CDSB Climate Disclosure Standards Board

Falling short?

Why environmental and climate-related disclosures under the EU Non-Financial Reporting Directive must improve

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About the Climate Disclosure Standards Board (CDSB)

CDSB is an international consortium of business and environmental NGOs. We are committed to advancing and aligning the global mainstream corporate reporting model to equate natural capital with financial capital.

We do this by offering companies a framework for reporting environmental information with the same rigour as financial information. In turn, this helps them to provide investors with decision-useful environmental information via the mainstream corporate report, enhancing the efficient allocation of capital. Regulators also benefit from compliance-ready materials.

Recognising that information about natural capital and financial capital is equally essential for an understanding of corporate performance, our work builds the trust and transparency needed to foster resilient capital markets. Collectively, we aim to contribute to more sustainable economic, social and environmental systems.

For more information, visit cdsb.net or follow the Climate Disclosure Standards Board on LinkedIn and Twitter @CDSBGlobal

We welcome your input and discussions. If you would like to comment on this document, please contact us at info@cdsb.net.

Executive summary

CDSB has reviewed the 2019 environmental and climate-related disclosures of Europe's 50 largest listed companies, with a combined market capitalisation of US$4.3 trillion, under the EU Non-Financial Reporting Directive (NFRD also referred to as 'the Directive'). The purpose of this report is to inform policymakers of the changes needed to improve environmental disclosures under the Directive, to ensure it meets its purpose of increasing the relevance, consistency and comparability of company reporting. It also aims to support corporate report preparers in enhancing their disclosures under the Directive by identifying good practice case studies and tips, drawn from the findings of CDSB's review.

Supported by the LIFE Programme of the European Union, the review consisted of a question set developed by CDSB to assess the strengths and weaknesses of companies' disclosures. This was based on consideration of the core 'content categories' of the NFRD (i.e. business model, policies and due diligence, outcomes, principal risks and key performance indicators), and reviewing progress in implementing the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD). Mainstream reports (i.e. annual report and accounts) were reviewed, alongside information disclosed elsewhere where it was clearly referenced from the mainstream disclosure.

The current state of EU environmental and climate-related disclosure

Overall, our review shows some signs of improvement in the environmental and climate-related disclosure of Europe's largest companies. The vast majority now provide at least some disclosure aligned to the content categories of the NFRD. However, we find that reporting often still fails to offer investors a clear understanding of companies' development, performance, position and impact, as it lacks the necessary quality, comparability and coherence. In the absence of this, investors remain unable to fully integrate environmental and climate-related considerations into their decision-making. Additionally, although some sectors showed demonstrable progress in adoption of the TCFD recommendations, overall implementation continues to lag behind the five-year implementation path set out by the Task Force.

Given that these observations are true of Europe's 50 largest listed companies, who could reasonably be expected to provide the highest quality disclosures, it is therefore clear that the current requirements of the NFRD are not yielding the outcomes desired from the Directive.

Risk matters

Risk disclosures relating to environmental and climate-related matters were highlighted as a key weakness for over three quarters of companies reviewed. Whilst 90% of companies did disclose at least one principal risk relating to climate or environment, only 54% considered both transition and physical risks as outlined in the TCFD recommendations, and just 6% defined the short, medium and long-term time horizons over which the identified risks would impact the organisation. Many companies failed to consider the strategic and financial impacts of risks for their business, assessing only the impact of their business on the environment and climate, demonstrating that they have yet to adopt fully the risk lens set out in the TCFD recommendations.

Materiality matters

Our review found that 42% of companies omitted potentially material environmental or climate-related information for their sector, while 30% disclosed immaterial information that was not aligned to their own materiality assessments, policies or principal risks. Just 4% currently use financial materiality to determine the environmental and climate-related content included in their mainstream reports. A lack of focus on investor materiality is likely to have contributed to some of the challenges identified in this review, including considering the impacts of principal risks on the business, the absence of indicators that link financial and non-financial information, and lengthy disclosures which attempt to address the needs of too many stakeholders.

For each company CDSB reviewed, the top 3 strengths and weaknesses of the disclosure were recorded and categorised, demonstrating a clear pattern in areas of good practice and improvement. The most commonly identified strength and weakness categories are presented below:

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

Key findings

Overall, our findings highlight that substantive improvements are still required in the quality, comparability and coherence of disclosures in order for the Directive to achieve its objective of providing investors and wider stakeholders with relevant, consistent and decision-useful disclosures.

Business model

Only **3 in 10** companies fully disclose the environmental and climate-related aspects of their business model

Policies and due diligence

Companies demonstrated confusion over key terms from the Directive and often **failed to provide context-specific information** on their policies and processes

Outcomes

All companies reported some types of outcomes, however, **variations in disclosure** format limit the comparability of information, both between companies and over time

Principal risks

9 in 10 disclosed their principal environmental and climate-related risks, but **1 in 5** disclosed no related operational, strategic or financial impacts

Key performance indicators

Less than **1 in 3** companies reported metrics directly linking environmental and financial activities and performance

TCFD

While companies in the financial and energy sectors showed progress in aligning to the TCFD, **few disclosed their overall resilience** to different climate scenarios

Materiality

1 in 3 companies failed to clarify how the materiality of environmental and climate-related information in the mainstream report had been determined

Disclosure location

4 in 5 companies included their non-financial statement in their mainstream report

Recommendations

Building upon the findings of our review, we put forward recommendations for policymakers and regulators and for companies, to ensure that the NFRD, and corporate disclosures made under it, deliver the information needed to drive meaningful progress in delivering the EU Green Deal.

Recommendations for corporate report preparers

As companies prepare their next annual disclosures, they should closely consider the findings of CDSB's review and the good practices highlighted in this report, to identify opportunities to further improve their reporting, taking into account the following points:

1. **Ensure linkages** are drawn across the Directive's content categories. Use your policies to structure and inform your programmes; report clearly and simply against your progress in achieving them;
2. **Clarify the materiality** of environmental and climate-related issues to your business, explaining how your mainstream, and wider sustainability reporting if appropriate, is informed by your view on materiality;
3. Disclose environmental and climate-related information deemed to be financially material in your **mainstream report**, to ensure it is available to an investor audience and can be considered holistically alongside your overall strategic and financial performance; and
4. Align your environmental and climate-related disclosures with the **TCFD core elements**, ensuring that risks and opportunities from climate change over the short, medium and long-term have been assessed and that you have considered the resilience of your organisation under different climate scenarios.

Recommendations for policymakers and regulators

The European Commission is currently reviewing the NFRD, considering options to enhance its effectiveness in ensuring investors, civil society and other interested parties have access to the information they need. Drawing upon the findings of our review, CDSB's recommendations for policymakers and regulators should be adopted in the revised Directive to support improved effectiveness:

1. Remove the exemption allowing the non-financial statement to be reported outside the **mainstream report**, as this will support accessibility, consistency and comparability of disclosures and our review demonstrates that, for most, this is already the norm;
2. **Review the principal risk requirements** of the Directive to ensure emphasis is placed on risks and impacts 'to' the business (not simply 'by' the business). Member State policymakers should consider the interface between the NFRD and other risk disclosure requirements implemented nationally to support companies in making cohesive disclosures;
3. **Incorporate 'climate' into the wording** of the Directive to ensure companies consider climate-related matters explicitly in their disclosures, including the associated financial impacts;
4. **Define key terms used in the Directive**, such as 'policies' and 'due diligence' to ensure a common understanding and application of the Directive's content categories;
5. **Embed the TCFD recommendations** into the Directive to drive stronger linkage of non-financial and financial reporting, and a more unified, harmonised and convergent approach; and
6. Ensure that **supervision of non-financial information** is at the same level as for financial information, in order to provide authoritative feedback to corporate report preparers.

Contents

Introduction

Introduction

In 2019 European companies published their second annual disclosures under the EU Non-Financial Reporting Directive (NFRD, also referred to as 'the Directive'). Since entering into force in 2017, the Directive has required certain large companies across Europe to prepare a 'non-financial statement' disclosing their business model, policies, outcomes, principal risks and key performance indicator (KPIs) on a range of non-financial topics, including but not limited to 'environmental matters'[i]. The Directive provided for inclusion of the non-financial statement within the 'management report'[ii], however it also included an exemption allowing for disclosure in a separate report, providing it was published within six months of the management report.

In November 2018, CDSB released its first review of corporate environmental and climate-related disclosures under the NFRD, commonly referred to as the 'First Steps Report'[1], finding that concerted action was required by policymakers, regulators and companies to provide better quality information to investors and markets. It then set out recommendations to achieve this. Building upon the approach of the First Steps Report, this review set out to assess progress made by European companies in disclosing environmental and climate-related information in the second year of reporting under the Directive. It aimed to provide an update on the level of alignment to the core content categories of the Directive, but also to consider the quality of such disclosures in greater detail, to assess if the NFRD in its current form meets its objective of providing investors and wider stakeholders with decision-useful sustainability information.

