Webinar: Are companies in Southern Europe ready for the European Green Deal?

Organised by Frank Bold, coordinator of the Alliance for Corporate Transparency for the launch of 2020 research on companies' climate and environmental disclosures on the 1st of December, 2020.

Summary of discussions

The EU has initiated an ambitious agenda on sustainable finance which aims to redirect capital flows in favour of the climate transition and sustainability, and is an essential piece of the European Green Deal and the Covid-19 Recovery Plan. In this context, companies and investors alike need reliable and meaningful information on sustainability risks and impacts in order to leverage investment opportunities and manage the pitfalls and opportunities in a fast-changing world.

On 1st December, Frank Bold hosted an online event to present the latest research conducted as part of the Alliance for Corporate Transparency on the disclosures made by 300 companies on climate and environmental matters (recording available here). The study was published as the EU Commission is finalising its reform proposal for the EU Non-Financial Reporting Directive, and lays down plans to develop European sustainability reporting standards.

Below, you will find a detailed summary of the presentations and input provided by key experts from the business, finance and civil society communities as well as the European Commission. The key takeaways from the discussion include:

- There is an urgent need to focus companies' sustainability reporting on relevant and decision-useful information. This is critical to effective management of companies in the context of the transformation of the EU economy.
- Banks have an important role in facilitating the climate transition. However, in order to properly assess and disclose risks, they too need the right data. Current problems include granularity, reliability and comparability of information. Providing such information is particularly challenging for SMEs.
- The reform of the EU Non-Financial Reporting Directive and development of EU standards are set to address this. This reform is also at the center of EU Green Deal, the EU sustainable finance agenda, and is key to achieve the EU objectives set in the Paris agreement and the EU climate law
- Standardised data is the backbone of sustainability reporting. Key issues to address in creating an EU reporting framework and standards include:
  - Double and dynamic materiality: identification of relevant risks and impacts that affect both the company and the environment/society
  - Methodology and indicators: clarification and standardisation of the measurement and reporting system for key issues (i.e GHG scope 3, supply chain related matters)
  - The role of SMEs: it is essential to include SMEs (through simplified or gradual approaches) in the sustainability reporting realm in order to ensure they gather critical data and enable banks to provide finance to their transformation
  - Ensure connectivity of information:There is a strong need to connect the analysis of potential and actual risks with the definition of policies and strategies, planning of actions and disclosure on outcomes and progress.

Joanne Houston, EU Policy Officer at Frank Bold

Key findings from the latest research on the climate and environmental disclosure of 300 companies from CEE and Southern Europe (slides available here).

- **Presentation of information:** almost 20% of companies do not publish any KPIs and only 24.4% report KPIs in summarised statements. Only 23.8% of companies report following a clear and interconnected structure, with Italy and Spain performing above average compared to other countries. **In terms of strategic information,** the major weakness was observed in terms of business opportunities related to sustainability challenges.

- **With regards to governance-related aspects**, there are more companies reporting on general governance arrangements than those providing more specific details, including how many companies disclose how sustainability issues are addressed by the Board.
- **Policies, outcomes, risks for climate and other environmental issues:** there is a gap between the total amount of companies reporting on these aspects and those that do so in a specific way. The extent of the gap between general and specific disclosures is highlighted by the fact that while approximately 31% of companies describe their policies in a specific manner, only 16% explain the alignment of **policies** with science-based targets. Few companies report on policy outcomes.
- Similarly, there is a big gap between companies reporting on **risks** and those using a below 2 degrees global warming scenario in their own corporate risk assessments. Companies can describe risks in a thorough manner, but if that is not placed in the context of the EU decarbonization timeline and the company's own pathway to carbon neutrality, critical information is missing.
- With regards to climate **targets** (meaning quantitative targets linked to climate change mitigation and adaptation) and companies' alignment with the Paris Agreement (key for understanding of a company's decarbonization plans and alignment with international objectives), reporting is still too low for readers to have an idea of such plans.
- Relevant results on other **environmental matters** include:
  - 70% of companies report no information on biodiversity;
  - more than half of all companies report on the use of water but less than 10% put this into context by reporting on risks to local water stress
  - 55% report on pollution-related policies and the much lower 7% reporting on quantitative reduction targets.
- Of the 300 companies assessed this year, 168 were included in the Alliance for Corporate Transparency previous assessment of 1000 company reports. An increase was observed in reporting on climate targets and on specific information relating to policies. But most of these changes are specific to Spain, which is most likely explained by the legislative changes in Spain; moreover, specific information is still reported by only a minority.

