 and 2021 were pilot studies, with less than 20 institutions disclosing, but they revealed a similar picture of widespread, but low level action, with understanding and action on deforestation risk lagging far behind climate. For 2022, the financial service questionnaire has been expanded to incorporate questions on climate, deforestation, water and biodiversity and 1,250 institutions have been invited to respond.

- These results highlight the need for the ESRS. Companies and financial institutions are demonstrating they are able to report across the deforestation KPIs, and a handful of companies are demonstrating that it is feasible to meet the requirements to score an 'A'. But incentives to be voluntarily transparent remain low, with just 25% of companies responding to the capital markets request, and incentives to go beyond first steps also remain low, with just 3% meeting CDP's bar for best practice.

- The ambition and scope of the ESRS E4 standard is clearly leading the way on mandatory reporting on corporate relationships with biodiversity, ecosystems and ecosystem services (or 'nature'). The inclusion of nature positive concepts (including no net loss and full recovery) and the need for transition plans is particularly forward thinking.

- There are various opportunities for tighter alignment with parallel pieces of work – particularly the TNFD – when it comes to the structure of the standard. Addressing these would help understanding and alignment and would make any remaining gaps easier to identify.

- There could be a much clearer explanation as to how the focus on biodiversity and ecosystems 'fits' with other environmental issues. At the moment they are presented almost as a stand-alone environmental issue. The TNFD Framework's 'Why nature matters' section provides an example of a clear narrative on how the various environmental issues fit and interact with one another.

- Further reading:
    - 2022 Global Forests Report
    - 2022 Financial Services Questionnaire infographic

Spotlight: Interoperability with international standards and frameworks

2021 marks a turning point in the development of global reporting standards. CDP has supported the development of both a global baseline for comparable global reporting through the International Sustainability Standards Board (ISSB) and those developed by the Global Reporting Initiative (GRI), as well as the robust standards in development in jurisdictions including the EU.

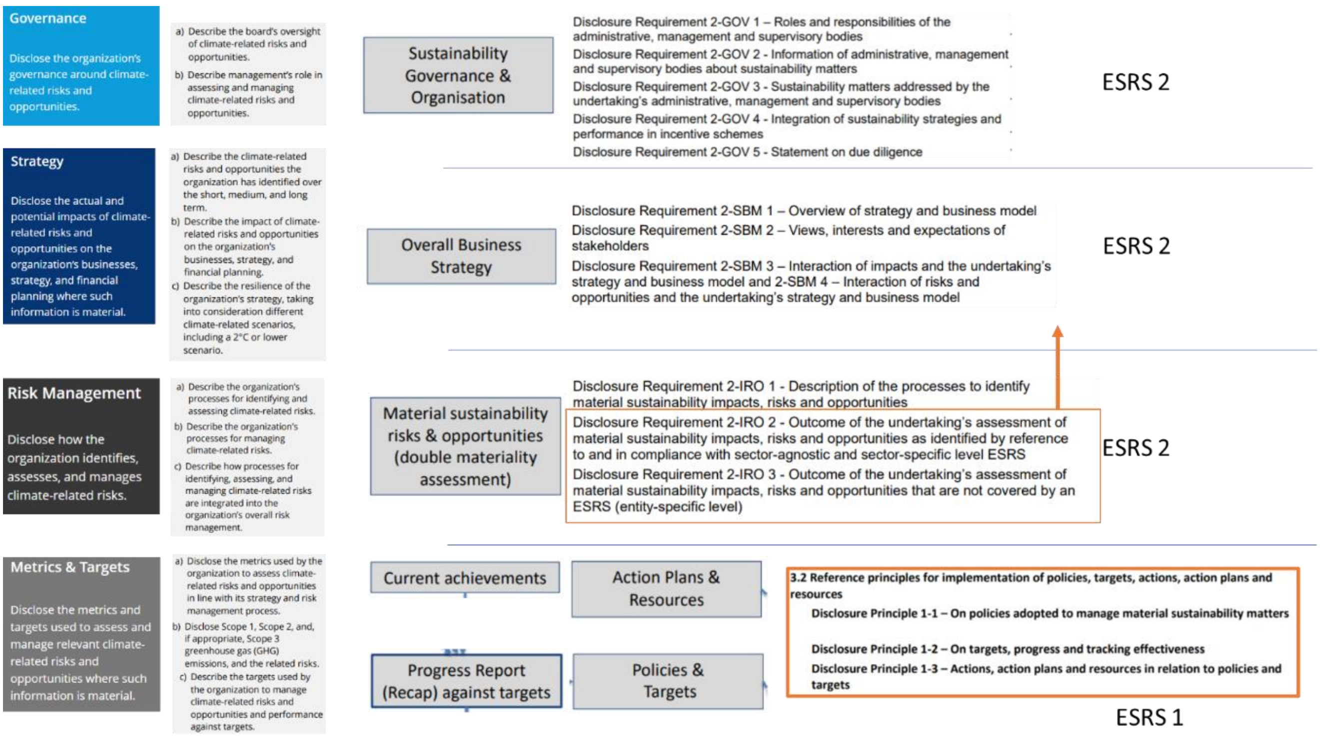
TCFD and ESRS structures are different, but compatible. However, the differences in the structure may pose challenges to practical implementation, may lead to confusion, and inevitably cause unnecessary costs to preparers and users alike.