Since the release of the European Commission's (EC) guidelines on reporting climate-related information in June 2019, a direct link has been drawn between companies' disclosures on 'environmental matters' under the Directive and the recommendations of the Financial Stability Board's (FSB) Task Force on Climate-related Financial Disclosures (TCFD)[2]. The guidelines set out the relationship between the NFRD and TCFD and outlined how companies could integrate the two disclosure requirements. Whilst the disclosures considered under this review were prepared before the release of these guidelines, it set out to consider the current progress made by companies on TCFD implementation and to consider the degree to which they were addressing the recommendations through the environmental and climate-related disclosures in their non-financial statements.

To answer these questions, CDSB reviewed the 50 largest listed European companies' 2018 reporting (published in 2019 for the 2018 financial year) and assessed in detail the environmental and climate-related content. The review was conducted manually by a set of expert reviewers using questions built around the requirements of the Directive alongside the recommended disclosures of the TCFD. Further detail on the methodology and review sample can be found on page 29.

This report sets out the key findings of our review, structured according to the core content categories of the Directive (i.e. business model, policies and due diligence, outcomes, principal risks and KPIs), with sections considering the aspects of TCFD, materiality and disclosure location and format in further detail. Throughout the report, good practice examples, 'good practice tips' for report preparers, and proposals for policymakers and regulators are provided by content category. Our key recommendations for policymakers, regulators and companies are provided on page 27, intended to support both the upcoming revision of the NFRD over 2020, and ongoing improvement in disclosures by corporate report preparers in the interim.

i For further detail on the requirements of the NFRD, see https://ec.europa.eu/info/business-economy-euro/company-reporting-and-auditing/company-reporting/non-financial-reporting_en, also CDSB's EU Environmental Reporting Handbook (2020) [PDF]. Available from: https://www.cdsb.net/sites/default/files/eu_environmental_reporting_handbook_print.pdf.

ii 'Management report' is hereafter referred to by CDSB as the 'mainstream report' and is also commonly referred to as the annual report and accounts.

Findings part 1: Environmental disclosure under the NFRD content categories

a) Business model

What the Directive asks for

"(a) a brief description of the undertaking's business model"

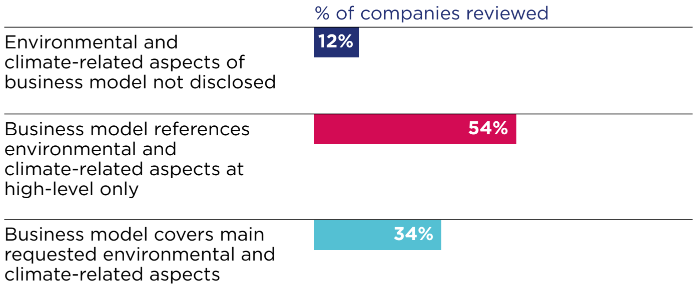
2017 Non-Binding Guidelines

- Highlighted the importance of the business model in providing overall context for the mainstream report; and
- Emphasised that disclosures should describe how the business generates and preserves value over the longer term, how it operates and how it transforms inputs into outputs through its activities.

2019 Climate-related Guidelines

- Advocated that companies should disclose the impacts of climate-related risks and opportunities on the business model, as well as the ways in which the business model can both positively and negatively impact the climate.

Environmental and climate-related business model disclosure



Business model disclosures play an important role in informing investors' understanding of the environmental and climate-related risks and opportunities faced by businesses. Disclosures were reviewed to assess how effectively companies were articulating these aspects in their reporting.

88% of the companies reviewed disclosed some environmental and climate-related aspects of their business model, however only a third did so in a manner that addressed the key aspects outlined in the guidelines to the Directive. The First Steps Report found that 44% of companies disclosed how their business models were affected by environmental and climate-related matters. Although more companies appear to now be referencing these matters, only a minority are doing so in a way that provides truly meaningful context (i.e. quantity versus quality).

Three quarters of companies that disclosed the environmental and climate-related aspects of their business model did so at the outset of their mainstream report, incorporating this into the description of their core business strategy and value creation model. However, a quarter opted to make a secondary business model disclosure within the non-financial statement, discussing the environmental and climate-related aspects in supplement to the main business model description provided elsewhere in the report. This made it challenging for readers to determine if these aspects were truly integrated into the business model or not.

Over half of business model disclosures were observed to be light touch in nature; providing only very high-level or cursory references to climate and environment. They did not fully articulate the strategic integration of these matters into the company's business model. For example, some disclosures provided illustrations of the business model, which included statements such as 'environmental sustainability'. However, they then provided no further context as to what this meant for the company, or any specific context on implications for its operations and value chain. Such disclosures do not align with the recommendation in the EC's 2017 guidelines to "avoid immaterial disclosures of promotional or aspirational nature", and therefore limit decision-usefulness for investors by obscuring material information.

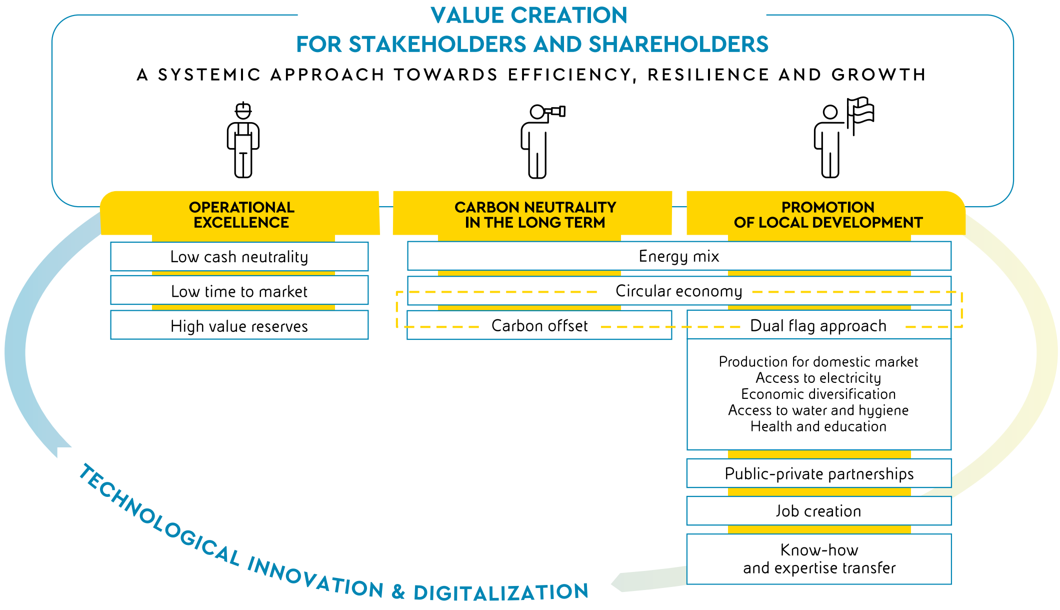
However, a third were able to provide a succinct and well-articulated account of their business. They demonstrated both an understanding of Environmental, Social and Governance (ESG) macro-trends which may impact strategy, such as climate change and natural resource scarcity, and clearly articulated how these aspects have been addressed through the company's value creation model (see example Figure 1).

Figure 1: Eni's 2018 Annual Report provided a succinct articulation of the business model, addressing the challenges facing its sector and its approach to tackling these, including clarifying specific issues it focuses on.

BUSINESS MODEL

Eni's business model is focused on creating value for its stakeholders and shareholders. Eni recognizes that the main challenge in the energy sector is providing efficient and sustainable access of local communities to energy resources, while combating climate change. This challenge may trigger new paradigms of development affecting patterns of consumption and supply, as well as on industrial processes. In this framework, Eni has adopted a systemic approach to pursue efficiency, resilience and growth, which organically integrates sustainability to make it business, incorporates emerging trends of decarbonisation and inclusive development including them in its industrial plan and in the operating model. Eni, therefore, adopts a business model, fuelled by the application of own innovative technologies and the digitalization process, leveraging on the following levers:

1 **operational excellence,**
2 **carbon neutrality in the long term,**
3 **promotion of local development.**



While the review demonstrates a growing recognition of the strategic significance of environmental and climate-related matters within businesses, further steps are required to ensure that business model disclosures fully represent and integrate the strategic risks and opportunities companies face.

Good practice tips for companies

- ☑ Include a diagrammatic representation of the business model, which demonstrates inputs, outputs and impacts of the organisation;
- ☑ Where secondary disclosure on environmental and climate-related aspects of the business model is made, ensure clear reference and linkage is made to this in the main business model description;
- ☑ Explain how the business generates not just financial value for its shareholders, but also economic, social and environmental value for society;
- ☑ Ensure the articulation is company-specific, for example by referencing specific products, services and the associated environmental and climate-related matters that are relevant to these; and
- ☑ Explain the wider ESG trends which inform the business model.

b) Policies and due diligence

What the Directive asks for

"(b) a description of the policies pursued by the undertaking in relation to those matters, including due diligence processes implemented"

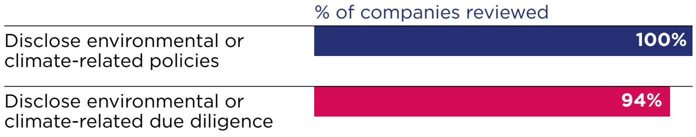
2017 Non-Binding Guidelines

- Companies' disclosures should provide a fair view of their policies, focused on material issues;
- Company-specific objectives, plans to deliver the objectives and how plans were implemented should be included; and
- Due diligence disclosures should explain management and board's responsibilities.

