NGO public reaction

On the Corporate Sustainability Reporting Directive (NFRD reform) proposal: most promising changes and caveats

As NGOs working on sustainable corporate transparency and responsibility, we have been supportive of the EU Commission's plans to reform the EU Non-Financial Reporting Directive (NFRD) and the development of mandatory European sustainability standards.

The European Commission has presented its legislative proposal for a Directive as regards sustainability disclosures by certain companies.

The proposal presents several major improvements which are essential to help companies focus and report on meaningful information and channel finance to activities and projects needed to meet the objectives of the European Green Deal and make the European economy sustainable.

The most positive developments include:

1. **The extension of the scope of the Directive to include all large companies**, which is important for the success of the sustainable finance strategy, because a vast majority of large European companies are not publicly traded but rely instead on bank financing; and for public accountability, because both private and publicly-traded companies may have severe impacts on people and the environment.

2. **A requirement to develop European generic and sector specific mandatory sustainability reporting standards.** This is essential to ensure relevance, clarity and comparability of disclosed information and to address the specificities of high-risk sectors.

3. **Clarification of the main reporting areas and the categories of information that companies should disclose is specified in greater detail. The principle of "double materiality" is also clarified and properly enshrined in the draft proposal.** Double materiality is key so that investors, other finance providers, supervisors and citizens and rights- and other stakeholders can understand risks and opportunities stemming from sustainability matters that companies face, as well as the actual and potential adverse impacts of corporate business models and operations on people and planet. This will provide a clear framework for the development of the above-mentioned standards.

4. **The proposal provides a clear mandate to report on plans to ensure the compatibility of company business models and strategies with the transition towards a sustainable economy and with the limiting of global warming to 1.5 °C in line with the Paris Agreement.** However, this requirement is not reflected in the provisions on mandatory sustainability standards. They only refer to standards that should address climate change mitigation and adaptation, without further qualifications. The transition will generate risks and opportunities that will have major implications for companies' business models and strategies. This requires a clear framework specifying what needs to be reported. EU standards need to provide clarification by addressing interim objectives and related timelines, publication of carbon footprints at all scope levels and capital alignment. As time is of the essence especially with regards to the climate transition, we need sustainability reporting standards to be ambitious, with the first set adopted by October 2022.

However, the proposal falls short on several important points, which significantly limit its desired impact:

1. Private companies, which don't meet the threshold of a large undertaking, are left out of the scope of the proposed Directive in contradiction to the **EU Parliament's clear call for the integration of all companies from high-risk sectors.** Similarly, SMEs listed on SME Growth Markets and other MTFs are excluded. This will create a two tiered system and is problematic on two accounts. First, investors and relevant stakeholders would not receive sustainability information on medium-sized companies with high actual or potential negative impacts, such as in the energy and mining sectors or agri-business that is linked to deforestation and land grabbing. Second, **this exclusion risks leaving smaller companies**

behind in the reallocation of capital to support transition to a sustainable economy, thus undermining the competition for the benefit of dominating companies. The Directive will specify disclosure of critical data which will influence access to loans and investments for transition. **Even a slight delay in the ability to collect and present the relevant data by companies not included in the scope, will put them (as well as national economies) at a competitive disadvantage.** Similarly, data disclosed by companies is critical to CSOs and rights-holders working to hold companies to account for their impact on people and the planet.

The exemption for large companies, which are part of corporate groups, is problematic. The proposed exemption is different from the rules for financial reporting, which do not exempt companies from publishing statutory financial accounts because they are also integrated into consolidated financial accounts. Throughout the EU, some sectors (such as the financial industry) are highly concentrated. Making disclosures subject to the determination of materiality at the group level may lead to non-disclosure of specific information on resilience and significant impacts of subsidiaries of such EU groups, resulting in lack of accountability at national level as well as to investors and stakeholders needing these insights.

2. The proposal includes the requirement for companies to report on sustainability due diligence, and actual and potential adverse impacts connected with the company's value chain, though the information about value chain should be provided only 'where appropriate'. In this respect, **the proposal fails to specify the essential aspects that EU standards need to address in particular with regard to reporting on human rights, including disclosure of salient human rights issues, key elements for supply chains disclosures, and quality criteria for KPIs**. The lack of clear directions would significantly hamper the development of the reporting standard given unsatisfactory level of reporting in this area and lower maturity of existing standards compared to the environmental area.

3. The proposal outlines the need to describe targets related to sustainability matters set by the undertaking, and disclose their progress against those targets and milestones. **However, to ensure target setting is relevant and connected to the company's impacts and risks, it is essential to specify that such targets must be linked to the outcomes of the company's double materiality determination**. Likewise, requiring companies to report on actions taken, and the result of such actions, to address adverse impacts must be linked to targets and progress against set targets. These connections are not made explicit in the proposal. Correcting it requires only minor changes, which however are critical to ensure meaningful information allowing understanding of how companies manage their risks and impacts.

