The time is ripe for EU policy reforms and standards on corporate sustainability reporting

Following the presentation of the Green Deal last December, the EU Commission initiated the reform of the EU Non-Financial Reporting Directive (NFRD) with the objective to improve quality, consistency, comparability, as well as accessibility of critical information on sustainability disclosed by companies.

This legal framework provides companies and financial actors with much needed rules and guidelines to report on the risks and impacts on people and the planet, and provide a basis for the EU Commission's effort to scale up sustainable finance[1]. The severity of COVID-19 and its economic and social consequences have underlined the need to further and strengthen our efforts on creating a sustainable and resilient economic system.

The undersigned civil society organisations welcome this ambition, and call on the European Commission to address the following two critical issues:

1. Clarify and improve the basic elements of the NFRD

The experience with the implementation of the NFRD and the analysis of the current status of companies' sustainability reporting provided by multiple relevant studies such as that of the Alliance for Corporate Transparency indicate that without clearer legal requirements, neither guidance nor voluntary measures alone - no matter how good - will have a sufficiently substantial and positive effect on the quality of companies' reporting.

The reformed legislation must specify at minimum the following:

- The double-materiality principle, that is the requirement to report information on the company's impacts on people and planet, as well as information on the company's management of risks to its own business arising from social and environmental matters; while ensuring that it serves the needs of investors and broader society.
- The materiality determination process i.e. required explanation of which specific issues the company considers to be material (from both of these perspectives) as well as why and how these issues were deemed material in order to allow independent verification of a company's exposure to both adverse impacts and risks. The law should specify that companies shall disclose this process (including inputs from affected stakeholders), and how the results of this determination translate into the company's governance and strategy.
- The interconnectivity of the reporting requirements - specifically that the determination of material issues should be based on an analysis of sustainability risks and impacts; which should then determine the content of policy disclosures, targets and choice of KPIs.
- Transparency requirements concerning governance of sustainability matters, in particular targets and how sustainability strategies are embedded in accountability at top level, through e.g. disclosure on matters discussed by Boards.

The reformed legislation should be applicable to all companies involved in activities or value chains that pose high risks to people and planet. The required information shall be incorporated in companies' management reports and subject to the same requirements concerning audit and enforcement as financial information.

2. Develop EU standards to ensure the relevance and comparability of sustainability disclosures

European Commission's Executive Vice-President Valdis Dombrovskis announced the development of non-financial reporting standards and invited the European Financial Reporting Advisory Group (EFRAG) to start preparatory work. Such sector-specific standards are indispensable to ensure that comparable and decision-useful information is disclosed by companies. The European Commission must initiate this process as soon as possible to ensure the NFR reform and standards are ready simultaneously.

The governance arrangements for the development of the EU standards will need to be carefully considered. Nevertheless, the Commission should urgently set parameters for the quality and content of the standards from the perspective of their ability to support the sustainability goals of the EU. For this task, the Commission should request EFRAG to organise a project with the help of the Corporate Reporting Lab that would be implemented by experts on sustainability reporting from all stakeholder groups, with due representation of civil society organisations.

The European standards can and should be a blueprint for a global standard on non-financial reporting but, as outlined in the introduction, the reform and development of standards can not be delayed. The EU should harness its pioneering work to instigate an international process but must urgently move forward with the policy reforms and standards on corporate sustainability reporting, as it is the foundation to achieve the proper implementation of the EU Sustainable Finance existing and future measures. This will in turn ensure that the recovery from COVID-19 supports the achievement of the European Green Deal, the SDGs and the EU's 2030 agenda.

SIGNATORIES

Frank Bold | WWF | CDP | ShareAction | Business & Human Rights Resource Centre | Themis Research | Future-Fit Foundation | global witness | Transparency International EU | Shift

[1] *"As things stand today, there is currently a sustainability reporting gap that is hampering progress towards a sustainable financial system. The needs of investors for corporate sustainability information are growing faster than any improvements in company reporting"* stated Valdis Dombrovskis in February 2020.

[2] The Alliance for Corporate Transparency project assessed the sustainability-related disclosures of 1000 EU companies pursuant to the reporting requirements introduced by the EU NFRD. The results have been published in an open access database here.

[3] This includes in particular the goals linked to the European Green Deal and policy coherence with the objectives and content of other elements of the European strategy on Sustainable Finance, such as the Regulation establishing the framework to facilitate sustainable investment, Regulation (EU) 2019/2088 on sustainability related disclosures in the financial services sector, and the announced initiative on the human rights and environmental due diligence.

[4] The European Corporate Reporting Lab was established by EFRAG, following the call by the European Commission in its March 2018 Action Plan on Financing Sustainable Growth. The European Lab serves the European public interest and its objective is to stimulate innovation in the field of corporate sustainability reporting in Europe by identifying and sharing good reporting practices. The Lab is governed by a multistakeholder Steering Group, and works to achieve its mission by defining and commissioning projects implemented by project task forces consisting of external experts selected in accordance with criteria ensuring regional and stakeholder balance.

[5] EFRAG should convene the best experts on ESG matters from the following groups: preparers (companies and financial actors), investors, civil society organisations, academics, leading international reporting frameworks as well as European supervisory authorities. The experience with the High Level Expert Group (set up in 2017-18) and the Technical Expert Group (2018-20) on Sustainable Finance proves the positive and wide-range support for this approach.