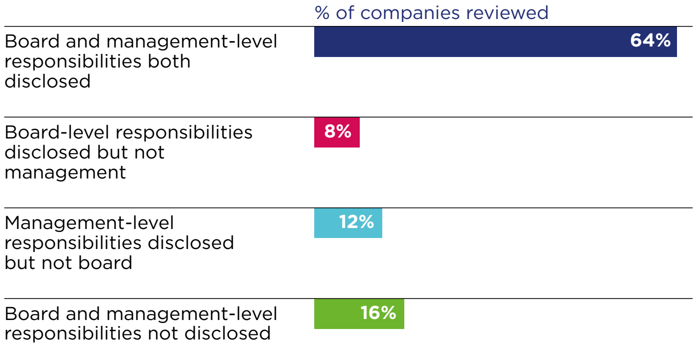
2019 Climate-related Guidelines

- Policies should describe any climate-related targets and how these contribute to the Paris Agreement; and
- The board and management's oversight of climate risks and opportunities should be disclosed.

Environmental and climate-related policy and due diligence disclosure



Board and management-level due diligence disclosure



Well-articulated corporate policies provide the basis to inform and structure a company's environmental and climate-related disclosure. Our review focused on the connectivity of policy and due diligence disclosures, considering how well companies outlined their approach and commitments.

Overall, policies and due diligence were among the most consistent areas of environmental and climate-related disclosures, with 100% of companies describing their policies and 94% disclosing their due diligence arrangements. This showed improvement from the First Steps Report, where despite almost all companies disclosing their environmental policies, 48% disclosed how they identify, manage and assess risks (an aspect of due diligence arrangements).

Although almost all companies disclosed these content categories, significant variation in the extent and quality of disclosures was observed. As 'policies' and 'due diligence' are not defined within the Directive, the way companies interpreted these terms also varied.

Policies

Policies were typically taken to be ambition statements relating to environmental and climate-related aspects relevant to the company, accompanied by details of the actions and targets that had been set to achieve the stated overall policy goal. Whilst many were able to provide succinct disclosures in relation to this, others provided very detailed descriptions of their commitments on a topic-by-topic basis. This limited the ability of the reader to discern a clear overall environmental or climate policy informing the company's approach. Conversely, some disclosures were far briefer, simply providing a statement of commitment to reducing environmental impact without presenting specific actions or context.

Strong policies provided a clear framework, establishing which environmental and climate-related aspects where considered material for the business, with company-specific commitments, timebound targets and actions. Such disclosures offered a sound basis around which due diligence, outcomes and KPIs were structured, leading to focused, coherent and connected reporting. Less strong examples contained ambition statements, but failed to specify the environmental and climate-related aspects considered material or the actions the company was taking. Additionally, in some instances the companies' stated policy did not obviously inform their reporting of other content categories, for example later disclosing KPIs for aspects which were not referenced in the organisation's policy commitments. This reduced the overall coherence of disclosures, leading to a lack of clarity over policies and progress against them.

64%

disclosed both board and management-level accountabilities with respect to climate and environmental matters

Due diligence

While 94% of companies provided environmental and climate-related due diligence disclosures, 64% disclosed both board and management-level accountabilities with respect to climate and environmental matters. 10% of companies interpreted 'due diligence' to relate to asset-level procedures, such as management systems, operational monitoring and controls, omitting the board and management responsibilities of concern for an investor audience. Often, companies used the term 'governance' as opposed to 'due diligence', suggesting this may be more commonly associated with the requested subject matter.

The linkage between due diligence arrangements and policies was often not explicit. For example, many companies stated their policies on environmental and climate-related matters within a dedicated sub-section of their mainstream report. However, due diligence disclosures were often made separately within the corporate governance report, without direct linkage to the policy description. Board and management committees with accountability for 'CSR' or 'sustainability' were commonly identified, however descriptions frequently lacked specificity regarding the environmental and climate-related policy aspects they considered, or what the practical responsibilities of these committees were.

The significant variation in interpretation of this content category suggests that defining key terms within the Directive is important to ensure a common understanding and application of these requirements. The importance of policies in providing the basis for a coherent and connected disclosure must also be emphasised.

Good practice tips for companies

- ☑ Include company and context-specific ambition statements within the policies, accompanied by timebound qualitative and/or quantitative targets to enable progress to be tracked over time;
- ☑ Use the policies as the basis to structure subsequent disclosures on due diligence, outcomes, risks and KPIs;
- ☑ Clearly specify both board and management-level accountabilities regarding environmental and climate-related matters and ensuring the linkages between them are disclosed; and
- ☑ Ensure direct linkages between due diligence arrangements and stated policies.

Proposals for policymakers and regulators

- Provide definitions of "policies" and "due diligence" within the Directive to ensure a common understanding and application of this content category; and
- Harmonise the due diligence guidelines with the TCFD recommendations to ensure emphasis is placed on information relevant for an investor audience, including board and management-level responsibilities and risk management processes.

c) Outcomes

What the Directive asks for

"(c) the outcomes of those policies"

2017 Non-Binding Guidelines

- Companies should provide useful, fair and balanced information on the outcomes of their policies; and
- Disclosures should help investors and other stakeholders understand performance and progress.

2019 Climate-related Guidelines

- The outcomes of companies' climate policies should be described, including performance against indicators and targets, aligned to risks and opportunities, including greenhouse gas emissions targets.

Disclosure of policy outcomes

	% of companies reviewed
Disclose the outcomes of their policies	100%

Top strengths and weaknesses of outcomes disclosures

Strengths	Weaknesses
Disclosing activities specific to the reporting year	Lengthy disclosures that limit coherence
Clearly aligning outcomes to stated policies	Inconsistent reporting, reducing comparability between companies
Balancing disclosure with both positive and negative performance	Lack of clarity over progress against policy commitments

Reported outcomes enable investors to understand how companies are progressing against their policy commitments and, ultimately, whether they are aligning their activities with these ambition statements. Our review considered the nature, format and usefulness of the disclosures on outcomes.

All 50 companies reviewed provided some disclosure on the outcomes of their policies, with a range of good practices evident in certain disclosures. These included providing clear linkages between the policies and related outcomes (for example by including a clear update on progress in the reporting year against each policy commitment, accompanied by quantitative performance progress against associated goals and targets, see Figure 2 below). This provided transparent and balanced information on both achievements and setbacks in the reporting year and addressed both in-year initiatives and the overall progress against policy commitments over the medium to long-term.

However, outcomes content was also an area where disclosures were often the lengthiest. Companies commonly opted for narrative disclosures, providing an update on various topics and performance areas, often without the use of summary tables or linkage to KPIs.

Lengthy and unstructured disclosures impede concise and coherent information, as it is challenging for the reader to determine specific progress within the reporting year, or to understand what level of progress activities represent relative to performance objectives. Stronger disclosures ensured that this was linked to KPIs and prefaced with clearly structured summary information to enable readers to gain a fair and balanced understanding of the key outcomes in the year.

The degree of linkage between stated policies and outcomes was also variable, with some companies providing a clear structure to their outcomes disclosure, aligned to their policies, while others did not. In the absence of direct links to the policies, disclosures on outcomes typically lacked clear focus. As a result, they run the risk of reading as a list of 'good news stories', limiting the ability of the reader to understand how these activities contribute to the organisation's overall strategic objectives, or to compare progress year-on-year. Instances of immaterial disclosure were also observed for this content category. Companies provided many pages of narrative without clear explanation of why the matters discussed were important, or how they contributed to the achievement of policy commitments.

Figure 2: Dutch semiconductor supplier ASML Holding accompanied its narrative update on 'How we did in 2018' with a summary table, providing performance against objectives and targets. This provided a clear view of progress, including where improvement was required to achieve policy objectives (ASML Integrated Report based on IFRS 2018).