Axelle Blanchard, CDSB Policy Manager

- There are some signs of improvement in companies' disclosure but clear challenges remain in providing decision-useful information answering the needs of various stakeholders. There are two results to highlight from the Alliance's research:
- **1. Risks disclosure and implementation of the TCFD recommendations:**
  - There is a lack of meaningful disclosures of principal risks and companies are not able to properly integrate identified risks into risk management processes.
  - This is linked to a general lack of implementation of TCFD recommendations, especially when it comes to disclosing forward-looking information and using scenario analysis to assess the resilience of the company against specific climate scenarios.
  - CDSB's analysis showed that companies are less likely to disclose business model impacts related to how business generates value at a more strategic level.
  - The TCFD recommendations are also about governance. Research shows lack of disclosure of board and management responsibility and accountability over climate and environmental issues
- **2. KPIs and targets:**
  - We clearly see challenges when it comes to disclosing GHG Scope 3 emissions. This is relevant in the context of the current finalisation of taxonomy-related disclosure requirements.
  - A lot of companies are unable to provide these climate-related financial KPIs that can connect their financial performance with environmental and climate-related issues.
- We also share the Alliance conclusions around the need to have consistency in the format and summarised overviews of such KPIs as well as connecting them with policies, outcomes, and targets in order to provide an integrated picture of the company's direction of travel and how it intends to manage environmental risks and impacts
- Both the Alliance findings and CDSB's research provide further evidence of the need to review the Non-Financial-Reporting Directive. As a result we hope that companies will be able to understand and disclose the relevant data that can meet:

- a) The need for consistent, comparable and decision-useful information for various stakeholders
- b) The need to increase sustainable investment and transparency for the EU to meet the Paris agreement and the climate law objective
- c) The need for stakeholders, including investors to comply with their own disclosure requirements coming from other regulation

Carlos Tornero, Senior Reporter at Responsible Investor

The European Commission is trying to tackle three challenges:

- **Lack of leadership:** in the absence of the SEC, the IFRS foundation or anyone you can think of, the European Commission is blazing a trail in this regard.
  - Earlier this year, the European Commission announced that the NFRD revision might involve setting EU standards. At the same time, the SEC announced the modernisation of S-K disclosure rules. Surprisingly, they didn't cover climate change risks.
  - With regards to the IFRS: they have been missing opportunities for a long time. Blackrock has been asking since 2016 for a standardised ESG disclosure within a consistent global reporting framework similar to international accounting standards. Other investors have been making more explicit statements around the same idea.
  - Until very recently, the main ambition of the IFRS and the IASB was to update voluntary guidance on narrative reporting. The IFRS recently issued a consultation on the role it should play in the sustainability reporting landscape and the proposal for sustainability standards board. The European Commission can't wait to see what comes out from this consultation, because the NFRD is the pillar of the Green Deal and the whole sustainable finance agenda.
- **Overcoming voluntary approaches** that simply have not worked out so far. Non-financial reporting has relied on the "alphabet soup", of voluntary standards, metrics, frameworks. They have served a purpose, but there is an appetite for something new.
  - The business case for mandatory approaches: the NFRD was a pioneering law in introducing new obligations on ESG issues, but failed to clarify how to comply with those new obligations. The Alliance for Corporate Transparency research carried out by Frank Bold provides evidence that there are shortcomings with this approach. The European Commission and policy-makers in general wouldn't like to make the same mistake again. Sustainability reporting has changed dramatically since the NFRD was passed, and during the last five years the alphabet soup has evolved.
- **Potential harmonisation of the reporting landscape**, with the potential mandatory standards 'made in europe' and using the existing ingredients of the 'alphabet soup'. For this we need to see what comes out of the EFRAG work and the European Commission position.
  - Standard-setting as part of the legislative work: we tend to think that this area is technical, but it is actually quite political and there are a lot of interests at stake. Recently, many organisations have started coming together to harmonise their projects (SASB, GRI, CDP, CDSB and IIRC and the upcoming merge of SASB and IIRC). This is not a coincidence; they want to be part of the potential European standards. This is the equivalent of the seduction dance in the animal kingdom. One of the crucial things to bear in mind is '**double-materiality**': existing standards lack this approach, which instead is part of the European Commission plans.