The ESRS structure can be easily improved to better correspond with the TCFD (and ISSB) reporting areas in the following way:

1. ESRS 2 IRO-2 and 3 should be moved to the beginning of ESRS 2 SBM. In this way, the SBM section would fully correspond to the TCFD/ISSB "Strategy" reporting area.
2. ESRS 1 Section 3.2. "Reference principles for implementation of policies, targets, actions, action plans and resources" should directly follow ESRS 2 IRO making ESRS 2 aligned with the TCFD/ISSB "Metrics and Targets" as regards the presentation of the disclosure requirements (or principles) on policies, targets and actions.

The TNFD's LEAP framework could then take better ESRS-TCFD alignment to the next level, providing a useful framework for the steps a company should go through to understand, prioritize, act and report on relationships with nature before recommending what they disclose across the TCFD pillars. The LEAP framework has been developed from the existing lessons learned from the development of other standards, has input from multiple stakeholders and is being refined every few months in response to public consultation. It, therefore, represents a form of agreed best practice and the steps it presents will be very familiar to companies already accustomed to approaches such as the Natural Capital Protocol. ESRS E4 covers much of the same steps as LEAP but has a far less logical structure and as a result it is much harder to understand or follow.

Although this would not necessarily be a perfect 1-2-1 linkage, these changes would ensure near full and sufficiently good alignment between the reporting areas, whilst not undermining the unique features of the ESRS, in particular the double materiality approach and a combination of cross-cutting and topical standards and disclosures.



The ISSB follows a TCFD structure so with these changes the ESRS structure would also align better with the IFRS exposure drafts while maintaining the unique characteristics of ESRSs.

The standards under development by the ISSB and EFRAG should be developed in a way that guarantees compatibility between them. CDP encourages organizations to prioritize reporting that embraces both value creation and impact on people and the planet. The findings of their financial reporting can then be based upon this.

CDP's role in the EU corporate sustainability disclosure regime

CDP has worked to create and improve the EU's sustainability disclosure regime since the early stages; from the proposal of the Non-Financial Reporting Directive in 2014, throughout its revision, and to the development of the new, much improved, Corporate Sustainability Reporting Directive, which is complemented by the important technical level of the European Sustainability Reporting Standards. CDP has also been instrumental in showcasing shortcomings in the sustainability of the financial system and helping to design the disclosure regime for financial companies.

Concretely, CDP staff have contributed to the:

- **European Commission technical expert group on sustainable finance.** Nico Fettes co-authored the report on disclosure metrics as part of the broader group working on the EU Taxonomy, Green Bonds and Paris-aligned and Transition benchmarks.
- **EIOPA's stakeholder groups on insurance and reinsurance, and occupational pensions.** Torun Reinhammar has been part of both groups and continues contributing to the occupational pensions one, on sustainability-related matters and EIOPA's opinions on EU regulation.
- **European Lab @EFRAG Steering Group.** Steven Tebbe was a member of the steering group of the European Corporate Reporting Lab and guided the work the Project Taskforces are tasked with, regarding the future of corporate reporting in the EU.
- **European Lab @EFRAG Project Taskforce on Reporting of non-financial risks and opportunities, and linkage to the business model (PTF-RNFRO).** Mirjam Wolfrum was a member of this Taskforce, working on the data sharing and technologies work package.
- **EFRAG Project Taskforce on European Sustainability Reporting Standards (PTF-ESRS).** Mirjam Wolfrum provided support to the secretariat of the Taskforce, working on the environmental standards and, specifically, on the standard on biodiversity and ecosystems. Pedro Faria is a member of the expert working group providing expertise to sector-specific standards.
- **ESMA Consultative Working Group of its Coordination Network on Sustainability (CNS CWG).** Torun Reinhammar is a member of the working group and provides technical input into various areas of ESMA's work on sustainable finance under the CNS.

With a mission to drive transparency and action to tackle the environmental crisis, CDP has always supported mandatory disclosure and the development of high-quality reporting standards to drive accountability and support companies in their reporting needs.

As the global environmental disclosure system, CDP will accelerate the implementation and rollout of both global and jurisdictional standards. Our system mainstreams standards' widespread adoption in a structured, comparable format, with jurisdictional-level specificities for companies where they apply.

Under its current strategy, CDP has committed to expanding its focus on climate, deforestation and water security to encompass a broader range of environmental targets, reflecting the planetary boundaries and helping markets and local governments act with the urgency required. Through this expansion of its proven disclosure system, CDP is set to be the definitive mechanism to track the nature, extent, and speed of corporate, city, state and regional action against their commitments in line with EU and global goals and their impact on the global environment.

For further information

General inquiries
policy.europe@cdp.net

CDP Government Partnerships
mona.freundt@cdp.net

Mirjam Wolfrum
Director Policy Engagement
mirjam.wolfrum@cdp.net

Mona Freundt
Senior Policy & Government Partnerships Manager
mona.freundt@cdp.net

Cory Fletcher
Senior Policy & Public Affairs Officer
cory.fletcher@cdp.net

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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 for governments to actively encourage ambitious actions by corporates and subnational jurisdictions and to improve data and insights on these organizations' transition to a 1.5°C and nature positive world.

By endorsing the CDP disclosure system, governments can speed up the implementation of international and national climate and nature targets by corporates and subnational jurisdictions in their country and drive faster progress towards achieving climate neutrality and full recovery of nature by 2050.

CDP Europe in European and international media

CDP Worldwide (Europe) gemeinnützige GmbH, c/o WeWork, Potsdamer Platz - Kemperplatz 1, 10785 Berlin, Germany
Managing Director: Maxfield Eric Weiss | Local court of Charlottenburg: HRB 119156 B | VAT Id.No.: DE270861830
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www.cdp.net/eu