Environment, health and safety objectives

Theme	Objective	Target year	How we did
Employee safety	Reduce recordable incident rate by 15% compared to average of previous three years (which results in a target for 2018 of 0.31).	2018	Our recordable incident rate of 0.24 is better than our target of 0.31.
Environmental efficiency own operations	100% Renewable electricity.	2020	We are on track. We achieved a 86.3% renewable electricity level in 2018 and have a plan in place to meet our 2020 target.
	10% Energy savings through projects.	2020	We are on track with our energy savings to achieve our target of 111 TJ by the end of 2020.
12 RESPONSIBLE CONSUMPTION AND PRODUCTION; 13 CLIMATE ACTION	5% Waste savings through projects.	2020	We ran some waste-reduction initiatives though more needs to be done since we have only achieved 1.6% (since 2016) of our targeted waste savings (of 5% of our waste generated in 2015).

new - new target/not started; work to be done - work needed to get the objective on track; on track - work ongoing, progress can be demonstrated; completed - objective has been achieved or, in case of ongoing objectives, the 2018 actions have been completed

Environment, health and safety KPIs

KPI	2016	2017	2018
ASML recordable incident rate [1]	0.44	0.26	**0.24**
Renewable electricity (of total electricity purchased)	71.0%	70.2%	**86.3%**
Energy savings worldwide through projects (in TJ) [2]	35.1	48.8	**77.3**
Waste savings worldwide through projects [2]	1.2%	1.2%	**1.6%**

1. The number of work-related injuries and illnesses, per 100 full-time workers. We use OHSA guidelines to determine work-related injuries and illnesses. Minor (first-aid level) injuries are excluded from the calculation of the recordable incident rate.
2. In 2016 we started a new master plan period which concludes in 2020. The savings reported are cumulated compared to base year 2015.

Although overall uptake of outcomes disclosure is high, more consistent, coherent and concise reporting is required to ensure that disclosures are material, fair, balanced and understandable.

Good practice tips for companies

- ☑ Ensure outcomes are clearly linked to the stated policy objectives, providing balanced updates which address both achievements and challenges, to avoid simply listing positive highlights only;
- ☑ Focus progress updates on performance in the reporting year and how this contributes to achieving longer-term policy commitments; and
- ☑ Accompany narrative updates with simple summary tables or bullet points, to ensure readers can easily determine what the key outcomes are.

Proposals for policymakers and regulators

- Provide a clear definition for 'outcomes' within the Directive to clarify both reporting expectations for companies and to enable more effective supervision by Member State regulators for this content category.

d) Principal risks

What the Directive asks for

"(d) the principal risks related to those matters linked to the undertaking's operations including, where relevant and proportionate, its business relationships, products or services which are likely to cause adverse impacts in those areas, and how the undertaking manages those risks;"

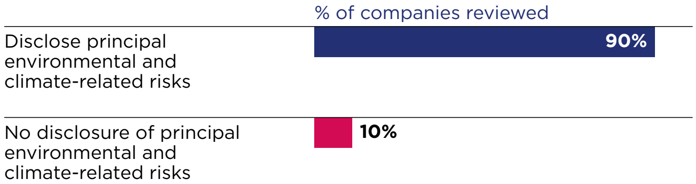
2017 Non-Binding Guidelines

- Companies should disclose information on principal risks, how they are managed and mitigated; and
- Perspective should be provided on short, medium and long-term principal risks and how they impact business model, operations, financial performance and the impact of the business' activities.

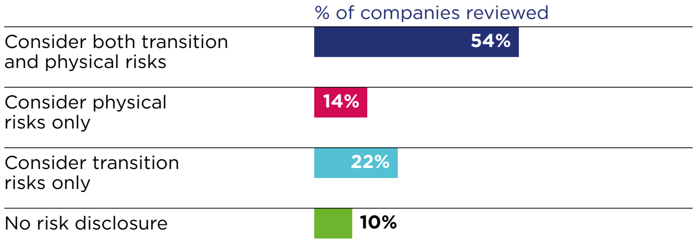
2019 Climate-related Guidelines

- Companies should describe principal climate-related risks, and assumptions made in identifying them;
- Companies should also describe risks from dependencies on natural capital impacted by climate, e.g. water; and
- Companies should disclose how risks are managed and how climate risk is integrated into overall risk management.

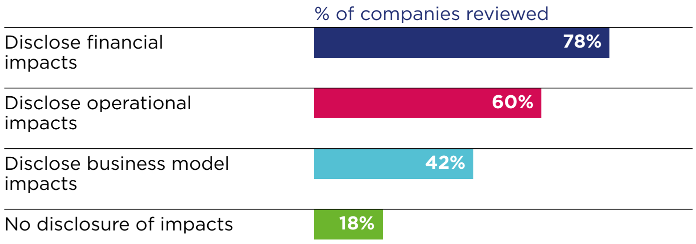
Disclosure of principal environmental and climate-related risks



Environmental and climate-related risk types disclosed



Impact types disclosed for identified environmental and climate-related risks



The environmental and climate-related risks which businesses face should play an important role in informing their business model, policies and KPIs. This is also a key emphasis of the TCFD. Risk was a particular area of focus for the review, identifying a number of gaps in current disclosure practices.

Of the five core content categories of the Directive, principal risk disclosures relating to environmental and climate-related matters were generally found to be the weakest. While 90% of companies did disclose at least one principal risk relating to climate or environment (showing improvement from the First Steps Report, where 79% disclosed at least one risk), only 54% considered both transition and physical risks as outlined in the TCFD recommendations (in contrast with 28% in the First Steps Report). Only 6% defined the short, medium and long-term time horizons over which the identified risks would impact the organisation.

Describing the impacts of risks

The level of description accompanying risk disclosures varied substantively, with some disclosures simply stating a list of risks, while others provided accompanying narrative regarding the nature, context and impact of identified risks. Overall, 82% of companies identified at least one impact type in their risk disclosure. The most frequently disclosed impact type was financial, and the least commonly disclosed impact area was business model. However, impact descriptions were often generic, stating simply the potential for 'operational disruption' or 'increased taxation', without providing entity or context-specific information or quantification. Additionally, 8% of companies disclosed their principal environmental or climate-related risks without any business impact description. For these companies, the risk disclosure was typically not framed from a business risk perspective; i.e. the general impact of the business on the environment or climate was mentioned, but the business implications of risks, for example through fines, increased regulation or reputational damage, was not discussed. See Figure 3 for a disclosure which combines these elements effectively.

Figure 3: In its 2018 Reference Document, **Kering disclosed the likelihood and impact severity for each identified environmental or climate-related risk. Company-specific examples of the potential impacts to different operational areas were given. This was accompanied by a description of the actions being taken to mitigate the risk, referring to other sections of the report where relevant.**

Climate change

Likelihood: **Impacts:**

Description of the risk

A negative impact on the Group's activities due to the effects of climate change. Lack of resilience or Group initiatives in response to the effects of climate change.

Example case(s)

- Supply chain: the growing frequency of extreme weather events (drought, flooding, etc.) could have a direct impact on the availability and quality of key raw materials such as cotton, cashmere and silk, which would translate into greater price volatility, and thus affect the production and distribution of finished products.
- The economic environment and even the social stability of certain regions (such as coastal regions in Asia) could be severely impacted by the effects of climate change, which would further increase pressure on the Group's supply chain.
- Manufacturing disruptions caused by the unavailability or decreased quality of raw materials, due to climate change and its impact on biodiversity and on the destruction of land and ecosystems.
- The implementation of stricter environmental regulations and standards to meet the challenges associated with climate change could have an impact on the Group's activities by increasing production costs and reducing operational flexibility.

Group actions

In the global economic and political outlook, climate change has become a key issue that demands an effective response.

The physical effects of climate change are susceptible to impact the Group's activities. While its own activities (production and distribution) are relatively unexposed due to their low carbon footprint (Kering's activities are not subject to carbon emissions quota regulations), this is not the case for the supply chain. A November 2015 report jointly authored with BSR, the global non-profit organization that works with a network of member companies and partners to build a sustainable world, analyzes exposure to climate risk. Entitled *Climate Change: Implications and Strategies for the Luxury Fashion Sector*, it analyzes current and future climate risks for cotton, cashmere, vicuña wool, silk and cow-, calf-, sheep- and lambskin leather.

In order to mitigate these risks, Kering has defined a climate strategy and is acting to make its supply chain more resilient, starting with the Environmental Profit & Loss account (EP&L). The EP&L allows Kering to measure its environmental impacts, including its carbon footprint, throughout the value chain and to monetize them. Beyond the risk management dimension, the EP&L is also used as a management tool to orient the Group towards sustainable sourcing solutions and to assess the raw materials used in product design.

The Group has set very ambitious targets for reducing its carbon footprint by 2025 and has had its own Science Based Target in this respect since 2017.

All of the policies, projects and actions implemented, the outcomes obtained and the associated performance indicators relating to climate change and the Group's climate strategy are presented in detail in Chapter 3 "Sustainability" of this Reference Document, which includes the Group's duty of care plan.

Standalone non-financial risk disclosures

Some disclosures demonstrated confusion over whether the Directive required specific non-financial risk disclosure in addition to existing principal risk disclosures. For example, where a business had not identified any material risks relating to 'environmental matters', there appeared to be a lack of clarity over the necessary disclosure. Some businesses provided an additional standalone disclosure of identified 'non-material' risks relating to the topics covered under the Directive, where no principal risks relating to environment and climate change were identified.

