Climate Disclosure Standards Board's (CDSB) response to the Inception Impact Assessment on Sustainable Corporate Governance

CDSB welcomes the commitment of the European Commission to improve the corporate governance framework as part of the European Green Deal and as a complementary action to support the successful implementation of the revision of the Non-Financial Reporting Directive (NFRD).

Independently of the shape this initiative will take, we wanted to provide a few comments around what it should aim to achieve, following the publication of the two studies requested by the European Commission on Due diligence requirements through the supply chain and Directors' duties and sustainable corporate governance.

First, we would like to refer to the following studies and reports on the lack of proper governance disclosures and the need to improve the corporate governance of companies:

- The review by the Alliance for Corporate Transparency of reports in 2019[1];
- CDSB's own review on the implementation of NFRD requirements in 2019 reports[2] ;
- The World Economic Forum White Paper on How to Set Up Effective Climate Governance on Corporate Boards: Guiding principles and questions[3] ; and
- The World Economic Forum White Paper on Integrated Corporate Governance: A Practical Guide to Stakeholder Capitalism for Boards of Directors[4].

Based on the above, it is clear that the current corporate governance framework does not fulfil its intended aims and outcomes and should therefore be strengthened. The European Union should also engage with Member States as some of the rules on these issues are defined at national level.

Enhanced reporting will contribute to companies' ability to integrate sustainability issues into business strategies and decisions

We believe that **reporting requirements can be a tool to promote changes towards better corporate governance practices within companies**. This means that strengthening and clarifying reporting requirements will contribute to incentivise companies to integrate sustainability considerations into all of their business decisions and become "as important as discussing interest rates, credit risk or future cash flows".[5]
It will also ensure that governance structures are benchmarked against the European green deal ambition and that remuneration policies are revised to reflect progress against these green deal business related objectives in order to drive action faster.

We acknowledge that **governance practices and reporting need to improve** in order to ensure an effective governance of climate and environmental-related risks and opportunities, through their inclusion into existing governance and risk management processes.

[1] https://www.allianceforcorporatetransparency.org/
[2] https://www.cdsb.net/falling-short)
[3] https://www.weforum.org/whitepapers/how-to-set-up-effective-climate-governance-on-corporate-boards-guiding-principles-and-questions
[4] https://fr.weforum.org/whitepapers/integrated-corporate-governance-a-practical-guide-to-stakeholder-capitalism-for-boards-of-directors/
[5] As noted by Marc Carney, former chair of the Financial Stability Board, speaking at the event "Creating Value in a Climate Emergency" organised by ACCA and IFAC during the 2020 New York Climate Week.

This is why we are advocating for **strengthened governance disclosures as part of the NFRD review, along with the recommended governance disclosures of the Task Force on Climate-Related Financial Disclosures (TCFD)**, which suggest that companies disclose both:

- board's oversight of climate-related risks and opportunities (and this could be done for all sustainability issues) ; and
- management's role in assessing and managing climate-related risks and opportunities.

In CDSB's own review on the implementation of NFRD requirements in 2019 reports, we found that a number of companies provided disclosures on their governance arrangements but **did not state the roles and responsibilities of board or management over environmental and climate issues,** including **the committee or individuals with oversight on these issues.** (see page 11) These results and the low quality of both governance of environmental, climate and social issues together with a lack of proper disclosures was also highlighted in the Alliance for Corporate Transparency research (see pages 6 and 11-13).

Enhanced reporting requirements will also ensure that investors are able to assess **whether the corporate governance of the company has fully considered environmental and climate risks and opportunities** and then **embedded them into strategic decision-making, business and financial planning on a daily basis with impacts on position and performance fully considered.**. This is why we also advocate for a **stronger interconnection between financial and non-financial information**, the latter being included in the management report of the company and subjected to the same governance processes and approval by the board of the company as financial information.