The experts working in the undersigned NGOs state:

"This long-awaited reform reflects the vast amount of evidence pointing to the need to strengthen the reporting obligations and specification of mandatory standards for companies to be able to close the ESG data gap in the Sustainable Finance plan. This is necessary to enable investors and banks to channel their investments to truly sustainable activities, guide companies to focus on data that matters for their business, and ensure transparency

on how companies linked to severe adverse impacts address such impacts." **Filip Gregor, Head of Responsible Companies at Frank Bold**

"We were glad to see the overall positive ambition of the Commission to push forward a much needed legislation on sustainable corporate transparency, including the requirement to create sector-specific EU sustainability reporting standards and the alignment of the environmental factors with the EU Taxonomy Regulations' six objectives. However, we are very concerned with the lack of ambition in terms of scope. The phase-in approach for listed SMEs of 3 years after entry into application is unacceptable and too late, including the exclusion of non-listed SMEs in high-impact sectors. SMEs account for 99.8% of all EU enterprises according to Eurostat and the impact on people and planet is irrespective of their size. The lack of ambition in scope will be reflected in the effectiveness of this proposal. " **Julia Linares, Senior Sustainable Finance Policy Officer at WWF European Policy Office**

"*We need everyone to pitch in and play their part in making sure the Green Deal does what it says on the tin. The Commission wants companies to report on what they are doing to align their business strategy with the objectives of the Paris Agreement – but more is needed. A crucial step is full transparency on the way in which European companies are planning to meet that goal: this involves setting rules on disclosing emissions on all scopes, requiring short and medium -term targets, as well as business transition plans in the upcoming standards. Sector-specific rules are also key to tackle the large carbon footprint of oil and gas companies. Raising the transparency bar on climate reporting is essential to increase companies' accountability on their impact on the planet, and show what they are doing to combat the climate crisis - praiseworthy or not"* **Caroline Avan, Corporate Governance Lead at Oxfam France**

"The EU's energy transition will need a vast amount of minerals. It's critical that the new EU sustainability reporting legislation creates a framework that will oblige mining companies to be transparent about their impact on people and the environment, including by ensuring they contribute to sustainable development, not corruption and conflict. We welcome the adoption of sector-specific sustainability reporting standards foreseen in the draft legislation. To ensure the success of the European Green Deal, the EU must prioritise robust standards for extractive industries." **Stephanie Rochford, Director of Member Engagement at Publish What You Pay**

"Current voluntary reporting standards have failed to reduce the impact that corporations have on people and planet. This version aims to increase corporate transparency – yet it still falls short by excluding the overwhelming majority of companies in the EU from its scope. Companies of all shapes and sizes are contributing to irreversible environmental and human rights harms. There is also a need to ensure there will be further details for specific sector reporting, such as those implicated in deforestation and land grabbing. In order to be effective, this law must go further to mandate that all companies – including financial institutions – disclose their impact, especially in high risk sectors. This law is absolutely necessary, and has been for years – requiring simple reporting from corporations should not be contested. We should also not lose sight that transparency, while important, is no substitute for real action on accountability." **Richard Gardiner, Senior Campaigner on Corporate Accountability. Global Witness**

"We welcome the revised and renamed Directive and the introduction of a reporting standard aligned with the Taxonomy Regulation. However, we are concerned that high risk companies are excluded and that reporting for listed SMEs is delayed 3 years. This is hardly in line with the EU Green Deal goal" - **Anna Grabowska, Sustainable Finance Manager, T&E**

"The Commission proposal strikes a right balance. We raise a concern, however, that high-risk, medium-sized companies are out of the scope of mandatory sustainability-related disclosures. Such companies can deliver a profound and wide-reaching impact on the environment and society. Moreover, sustainability risks may lead to widespread and significant financial impact on companies and their operations. Neglecting sustainability risks, whether by large or medium-sized companies, has knock-on effects that can lead to economic disruption and financial instability." **Aleksandra Palinska, Senior Research and Advocacy Officer, Finance Watch**

"ShareAction welcomes the Commission's ambition to strengthen the sustainability reporting obligations, that ensure legislative consistency with the Disclosure Regulation. Investors need stronger ESG data in order to consider the impacts linked to their investments and to reorient capital flows towards sustainable activities. We

are concerned about the current exclusion of non-listed SMEs in high-impact sectors. A company's impact on sustainability factors and the financial materiality of sustainability factors on the company do not depend on the company's listing on stock exchanges. All companies that significantly impact the environment or society as a result of their operations need to be included." **Maria van der Heide, Head of EU policy, ShareAction**

"For the financial market to unleash its transformative potential for the real economy, effective regulation and incentives are needed. This includes in particular binding reporting and fiduciary duty obligations for the entire supply chain in line with the 1.5°C limit of the Paris Agreement and with human rights obligations. Germany and EU regulators need to ensure that the information reported by companies is clear enough for interested stakeholders to understand how businesses identify and manage their impacts on environmental and social impacts." **Christoph Bals, Policy Director, Germanwatch**

"E3G welcomes the revised and renamed Corporate Sustainability Reporting Directive.This announcement coincides with today's launch of the Glasgow Financial Alliance for Net Zero (GFANZ), representing the world's largest finance firms, promising to stop emitting or funding harmful emissions by 2050. This commitment clearly illustrates the financial sector's expectations for policymakers and regulators to facilitate their decarbonisation and their portfolio companies' transition to net-zero, including in terms of the necessary sustainability disclosures and reporting guidelines. The Commission's draft is a step in the right direction anda great opportunity for the EU to support companies in effectively transitioning their businesses." **Tsvetelina Kuzmanova, Policy Advisor, E3G - Third Generation Environmentalism**

"Transparency and sustainable corporate governance are two sides of the same coin. Sustainable corporate transparency requirements are crucial, but will hardly transform business conduct on their own. Without strong due diligence requirements obliging companies to effectively identify, prevent and mitigate human rights and environmental harms in their value chains, there may be nothing useful or relevant for them to report on." - **Claudia Saller, Director of the European Coalition for Corporate Justice (ECCJ)**

For specific evidence supporting the need to define reporting obligations and develop mandatory standards, please see the research implemented by the Alliance for Corporate Transparency on the ESG disclosures of 1000 EU companies in 2019 as well as the latest study on 300 companies reporting on climate and environmental issues.