National disclosure requirements relating to risk further confused reporting in some jurisdictions. For example, in the case of French companies, where risk disclosures are required under both the Corporate Duty of Vigilance Law and the NFRD, we found most companies provided separate risk disclosures for the two requirements. Sometimes these offered differing perspectives on the most important risks and some companies stated that separate risk assessment processes had been developed to inform these disclosures.

Additionally, 28% of companies did not disclose how environmental and climate-related risks are integrated into overall risk management, as recommended in the Directive's climate-related guidelines and the TCFD. Without clearly articulating how environmental and climate-risks are integrated into wider business processes, investors are unable to discern how these risks are used to inform companies' decision-making and how significant they are considered to be, relative to other business risks. Standalone disclosures of immaterial risks are potentially misleading and do not support improved investor decision-making.

Responding to risks

70% of companies provided information on the management actions undertaken to mitigate environmental and climate-related risks. Strong disclosures ensured linkage back to policies, due diligence and outcomes. This helped to ensure connectivity, evidencing how risk management informed the company's policies. 20% of companies disclosed environmental and climate-related risks without disclosing or linking to management actions and 10% provided no environmental or climate-related risk disclosure. In such instances, it was challenging for the reader to determine how, or whether, risk processes meaningfully informed the company's environmental and climate-related policies and programmes.

78%

The percentage of the review sample for which risk disclosures were identified as a key weakness

Risk disclosures represent a key area for improvement in NFRD disclosure. This should be a focus for both companies and policymakers to ensure that material environmental and climate-related risks are being identified, assessed and managed to support long-term socio-economic and environmental resilience.

Good practice tips for companies

- ☑ Provide business-specific examples of how identified risks may impact the organisation's operations, business model and financial performance as applicable;
- ☑ Clearly state the time horizons over which risks have been considered and ensure risk descriptions state the likely impacts over the short, medium and long-term; and
- ☑ Link risks and their management to environmental and climate-related policies, due diligence and outcomes.

Proposals for policymakers and regulators

- Review the principal risk requirements of the Directive to ensure emphasis is placed on risks and impacts to the business (not simply 'by' the business); and
- Member State policymakers should consider the interface between the NFRD's requirements and other risk disclosure requirements implemented nationally, to support companies in making cohesive disclosures.

e) Key performance indicators (KPIs)

What the Directive asks for

"(e) non-financial key performance indicators relevant to the particular business."

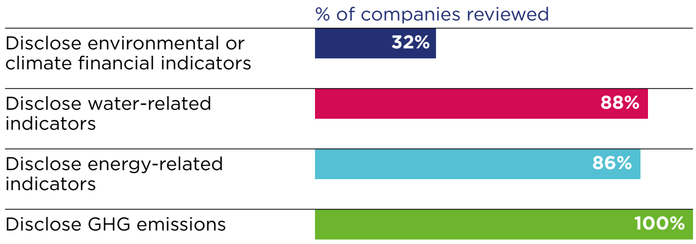
2017 Non-Binding Guidelines

- Companies should report KPIs that are consistent with the metrics used internally and for risk assessment processes; and
- KPIs should be high quality and broadly recognised to improve comparability.

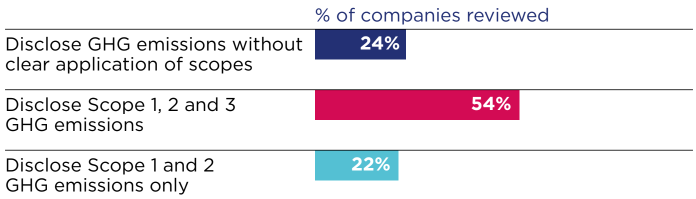
2019 Climate-related Guidelines

- Indicators are set out covering greenhouse gas emissions, energy, physical risks, products and services and green finance, with companies advised to report upon those it considers to be material; and
- Indicators should be aligned to climate-related risks and opportunities addressed in the business' strategy and risk management processes.

Environmental and climate-related KPI disclosure



GHG emissions disclosure



KPIs could perhaps be considered as the most familiar aspect of the environmental and climate-related disclosure landscape to many companies. However, challenges still remain in ensuring the consistent and comparable reporting of metrics that reflect risks and enable relative performance to be understood.

For some companies, KPIs were one of the most mature aspects of their non-financial disclosure, however it was also an element where substantive variation in quality was observed. For 30 companies, KPI disclosures were identified as a 'top three strength', whereas for the remaining 20 companies KPIs were recorded as one of the 'top three weaknesses'.

All companies in the review sample disclosed climate or environmental KPIs, with the most frequently reported metrics being greenhouse gas (GHG) emissions (100%), water consumption, withdrawals or intensity (88%) and energy consumption, intensity or generation (86%). The least commonly disclosed KPI type assessed was environmental and climate-related financial KPIs[iii], with under a third of companies disclosing one or more metric of this type.

In addition to these KPIs, organisations chose to disclose many other metrics, depending on their impacts, risks and policies, including waste generation, air quality and environmental certifications schemes (such as ISO 14001 or product-specific certifications). Some companies opted to report upon specifically developed metrics which they have used to track their policy commitments, for example, aggregate indices combining environmental goals into a single progress indicator, which are not broadly recognisable or comparable.

96% of companies provided at least one year of prior performance for KPIs, however some either did not provide comparators, or only stated their metrics in relative as opposed to absolute terms. While many grouped their indicators into summary tables, others only stated them in narrative disclosures, making it hard to identify which were used by the company to inform its programmes. Additionally, disclosures often failed to distinguish between KPIs (used by the business to track its performance and policies) and wider indicators (reported for stakeholder interest), with no description of how metrics informed internal processes and decision-making.

30 companies
KPI disclosures identified as top three **strength**

20 companies
KPI disclosures identified as top three **weakness**

iii Environmental or climate-related financial KPIs are indicators which link to the company's products and services or financial performance, e.g. turnover from climate-related products and services, low carbon capital expenditure or climate-related green bond ratios. Further detail can be found in the Directive's climate-related guidelines.

Greenhouse gas emissions

Although all organisations provided some GHG disclosure, the quality and comparability of reporting was highly variable. While many companies stated that they utilised the GHG Protocol Corporate Reporting Standard[3] as the basis of their disclosures, 24% did not provide sufficient clarity to determine the application of emissions reporting scopes – i.e. Scope 1 (Direct), Scope 2 (Electricity Indirect) and Scope 3 (Other Indirect) emissions – while a further 22% only disclosed Scope 1 and 2 emissions. Additionally, under the GHG Protocol disclosures can be made using operational or financial reporting boundaries, with reviewed companies typically taking an 'operational control' approach. This means emissions disclosures may not align to the same reporting boundaries as financial reporting, reducing the connectivity between non-financial and financial reporting and limiting the ability to compare companies that take different boundary approaches. Although GHG emissions could be expected to be one of the most advanced areas of disclosure for companies due to the existence of widely-accepted and applicable reporting standards, issues in the clarity, comparability and consistency of indicators remain.

Figure 4: Airbus' 2018 Annual Report **included a summary table of indicators relevant to the business, which included prior year data and clarity over the scope of GHG emissions reporting. Details on the methodologies for key metrics were also provided.**

Airbus monitors and makes available data verified by external auditors, and publishes transparently its industrial performance. Environmental data has been externally audited since 2010. Below is a selection of externally reviewed environmental indicators.

Environmental performance	GRI	KPI	Unit	**2018**	2017
Energy	EN3	Total energy consumption (excluded electricity generated by CHP on site for own use) ✔	MWh	3,962,484	4,098,475
		Energy consumption from stationary sources ✔	MWh	1,296,135	1,357,724
		Energy consumption from mobile sources ✔	MWh	1,098,179	1,206,689
		Total electricity consumption ✔	MWh	1,568,169	1,534,062
		Generated electricity from CHP on-site for own use ✔	MWh	190,287	190,127
Air emissions	EN16 EN17	Total Scope 1 + Scope 2 CO_2 emissions ✔	tonnes CO_2	965,633	1,013,101
		Total direct CO_2 emissions (Scope 1) ✔	tonnes CO_2	553,063	591,002
		Total indirect CO_2 emissions (Scope 2) ✔	tonnes CO_2	412,570	422,099
		Indirect CO_2 emissions Business Travel (Scope 3)	tonnes CO_2	111,666	na
		Indirect CO_2 emissions Oversize Transportation* (Scope 3)	tonnes CO_2	185,500	na
	EN20	Total VOC emissions**	tonnes	1,526	1,565
	EN21	Total SO_x emissions	tonnes	17	15
		Total NO_x emissions	tonnes	321	314
Water	EN8	Total water consumption ✔	m^3	4,016,913	4,011,897
	EN22	Total water discharge	m^3	3,336,712	3,416,506
Waste	EN23	Total waste production, excluding exceptional waste ✔	tonnes	98,592	105,839
		Material recovery rate ✔	%	57,8	58,5
		Energy recovery rate	%	20,7	20,6
EMS certification		Number of sites with ISO 14001 / EMAS certification*** vs total number of covered by environmental reporting	Unit	60/71	61
		Workforce effectively covered by reporting over workforce subject to reporting according to the environmental guidelines.****	%	89	90

A220 sites are not yet included according to reporting rules.
✔ Data audited by Ernst & Young et Associés. Limited assurance report is available on **www.airbus.com**. 2018 data covers 89% of total group employees.
* Oversize emissions cover transport of large and non standards shipments. 2018 values cover Aircraft commercial aircraft activities.
** 2018 VOC emissions data is estimated. The precise 2018 data will be consolidated and available in March 2019
*** Number of sites covered by the environmental reporting which are certified ISO 14001.
**** Airbus environmental reporting guidelines include sites worldwide with a workforce on-site higher or equal to 50 employees. Note that only 100% consolidated entities are taken into account to calculate this 50 employee threshold. For electricity, coverage is slightly higher (90.3%) due to inclusion of AD Stevenage site.

