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The Consumer Voice in Europe

Consumer interests in Sustainability Reporting

A consumer perspective on the proposal for a Corporate Sustainability Reporting Directive

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Why it matters to consumers

Consumers increasingly care about the impact of their investments on the world. However, consumers investing into specific companies also often lack sufficient information about their sustainability impact. Investors and financial services providers offering such products often struggle to access comparable and reliable sustainability information of the companies in which they invest. Mandatory sustainability reporting standards would give consumers more clarity about the sustainability of their investments, and help to support the transition towards a more resilient, low-carbon economy.

Summary

BEUC strongly welcomes the proposal for a Corporate Sustainability Reporting Directive (CSRD). It features several improvements civil society representatives have been calling for and by and large reflects the recommendations issued by the European Financial Reporting Advisory Group (EFRAG), earlier this year.

Despite the improvements, a few gaps in the reporting regime have not been sufficiently addressed in the proposal. To close these gaps and truly make progress towards transparent sustainable finance markets, the following measures are necessary:

1. All listed companies and all companies in high-impact sectors, including non-EU companies whose securities are admitted to trading in the EU must be included in the scope of sustainability reporting.
2. Businesses create different sustainability risks according to their activities. Mining, for example may have very different consequences than producing textiles. The non-financial statement must be tailored to the business risk. This applies to the potential harm caused through the activity and the risk incurred due to changing environmental factors like floods, for example. This means that the reporting must be specific to the risk profile of a company, to be relevant to (retail-) investors.
3. The CSRD includes a mandate to create European mandatory sustainability reporting standards. When these are being developed, they should cover all aspects of sustainability reporting mandated by the level 1 text. In particular, this needs to include reporting standards for the 1.5 °C objective.

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1. The development of sustainability reporting in the EU

Environmental, social and governance (ESG) aspects of business practices are drawing increasing attention from consumers, politicians, scientists, NGOs and even businesses and their associations. The reasons for this interest may vary from risk-management to activism, but they coincide in what they need: comprehensive, comparable, accurate and detailed information on the sustainability impact of businesses.

All these groups require information to make judgements about the sustainability of various business operations. To accommodate this growing need, the EU adopted the Non-Financial Reporting Directive (NFRD) in 2014, to allow stakeholders to evaluate the sustainability performance of large businesses.

The NFRD requires public-interest companies with 500 employees to disclose information related to their environmental impact, treatment of employees, human rights practices, anti-corruption measures and diversity of their boards. At present, around 6,000 large companies in the EU are subject to these reporting obligations.[1]

This Directive allows reporting businesses significant room to decide for themselves what information to disclose and in what way. This leeway has led to a high degree of inconsistency in the reporting of non-financial information reducing the value of the information raised. In 2017, the European Commission published guidelines to help standardise this process, however, because they were not mandatory, the effect was limited.

In April 2021, the Commission proposed the Corporate Sustainability Reporting Directive (CSRD) to extend the scope of the NFRD, improve the reliability and detail of the information provided and to improve the usability of this information.

BEUC strongly welcomes the initiative and the concrete proposal. This paper will analyse the proposed measures and suggest amendments where greater detail or ambition would benefit consumers, both in their role as customers and as retail investors.

2. What the CSRD improves

The CSRD proposal, includes several substantial improvements over NFRD. These changes will increase sustainability related transparency in the European Union and thereby benefit, consumers, industries, and markets alike.

On the consumer side, the increased availability of ESG information, as well as its improved comparability and ease of access will mean two noteworthy improvements for consumers:

1) In their "standard" role as consumers, the additional reporting may enable consumers to choose products and services, which were created sustainably, possibly by using third party analysis of the newly available information. This may not only create market incentives for greater sustainability but also allow consumers to choose products and services in accordance with their values.

[1] EFRAG final report 2021, P44.

2) In their role as retail-investors, the CSRD may make it easier for consumers to align their investment decisions with their respective world views. This information will also allow retail investors to avoid sustainability related risks such as stranded assets, which may improve the risk profile of sustainable investments. The changes will also make it easier for consumers to select products and services for their environmental and social impact thereby enabling greater consumer choice and activism. The proposal includes these changes:

2.1. A wider view and a few oversights

The CSRD proposal extends of the scope to include all large companies, banks and insurers, and all listed companies except for listed microenterprises. This is a significant extension in scope of the current NFRD which targeted only large companies. However, the proposal also allows for corporate groups to report in one consolidated document, which exempts their constituent large companies from individual reporting obligations. This is particularly noteworthy for two reasons: First, some industries - like the financial industry for example – are highly concentrated into groups and this provision may drastically reduce the granularity of the information provided. Second, this provision for corporate groups is a deviation from financial reporting standards, where group members still must report individually.

Furthermore, the proposal also includes small and medium enterprises (SMEs) which are listed on EU regulated markets. However, the reporting obligations for these enterprises are delayed by three years, partially to allow for a recovery from the COVID-19 crisis before the regulatory burdens are introduced to them. The CSRD also exempts SMEs, which are listed on growth markets or multilateral trading facilities (MTFs) entirely.

2.2. Clear reporting standards and procedures

All information disclosed under CSRD requires a third-party audit. This may greatly improve the reliability of the information provided and it may serve as a trust building measure for retail investors.