Enhanced governance will help improve due diligence practices and reporting

We welcome the link made between corporate governance and due diligence as we see **due diligence as a set of robust internal control processes aiming at ensuring that the company identify and manage environmental and climate risks with the same rigour as financial information**. They should then be able to **report on these processes as part of their non-financial reporting obligations.**

Our analysis of companies' environmental and climate reporting show that companies often confuse governance, due diligence and risk management in their disclosures, in part because of **a lack of proper definition of "due diligence" embedded in a legislative text.** While 94% of companies reviewed provided some environmental and climate-related due diligence disclosures, 10% of companies interpreted due diligence to relate to asset level procedures, such as management systems, operational monitoring and controls, **omitting board and management responsibilities**.

In addition, **due diligence disclosures were often made outside the non-financial statement** within the corporate governance statement and without direct linkage to the information provided for other requirements such as the description of policies. To remedy this situation, we suggest that **companies use policies as the basis to structure subsequent disclosures on due diligence**, outcomes, risks and KPIs and ensure direct linkages between due diligence arrangements and stated policies. (see pages 10 and 11)

These results have also been confirmed by the Alliance for Corporate Transparency Research in the case of human rights due diligence disclosures : **only 22.2% of companies report on due diligence processes on human rights, and 6.9% refer to their commitment to provide remedy for harmed people**, both representing key elements of corporate responsibility to respect human rights as outlined in the UN Guiding Principles on Business and Human Rights.(see page 69)

We consider due diligence as a key feature within a company's internal governance and non-financial reporting. This is why, although due diligence requirements go beyond reporting on due diligence practices, we encourage policy makers to **pay close attention to the consistency of due diligence requirements within the existing reporting landscape at European but also national level.** Our complementary analysis of due diligence reporting in countries that have already introduced legislative requirements (such as France) show that if not properly designed, such requirements can create inconsistencies and duplicative requirements on where and what to report in conjunction with the non-financial statement required by the NFRD.

Directors' duties and the role of boards with respect to environmental and climate risks and opportunities should be strengthened to end the short-term focus of businesses and adjust for timeframes realistic for achieving the European Green Deal

Fostering long-termism will require a change in companies' corporate governance. In that regard, the World Economic Forum has recently published a White Paper on integrated corporate governance in the context of the Covid-19 crisis. The paper calls for **a transition from shareholder to stakeholder capitalism** under a more integrated corporate governance with stronger links between shareholder model of corporate governance and stakeholder driven model of corporate responsibility. This means in practice **reviewing the organisation, missions and purpose of the Board of Directors** to reinforce stewardship on environmental, social and governance issues and allowing their systematic integration into firm's strategy, resource allocation, risk management and performance evaluation as well as reporting policies and processes.

It is a duty of corporate boards and directors to safeguard the long-term viability of the business through a better understanding of the risks and opportunities arising from environmental and social issues for the business of the company and set the tone at the top of the organisation and "walk the talk". We support **broadening the scope of directors' duties to cover all six types of capitals the International Integrated Reporting Council (IIRC) have identified** as the basis of a company's value creation (i.e.: financial, manufactured, intellectual, social and relationships, human and natural capitals).

In practice, this means that companies should be required to :

- **Develop, clarify and report on the governance structure and processes** the company has in place to deal with these issues, which should be addressed by the board on a regular basis and dealt with in relevant committees such as the risk, audit or remuneration committees and integrated to form business as usual activity;
- **Implement the TCFD recommendations** and **include all material information in the management report of the company**;
- **Ensure environmental (including climate) board expertise and competency** through ad hoc nominations of external board advisers or non-executive board members, regular updates from relevant senior management and training for board members and company executives;
- **Integrate environmental and climate-related matters into directors' duties and remuneration schemes ;**
- **Ensure that climate and environmental risks are included in the risk register,** just like any other risk the company is exposed to ;
- Assess and take strategic decisions based on **the company's resilience against specific climate scenarios;** and
- **Set up net zero science-based targets[6] and strategies supported by relevant Key Performance Indicators related to overall climate and environmental objectives including planetary boundaries, Sustainable Development Goals, and the Paris Agreement**.

[6] https://sciencebasedtargets.org/net-zero/