Remuneration

Inclusion of metrics in board and management-level remuneration arrangements provides clarity over the indicators used to measure the success of policies and supports integration of non-financial information into business decision-making. In total, 56% of companies disclosed the inclusion of some qualitative or quantitative environmental criteria within their board or management-level remuneration. 30% disclosed quantitative targets or goals used to assess and determine pay levels, relative to 11% of companies doing so in disclosures reviewed in 2018, demonstrating some growth in this practice.

Linkage to policies

Strong disclosures clearly linked environmental and climate-related KPIs to policies, with metrics used effectively to report progress against commitments. This provided a balanced and understandable view of overall progress, which could be tracked consistently year-on-year. In other cases, the KPI disclosure was not well-linked to the wider non-financial information, meaning it was not possible to determine how these metrics related to the organisation's policies, or whether these metrics were meaningfully used within the business or provided 'for the sake of disclosure'. Such issues were more likely to be encountered where companies' overall policies were described in a vague and overarching nature, as highlighted earlier.

Our review demonstrated a significant polarisation in environmental and climate-related KPI disclosure practices. 60% of companies used indicators adeptly to provide concise, balanced and understandable updates on their policy progress. However, 40% struggled to use indicators effectively, leading to confusing and inconsistent disclosures. Good practices must be drawn upon by both companies and policymakers to ensure overall consistency, comparability and decision-usefulness of KPI disclosures.

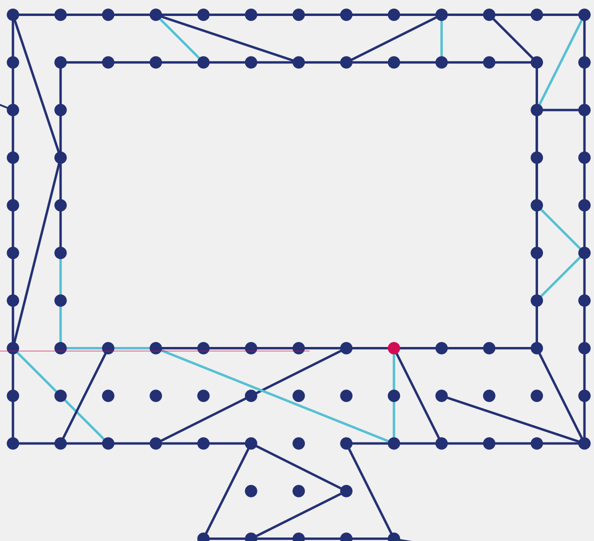
Good practice tips for companies

- ☑ Provide a minimum of two years' prior data to enable performance trends to be assessed;
- ☑ Distinguish between KPIs and wider indicators, to ensure the priority metrics used to measure progress against policy objectives are understood;
- ☑ Summarise KPIs in a table or graphic to enable them to be easily identified by the report users; and
- ☑ Clearly link policies, outcomes and KPIs so that the metrics used inform understanding of the company's overall progress, performance and position.

Proposals for policymakers and regulators

- Add a requirement into the Directive to link policies, outcomes and KPIs so that the metrics used inform understanding of the company's overall progress, performance and position.

Findings part 2: TCFD and additional considerations



TCFD disclosures of Europe's largest companies

In June 2019, the European Commission released its Guidelines on reporting climate-related information[4] (Climate-related Guidelines), which integrated the TCFD recommended disclosures and supplemented its Non-Binding Guidelines on Non-Financial Reporting published in July 2017[5] (Non-Binding Guidelines). It should therefore be noted that the Climate-related Guidelines were not available to companies when preparing their 2018 disclosures under the NFRD. However, given that the TCFD recommendations were released in 2017, the review provides a useful opportunity to review the progress European companies are making in aligning to the recommended TCFD disclosures.

To assess TCFD implementation, a series of questions were integrated into the core methodology, to supplement the information already relevant to the recommendations gathered. Key findings are presented by TCFD core element below:

Governance

- 72% of companies reviewed disclosed board-level accountabilities and 76% disclosed management-level accountabilities regarding climate-related and environmental matters;
- 10% provided disclosures on their due diligence or governance arrangements, but did not state the roles and responsibilities of board or management; and
- Typically, companies did not explicitly separate climate-related accountabilities from those of other environmental matters, stating the committee or individual with oversight for the issues without sufficient detail on the specific arrangements or topics considered.

Strategy

- 90% of companies disclosed their principal environmental or climate-related risks, however only 54% demonstrated consideration of both physical and transition risks;
- While 82% disclosed at least one business impact associated with their reported risks, only 42% specifically addressed the impacts on their business model or strategy, and only 6% clearly described the impacts of the risks over the short, medium and long-term;
- 14% of companies disclosed their strategic resilience to different climate scenarios; and
- Others stated they had undertaken scenario analysis but did not provide quantitative disclosure of the outputs, or offer an overall view on their strategic resilience to the scenario(s) considered.

Alongside reporting by companies against the core content categories of the NFRD, this review also considered progress made in implementing the TCFD recommendations, and its four core elements as highlighted in the following table:

Governance
72% disclose board-level responsibility for environment and climate change and **76%** disclose management level
Strategy
Just **14%** of companies disclose their strategic resilience to different climate scenarios
Risk Management
72% clarify how environmental and climate-related matters are integrated into wider risk management processes
Metrics and Targets
30% include an environmental or climate-related target in leadership remuneration

Risk Management

- 72% of companies disclosed that environmental and climate-related risks were integrated into the organisation's overall risk management. While 4% disclosed a separate process for identifying, assessing and managing environmental or climate-related risks, they did not specify how these risks were integrated into their wider risk management processes; and
- Due to the emphasis on risks in the NFRD, environmental and climate-related opportunities disclosures were not reviewed. CDSB's 'Red Lines' for suggested amendments to the Directive, published in February 2020, set out how this could be addressed.[6]

Metrics and Targets

- All organisations disclosed at least one environmental or climate-related metric, however the degree of direct linkage between reported metrics and risks and strategy was variable, with some companies appearing to report a substantive number of indicators without clarity as to how these were used internally;
- All companies disclosed at least one GHG metric, however 24% did so without clear application of the emissions reporting scopes and 46% did not disclose any Scope 3 emissions categories; and
- 30% had linked a quantitative environmental or climate-related target, most commonly a GHG emissions target, to board or management-level remuneration.

Overall, progress in implementing the TCFD recommendations was found to be lacking, with many sectors failing to address them effectively in their disclosures. The most progress was seen among companies in the energy and financial sectors. However, in other sectors, such as healthcare and consumer goods, limited progress was observed.

NFRD and TCFD Linkages

The synergies in subject matter between the NFRD and TCFD represent an opportunity to facilitate more harmonised, streamlined and consistent reporting. However, in practice few companies are achieving the full potential of more integrated and efficient disclosure, by considering the requirements in tandem;

- There were very few instances where companies provided TCFD-aligned disclosure in an integrated manner alongside their environmental matters' content aligned to the NFRD;
- Commonly, limited reference was made to TCFD within the mainstream report, with readers signposted to external resources, such as a sustainability or standalone climate risk report;
- Where TCFD-aligned disclosure was included in the mainstream report, it was often as a standalone section, in addition to NFRD disclosure. This led to duplication, unnecessarily increasing reporting efforts; and
- Due to the overlapping aspects of the two reporting requirements, this was observed to cause inconsistencies and confusion within reporting, for example in relation to principal risks.

Good practice tips for companies

☑ CDSB has produced a number of resources to support companies in implementing the TCFD recommendations, including the TCFD Implementation Guide[7] and TCFD Good Practice Handbook[8], and E-learning courses on climate-related disclosure available at tcfdhub.org; and

☑ CDSB and CDP's recently published 'The Building Blocks' paper [9], which illustrates how CDP data and the CDSB framework can be used successfully to fulfil the TCFD recommendations.

Proposals for policymakers and regulators

- Incorporate 'climate' into the wording of the Directive to ensure companies consider this issue explicitly in their disclosures; and
- Embed the TCFD recommendations into the Directive to drive stronger linkage of non-financial and financial reporting, and a more unified, harmonised and convergent approach to ESG disclosures.