Giulia Genuardi, ENEL Head of Sustainability Planning and Performance Management and Member of EFRAG's Project Taskforce on non-financial reporting standards

- **Sustainability and non-financial data are fundamental to understand the business model of a company** and sustainability data is a key element to plan our activities. It's not an exception: it is the backbone and baseline in the starting point to evaluate a company.
- A company has many relations with different stakeholders, who want different data. It is not so simple to reach all the needs of different stakeholders. We need to respect the differences, but **a structured corporate reporting framework is absolutely necessary.**

- Financial reports and the sustainability report are complementary, at the same level, and they are important to reduce the risk of the company, not only potential, but also operational risks of the company. For this reason, data is fundamental, and the identification of stakeholders as well.
- **The element in common is that of materiality assessment.** Materiality is the process, the navigator to identify the right data and stakeholder needs. We have to address a dynamic materiality, because the context in which the company operates changes continuously.
- **The concept of 'double-materiality':** in the management of the energy transition, it's also absolutely necessary that we manage the just transition. We have to consider the impact of the world on the company, but it's also necessary that we consider the impact of the company on the environment, the collectivity, on the community.
- We have an 'alphabet soup' but, at the same time, we have a big ambition and challenge. Different actors use different definitions of sustainability. Transparency on the definition of sustainability is necessary. For instance, different ESG raters use different sustainability definitions and evaluate companies in a different way.
- **Through the Non-Financial Reporting Directive we can create the backbone of the information that is necessary to have.**
- It's useful for stakeholders to evaluate the performance of the company, but it's also useful for the company to collect aggregated information of their supply chain (mostly SMEs).
- At the same time, we have to guarantee a correct balance between the backbone of information and the materiality of the information for the company. It's necessary that we have a backbone of information to guarantee compatibility, but it's also important to reinforce the role of 'dynamic' materiality to reach new topics that may not be covered by the Non-Financial Reporting Directive.

Dimitrios Dimopoulos, Director of the Sustainability Unit at Piraeus Bank, member of UNEP FI

- **Piraeus bank has a long history in sustainability.** In 2012 we implemented an EU project and developed a tool to measure and estimate the impact of climate change on our clients and companies within Greece. It is something that we are now moving on very fast, having committed to the science-based targets initiative; we're working on a baseline for our finance emissions in 2021, so we will be able by the end of next year to have a baseline to track progress in how we will decarbonise our portfolio.
- **Climate risk in the bank is gaining traction:** we're working very closely with the risk department and trying to introduce a climate-risk culture in all functions of the bank. Two years ago, as members of UNEP FI, we helped create the Principles for responsible banking, where currently we're at the stage of developing across the board goals and targets so that we can meet the Paris climate agreement targets and the SDGs.
- **Collectively, as members of UNEP FI, which includes large and smaller banks, one of the issues we face is data:**
  - **External problem:** how do we get the right data from our customers, our clients. We need this information to run our assessments on climate risks and try to set targets. One issue is therefore our client's reporting and the quality of this data at the level that is required, that fits the purpose.
  - **Internal problem:** in some cases, the granularity of the data is not there and the sustainability 'tagging' is not up to scratch to get the data that we need to analyse.
- **With the EU taxonomy,** things are going to get tougher. We will need to define green ratios and classify our portfolio according to the EU taxonomy which will be a very fundamental tool in addressing sustainable financing.
- **Issue with SMEs:** they represent 99% of businesses in Europe, 60% of the total value of the economy. There are 23 million SMEs in Europe and most of them do not have the resources to provide that information. **It's very important that we develop approaches that will allow SMEs to report the fundamental information and data we need** so that banks can draw on the results and analyse the data needed to measure the impact of climate.
- **Methodological issues:** you might have the data, but if you don't have methodologies for the analysis of this data or methodologies that can help banks to develop climate scenarios and set targets according to the Paris agreement, it's also another problem. Standardising methodologies is one of the challenges for banks. At UNEP FI we are working to develop methodologies on climate and biodiversity risks.
- **Standardised data will allow us to compare and help in being more transparent and accountable.** What is happening in the EU, what the ECB and European Banking Authority are doing in developing comprehensive technical

standards to implement disclosure requirements for climate risk is very important. When you combine the standards of data with the standardized methodologies, you can see progress in this build of reporting. But it is not only about reporting, it is also a question of understanding, seeing, and realizing where your impacts are, putting emphasis on your positive impacts, trying to reduce your negative impact and setting the right and ambitious targets.