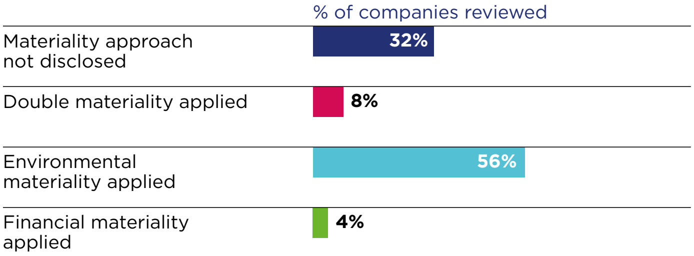
Materiality

A distinguishing aspect of the European Commission's Climate-related Guidance to the Directive[4] was the concept of a 'double materiality' perspective[iv], covering both financial and 'environmental and social' materiality to meet the needs of both investors and wider stakeholders.

68% of companies described the process they used to determine materiality of environmental and climate-related information for inclusion in the mainstream report. 56% used environmental materiality criteria only. This typically consisted of a stakeholder prioritisation assessment presented as a list of key topics, or a materiality matrix demonstrating issues of importance for both the business and its wider stakeholders. Commonly, this disclosure was accompanied by a brief description of the process used to inform the assessment, typically stakeholder interviews. Just 4% of those that disclosed their materiality process applied financial criteria, such as stating that investor priorities were used to determine reporting topics for the mainstream report. The application of a double materiality perspective to disclosure (8% of respondents) is not currently commonplace among European companies.

While disclosure of stakeholder materiality assessments was a common practice for many companies, often the application of the assessment outcomes to the mainstream report was not explicitly described. In the absence of this linkage, the company's rationale for undertaking a materiality assessment often appeared to be for the development of a company sustainability strategy, or for the purposes of aligning with ESG disclosure frameworks, as opposed to serving as a tool to directly inform disclosure.

Materiality approach applied to environmental and climate-related disclosures



Based on a comparison of disclosures across companies in the review by sector, instances of potentially immaterial disclosure and the absence of potentially material information were recorded. For 42% of companies, the omission of potentially material information, such as principal risks which other companies in the sector had reported to be material, was noted. 30% of companies were found to have reported potential immaterial information, such as detailed disclosure on topics not stated to be material to the company by its own materiality assessment, or on subjects not linked to its stated policies or principal risks.

A lack of focus on investor materiality is likely to have contributed to some of the challenges identified in this review. These include the failure by many companies to:

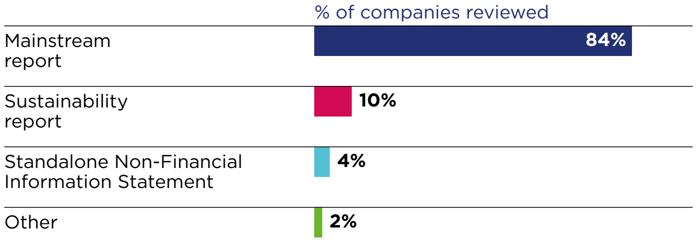
- **Consider the impacts of principal risks on the business as well as by the business;**
- **Report metrics directly linking financial and non-financial information, such as disclosures of low carbon capital expenditure;**
- **Disclose outcomes which focus on key actions, linked to clearly established commitments and targets; and**
- **Avoid lengthy disclosures which attempt to address the needs of too many stakeholders.**

iv 'Double materiality' refers to the consideration of both financial materiality (impacts on a company's development, performance and position of most interest to investors) and environmental and social materiality (the external impacts of the company's activities, of interest to wider stakeholders).

Location and format of disclosures

While the NFRD is not wholly prescriptive on the location and format of environmental and climate-related disclosures, these aspects play an important role in ensuring readers can access and use the information they require to inform their decision-making and capital allocations.

Primary location of companies' non-financial statement under the Directive



Where companies are reporting

84% of companies used their mainstream report as the primary location of their non-financial statement. 10% used a separate sustainability report, with 4% preparing a standalone non-financial information statement in addition to their mainstream and sustainability reports. Of those that provided disclosure within the mainstream report, 55% integrated the content within relevant report sections (such as strategy, risk and corporate governance), whereas 45% included a standalone statement with all of the content in its own section. Commonly, those choosing to integrate the information adopted a 'hybrid' approach, where business model, due diligence and principal risk disclosures were integrated, but policies, outcomes and KPIs were published in a dedicated environmental or climate-related section of the report.

Less is more?

On average, companies included 14 pages of environmental and climate-related content in their mainstream report, with a range of 1-70 pages and an average of 5% of the mainstream report dedicated to the topic. The longest environmental and climate-related disclosure which did not include all of the requirements of the Directive was 14 pages; the shortest disclosure which included all of the content categories was just 2 pages. It was often observed that the strongest disclosures, which balanced comprehensive disclosure of relevant environmental and climate-related information with concise reporting, were no longer than 5-10 pages. Whilst some organisations are choosing to produce significant disclosures under the Directive, this demonstrates that less can indeed be more.

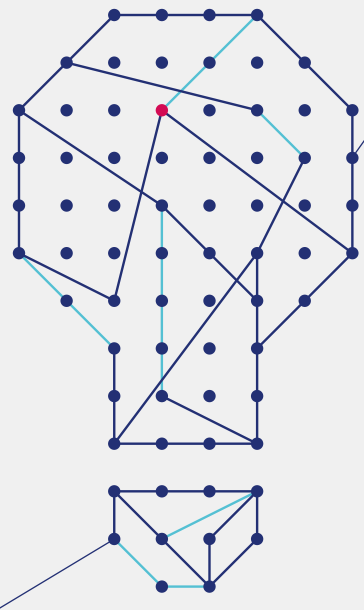
Signposting the information

Many companies chose to include cross-reference tables within their mainstream report, signposting readers to the location of the specific content on 'environmental matters' within the mainstream report, and to separate disclosures where appropriate. Similarly, many disclosures helpfully included page references and links within and between report sections, for example linking risks to outcomes disclosures, which helped to support the reader in gaining a coherent understanding of the company's overall position, performance and approach.

14 pages

of environmental and climate-related disclosure in the mainstream report on average

Conclusions and recommendations



Conclusions

Our review provides the most up-to-date analysis of disclosures of environmental and climate-related matters by companies across Europe. While we find that the majority of the top 50 companies are providing disclosures aligned with the Non-Financial Reporting Directive's core content categories, disclosures continue to lack the quality, consistency and comparability intended by the Directive. This is necessary to provide investors and wider stakeholders with information that can inform their decision-making. Research published by CDP earlier in 2020[10] demonstrated that low-carbon investments must double in pace in the European corporate sector to be on track for net-zero emissions by 2050, in line with the 'climate neutrality' target set out in the EC's European Green Deal.[11] In order to inform this investment, the market requires reliable and high-quality company disclosures.

When considering the core content categories of the Directive, we find improved levels of disclosure in comparison to our 2018 First Steps Report. If we look simply at whether they have complied or not, most of Europe's 50 largest companies have been able to meet the requirements in the second year of reporting. However, compliance alone is not enough, and the high-level compliance figures mask the utility and decision-usefulness of the information disclosed. Quantitative analyses of reporting practices alone are not always indicative that organisations are presenting a fair and balanced view. This echoes and builds upon the findings of the Alliance for Corporate Transparency's review of 1000 2019 European disclosures under the NFRD. They concluded that companies' sustainability reporting across the Directive's five topics (including 'environmental matters') was not sufficient to understand their impacts, risks or their plans.[12]

Our findings highlight that substantive improvements are still required in the quality, coherence and connectivity of environmental and climate-related reporting to improve its overall decision-usefulness. In many cases, clear linkage between the Directive's content categories was absent, with each treated in isolation. This therefore failed to provide a coherent view of the company's overall development, performance, position and impact. 1 in 3 due diligence disclosures did not address leadership's role in overseeing environmental policies, with a linkage between governance arrangements and a business' stated policies often not made at all. Outcomes disclosures showed significant variation in detail and format, reducing the ability of report users to compare companies and understand relative performance. The synergies between the NFRD and TCFD are not being realised to achieve more harmonised and streamlined disclosure. In order for NFRD disclosures to provide investors and wider stakeholders with the information they require, it is vital that efforts are made to further improve their quality.

A key area of weakness in disclosures under the NFRD's existing requirements is principal risks, with more companies failing to report in line with the Directive's guidance on this content category than any other. While the majority of companies do report their risks, many apply a 'CSR-driven' perspective to the disclosures, considering only the risks their activities pose to the natural environment. Many thus fail to consider the strategic risks their business models may be exposed to over the longer-term as a result of environmental and climate-related matters. As a result, investors do not receive crucial information to guide their decision-making and capital allocations. It is essential that strategic environmental and climate-related risks are identified and understood, so businesses can incorporate them into their policies and processes and, ultimately, so that they will be financially resilient in the long-term.

While it is acknowledged that the 50 largest companies represent only a small subset of those in scope of the Directive, it could be assumed that these companies are likely to produce disclosures of a relatively high quality, given their reporting processes are likely to be well-established and they are likely to be better resourced. Whilst it is encouraging that we see improvement in the disclosures, that there is still significant improvement required among this well-resourced cohort of companies, suggests that reporting by European companies overall has some way to go yet. Continued improvement of European disclosure is necessary to ensure that investors obtain the information they need to fully understand the sustainability of their investments and provide companies with the financing they need to help achieve a climate resilient, just green transition.

"Continued improvement of European disclosure is necessary to ensure that investors obtain the information they need to fully understand the sustainability of their investments."

Recommendations

Building upon the findings of our review, we put forward recommendations for policymakers and regulators and for companies, to ensure that the NFRD, and corporate disclosures made under it, deliver the information needed to drive meaningful progress in delivering the EU Green Deal.

Recommendations for corporate report preparers

As companies prepare their next annual disclosures, they should closely consider the findings of CDSB's review and the good practices highlighted in this report, to identify opportunities to further improve their reporting, taking into account the following points:

1. **Ensure linkages** are drawn across the Directive's content categories. Use your policies to structure and inform your programmes; report clearly and simply against your progress in achieving them;

2. **Clarify the materiality** of environmental and climate-related issues to your business, explaining how your mainstream, and wider sustainability reporting if appropriate, is informed by your view on materiality;

3. Disclose environmental and climate-related information deemed to be financially material in your **mainstream report**, to ensure it is available to an investor audience and can be considered holistically alongside your overall strategic and financial performance; and

4. Align your environmental and climate-related disclosures with the **TCFD core elements**, ensuring that risks and opportunities from climate change over the short, medium and long-term have been assessed and that you have considered the resilience of your organisation under different climate scenarios.

Recommendations for policymakers and regulators

The European Commission is currently reviewing the NFRD, considering options to enhance its effectiveness in ensuring investors, civil society and other interested parties have access to the information they need. Drawing upon the findings of our review, CDSB's recommendations for policymakers and regulators should be adopted in the revised Directive to support improved effectiveness:

1. Remove the exemption allowing the non-financial statement to be reported outside the **mainstream report**, as this will support accessibility, consistency and comparability of disclosures and our review demonstrates that, for most, this is already the norm;

2. **Review the principal risk requirements** of the Directive to ensure emphasis is placed on risks and impacts 'to' the business (not simply 'by' the business). Member State policymakers should consider the interface between the NFRD and other risk disclosure requirements implemented nationally to support companies in making cohesive disclosures;

3. **Incorporate 'climate' into the wording** of the Directive to ensure companies consider climate-related matters explicitly in their disclosures, including the associated financial impacts;

4. **Define key terms used in the Directive**, such as 'policies' and 'due diligence' to ensure a common understanding and application of the Directive's content categories;

5. **Embed the TCFD recommendations** into the Directive to drive stronger linkage of non-financial and financial reporting, and a more unified, harmonised and convergent approach; and

6. Ensure that **supervision of non-financial information** is at the same level as for financial information, in order to provide authoritative feedback to corporate report preparers.

Appendices

Appendix 1: Methodology

This review was conducted by considering the disclosures of 50 listed European companies for the 2018 financial year (reports released in 2019). The companies were selected using the following criteria:

- Publicly listed and headquartered in an EU Member State;
- Over 500 employees;
- The largest 50 companies by market capitalisation selected based on 2019 average market capitalisation; and
- Company reporting in English[v].

The sample represented US$4.3 trillion in market capitalisation[vi], 8 jurisdictions in which the NFRD was implemented (Figure 5) and 10 industry sectors (Figure 6).

The analysis method consisted of a manual assessment grid, comprising of approximately 30 core questions and further subsidiary questions which covered the topics of the NFRD and TCFD. There were a mix of open and closed-ended questions, designed to elicit both quantitative and qualitative data. Responses were categorised using appropriate criteria depending on the nature of the question, for example "Yes", "No" or "Not applicable".

Accompanying details from the company reports were recorded by the review team to support the development of the qualitative observations from across the review sample. This was intended to supplement the quantitative data points. Qualitative observations, however, are by their nature subjective and remain the expert opinion of the CDSB review team. To ensure reliable application of the assessment methodology, the review team met regularly to review queries, recording agreed resolutions for consistency. A detailed calibration check was also undertaken following completion of the review to ensure close alignment of responses and fair application of the criteria to all companies in the sample.

The mainstream report of each company was reviewed in the first instance. Where information pertinent to the non-financial statement or wider question set was located outside of the mainstream report, this was only reviewed where clearly signposted from the mainstream report (for example through inclusion of a hyperlink, or clear reference to a named report), or where it was determined by the review team that the company has provided its non-financial statement in a separate disclosure. This emulates the ease with which other users would find this information.

While some comparisons to the findings of CDSB's 2018 review, published in the First Steps Report, are provided, it should be noted that due to differences in the review methodology and company sample, direct comparability of results cannot be guaranteed and any observations provided are intended to provide an overview of high-level trends in corporate environmental and climate-related disclosure practices only.

Figure 5: Distribution of company sample by jurisdiction

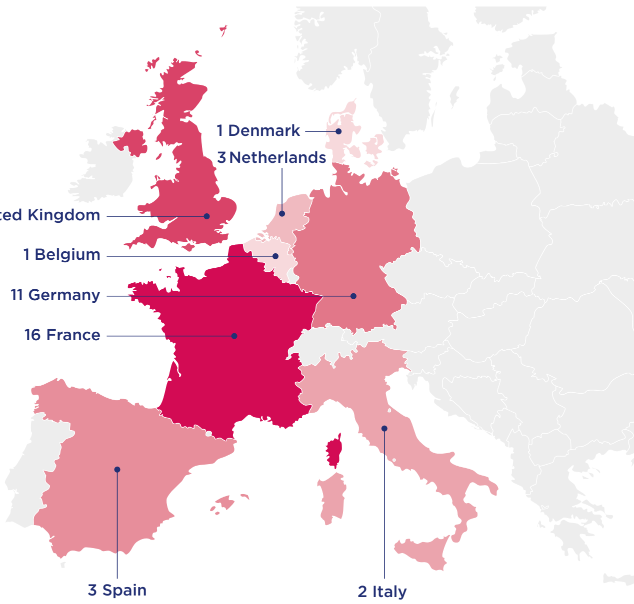
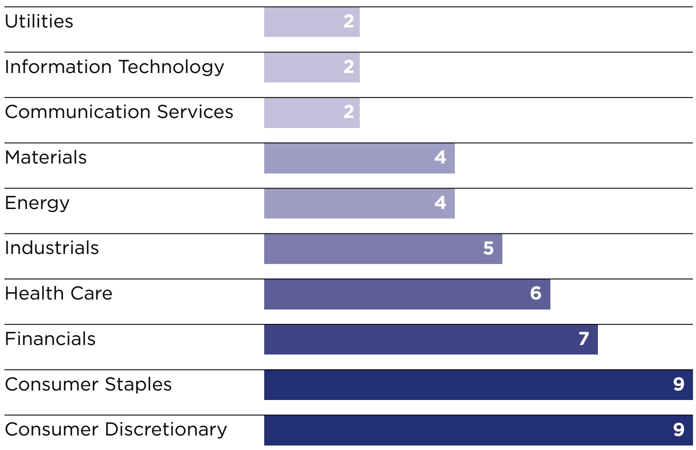


Figure 6: Sample distribution by industry sector



v The working language of the CDSB review team

vi Based on 2019 average market capitalisation data

Appendix 2: List of companies reviewed

Communication Services
Deutsche Telekom AG
Vodafone Group Plc

Consumer Discretionary
adidas AG
BMW AG
Christian Dior SE
Daimler AG
EssilorLuxottica
Hermès International
Industria de Diseño Textil, S.A.
Kering
Volkswagen AG

Consumer Staples
Anheuser-Busch InBev SA/NV
British American Tobacco p.l.c.
Danone S.A.
Diageo plc
Heineken N.V.
L'Oréal Group
Pernod Ricard SA
Reckitt Benckiser Group plc
Unilever PLC

Energy
BP p.l.c.
Eni S.p.A.
Shell International B.V.
TOTAL SA

Financials
Allianz SE
AXA SA
Banco Santander S.A.
BNP Paribas
HSBC Holdings plc
Lloyds Bank plc
Prudential plc

Health Care
AstraZeneca PLC
Bayer AG
GlaxoSmithKline plc
Merck KGaA
Novo Nordisk A/S
Sanofi

Industrials
Airbus SAS
Safran
Schneider Electric SE
Siemens AG
VINCI

Information Technology
ASML Holding N.V.
SAP SE

Materials
Air Liquide S.A.
BASF SE
Linde plc
Rinto Tinto plc

Utilities
Enel SpA
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