- **An EU central data register** based on common standards would be very important, so that banks can have access, especially to information regarding SMEs.

Juanjo Cordero, Partner at Sustentia

- **The main gap in non-financial reporting is that a risk management approach is missing.** As set out in the UN Guiding Principles on Business and Human Rights, due diligence should be applied in the whole management of information on non-financial reporting.
- **The starting point should be the identification of risks.** From there, once the risks are identified with the 'double-materiality' perspective (risks for the company and the environment/people), the policy commitments, the goals, the actions and the targets have a meaning. Otherwise, there are a lot of companies that have commitments or policies, but they have not properly identified risks. Companies need to provide information on how they are managing risks they have identified. How do they manage them? What is their commitment and what are the results they obtain out of the actions and plans they have? This is something that we find missing year after year. Sometimes the information on risk seems not to be written by the same department. It's in a separate section of the report and is not connected to the rest of the information. It may not be lack of will of transparency, but a lack of understanding of the goal of non-financial reporting
- Spanish companies have performed much better than last year on climate-related information, policies, risk descriptions, and outcomes compared to the rest of the countries. In Spanish legislation, there are specific requirements on values, KPIs and GHG emissions. It is required but yet not all companies are fulfilling these requirements. The same thing happens with targets. The research shows very good results from Spanish companies (about 50% of them). But Spanish legislation requires information on those targets. From an optimistic perspective, Spain is doing much better as we also see some very good improvements on science-based targets (last year below 15% and this year it's above 40%). I don't think these results can be extrapolated for all Spanish companies, but they show that there's a good trend in Spanish companies' reporting on this issue.
- **The Spanish example is good to highlight that regulation has an effect on the reports published by the companies; legal requirements**. If these legal requirements are not as specific, we find vague, sometimes useless information. There should be an oversight body or a system of sanctions helping to enforce the law.
- **On supply chains transparency,** there is a general lack of information about risks and impacts on value chains. Taking into consideration that business models are nowadays based on strategies of offshoring and outsourcing their value chains, most risks and impacts are located in suppliers and subcontractors in the value chain. **The results in this research are disappointing**: specific indicators (i.e GHG Scope 3, engagement with value chains for use of natural resources, pollution discharges and biodiversity) are around 1-2% of companies only. It is critical that due diligence for risks and impacts in suppliers and subcontractors is included.

Giulio Lo Iacono, Responsible, Alleanza Italiana per lo Sviluppo Sostenibile (ASviS)

- **Reasons for the gap in Italian companies' disclosures between their reporting on risks, and on their actions to mitigate these risks.** This is partially due to the fact that real evaluation of ESG risk started quite recently. Even though climate and environmental models in terms of the performances and risks are easier to measure than social ones, we still lack general coherence between identified risks and concrete actions taken to mitigate these risks.
- Sustainability risks are often more challenging to quantify than traditional risks: once a sustainability risk has been identified, it can be very challenging to quantify the impact of the risk during the assessment phase. And still, there is in many cases a lack of cooperation, of collaboration between sustainability and enterprise risk functions.
- **The current risk management frameworks do not provide enough guidance to companies.** When managing more traditional risks - commodity risk, trade risk, market risk and so on - companies have developed a significant capability over time to quantify the impacts and then apply the know-how, or business managers and risk managers

to make a call. For emerging sustainability risks, business managers often do not have the tools to implement and mitigate the assessed environmental risk.

- **The sustainability timeline is longer than that of traditional risks,** and is another reason why sustainability risks are often overlooked, or less prioritized than other risks: The timelines considered during risk assessment for most companies are two or five years; some companies use a time horizon of five or ten years, especially in cycles that have longer investment time horizons. In contrast, sustainability materiality assessments typically look at a time horizon of ten, twelve, or 30 years. And for so many companies, especially during this Coronavirus-crisis, it's very difficult to have this kind of long-term perspective. However, this crisis coming from the pandemic showed us that **more resilient companies, more sustainable companies are often less vulnerable to systematic risks and more resilient to shocks.**
- Small and medium enterprises are the backbone of Europe's economy: they employ around 100 million people, accounting for more than half of Europe's GDP (in Italy SMEs account for 92% of the companies). We know that for them it's more difficult to evaluate their environmental and social impact; it's hard for them to have a sustainability function, and this is why **the European Union should consider SMEs in the effort towards a more sustainable and resilient system.** We need a much more simplified approach. SMEs often commit themselves to ESG disclosure just if they are suppliers of bigger companies, or if they want to access sustainable finance investments. But this is not enough.
- ASVIS asks that the legislative decree which makes non-financial reporting mandatory for just over 200 very large companies should be reviewed. Four years after the publication of this decree, the business community has fully realised that non-financial reporting is a vital tool for enabling individual companies to access the most dynamic form of finance, which is responsible finance, and that adoption of sustainability-oriented management practices allows not only for significant cost reductions, but also productivity gains. **Therefore it is time to immediately make non-financial reporting mandatory for all large companies and also, gradually, for medium-sized companies.**

Ricardo Laiseca, Managing Director and Head of Global Sustainability Office at BBVA

- We have a long history on sustainability and involvement with international initiatives. In our journey, we've learned two lessons: Firs**t, sustainability is not a well-known concept, we have a real gap of understanding what it means, how to integrate it in our companies. Second, sustainability is very related to transparency.** In order to transition, to move forward, it's important to have cooperation, data, and to understand the real risks, and their real impact on the strategy and activities. **The results of the Alliance for Corporate Transparency research show that we must continue working on how to integrate those risks in the disclosure of the companies.**
- Disclosure is a key aspect of the whole strategic program of any major company. It is required to take decisions and necessary to inform investors. Without data and corporate disclosure, it's impossible to align your portfolio, manage your risk, and assess in the end your performance and risk. **Banks are singular companies; as services companies our direct impact is very small but our role is critical in order to support the transition** because we finance the productive activities and we can also influence the day-to-day regulatory work.
- **We fully agree on previous references on SMEs and supply chains:** this is not just about big corporates and listed companies. Sustainability data should be required from any company. Big companies need to assess the supply chain, and data is critical for that.
- We require some major understanding of the risks. This is also about supporting our clients, not just for internal use. As financial institutions, our impact is small, but we recognise that we must be a major part of the solution.
- We need to find the right balance between regions and countries and a common standard in the EU in order to make results comparable. The non-financial reporting framework should be a purpose one - disclosures should help our clients' transition.

Elena Arveras, DG FISMA, EU Commission

- In the context of the NFRD revision, we are planning a proposal by Q1 next year, probably by the end of March. In this context, and in order to overcome some of the problems identified, we are looking into three or four major areas:
- **The need to broaden the scope of the NFRD requirements**, in order to bring in more companies that are currently not subject to any reporting obligations.

- The need to not leave anyone behind is important, but we need to keep in mind the 'proportionality principle', while at the same time not leaving SMEs out of the transition.
- **The issue of standardised information.** All the problems in terms of comparability, relevance and reliable information cannot be properly addressed if data is not reported in a standardised manner. The issue of accessibility and usability of information in terms of digitalisation cannot be addressed either, if we do not have a starting point that is standardised information. **We believe that it would be very difficult to resolve all the problems identified without these standards.**
- **The issue of scope and SMEs:** we are looking into the need for a simplified set of standards for SMEs that could be voluntarily applied. This could help everyone participate in the provision of non-financial information, so that no one is excluded from access to capital, or from being in the supply chains of larger companies.
- **The need for an audit requirement from companies under the NFRD**, so that this information is more reliable: There are different levels of assurance engagement that could be required: either a limited assurance engagement, or a reasonable assurance engagement. We are considering the different impacts, positive and negative, for different actors and stakeholders affected under each approach. We'll consider whether this is in the end needed.
- **On the aspect of standardisation:** It relates to different problems: not only to the comparability, but also to allow the digitalisation and the audit of the reports. In this context, **EFRAG is already working on doing some preparatory work in the field of standard-setting**, so that if the decision is adopted that we do need standards, this work can start relatively quickly and can be as advanced as possible.
- If we want a first reporting cycle according to detailed requirements according to our revised NFRD to be soon enough, we really need these standards to be ready as soon as possible. We need to wait for the final decision of the College of Commissioners and co-legislators. EFRAG's taskforce has already published a progress report to indicate their thinking in this area.