The new proposal also introduces a requirement to develop European mandatory sustainability reporting standards. These standards will be binding and cover both generic sustainability reporting as well as sector specific standards. This will tackle the issue of inconsistent reporting which has plagued the NFRD until now. More constant information will primarily benefit the comparability of the data raised, benefiting consumers and industry alike. It will furthermore increase the accessibility of said information by enabling investors to "know where to look" for a particular piece of information, reducing the research costs for investors seeking sustainability information.

This clarification of the main reporting areas and the categories of information, specify in greater detail what companies must disclose. The provisions include a reporting obligation on self-set sustainability targets and progress towards them. This is an important improvement, because it increases investors' ability to track not only claims but actions taken, reducing the risk of greenwashing through overpromising on sustainability objectives.

The proposal mandates the development of a single electronic reporting format, which is machine readable. This will improve the accessibility and comparability of disclosed information. This measure ties into the European Single Access Point (ESAP), which is a project intending to create a consolidated, machine-readable database on sustainability

information in the European Union.[2] While this measure may be primarily useful for institutional investors and asset managers, it also provides potential benefits to consumers. Easier access to sustainability information may reduce the overhead costs of sustainable portfolios. Access to such information is also likely to benefit scientists and NGOs in their research, which in turn may increase awareness and quality of sustainability analysis and modelling.

2.3. Double materiality and Science based reporting

The guidelines updating the NFRD, introduced the principle of "double materiality". This term means that two aspects of sustainability reporting are important – or material – to investors: the impact the activity is having on the environment and the risk that environmental changes pose to the business. The CSRD will, for the first time, enshrine double materiality reporting as a binding standard. This is a significant improvement over previous iterations of sustainability reporting, because it ensures that there is structural data on what parts of the economy are at risk due to climate change and which parts contribute to these risks.

The proposal provides a clear mandate for reporting 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. This is particularly laudable, as it provides an incentive for companies to develop and pursue sustainability objectives that are in line with climate science and any further and parallel efforts in European sustainable finance should take care to match the CSRD in this ambition. For consumer information to be accurate, it has to be science-based, and in terms of global warming, this means adhering to the Paris Agreement. This provision should therefore serve as an example for other initiatives in sustainable finance, to help coordinate the ambition levels between regulations.

As can be seen from this extensive list of improvements, the CSRD improves the transparency of sustainable finance markets substantially. It does however also contain a few flaws and oversights in its provisions, which will be the topic of the following chapter.

3. What the CSRD fails to solve

3.1. Scope of who needs to report

SMEs are an essential part of the European economy, yet many of them remain left out of the new proposal and the others will be included only after a substantial delay. Even though the scope of CSRD is significantly improved over NFRD, this proposal still excludes substantial parts of the economy for the foreseeable future. In 2015, 99% of all enterprises in the European Union were SMEs and 94% of these were independent[3], and therefore not covered by the collective reporting provisions outlined above. Naturally, large corporations provide a disproportionate volume of economic output, but SMEs still contributed around 40% of turnover in European countries in which the relevant data was available.[4] Not including such a large part of the economy in sustainability reporting creates several severe issues:

[2] https://www.beuc.eu/publications/beuc-x-2021-021_consultation_response_esap.pdf
[3] https://ec.europa.eu/eurostat/statistics-explained/index.php?title=Statistics_on_small_and_medium-sized_enterprises
[4] https://ec.europa.eu/eurostat/statistics-explained/index.php?title=Statistics_on_small_and_medium-sized_enterprises

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First, consumers will be unable to accurately assess the sustainability impact of smaller businesses against their larger competitors. This may become an issue for both consumption and investment decisions. For classic consumer interests this means that there will be no comparability for the sustainability of products and services that are provided by SMEs or on markets where a few smaller companies compete against a larger one. From the retail investment perspective, this means that consumers will be largely unable to identify particularly sustainable enterprises they would like to invest in.

Unfortunately, this may also be the case in high impact sectors, like textiles for example. Small and medium enterprises may have significant environmental and human impacts and are therefore vital to any congruent sustainability consideration. This is also why the European Parliament[5] has pointed out that the inclusion of high-impact SMEs is vital to this transparency effort. The impact of a medium sized mining company may be significantly more relevant than that of a larger business in a less critical field of operations. Similar concerns have also been raised by NGOs[6] and national consumer organisations.[7]

Sustainable finance creates incentives for sustainable growth: companies benefit from increased financing options, if they can demonstrate that they are particularly sustainable. This promotes innovation and may help grow smaller companies that attempt to establish novel ways of providing goods and services. However, if small enterprises are cut off from the standardised reporting mechanism, then most of this idea is lost.

It is understandable that the European Commission would try to shield SMEs from undue burdens in the form of expensive reporting obligations. However, most SMEs rely on financing by banks, rather than capital markets and these financial institutions will report on the sustainability of their own investments. This means that there will be "trickle down" reporting obligations anyway.[8] The major difference is that these will not be consistent, standardised, or conducive to later "independent" reporting.

Asymmetric reporting obligations may also create disadvantages for SMEs that persist even after the playing field has been levelled. Sustainability is a matter of consistency and progress. Consumers want to know that progress is being made and that results are not just short-term reporting in favourable circumstances. If SMEs lack timeline data to publish, because they started reporting later than their corporate competitors, then their reports will seem less impressive by comparison.

3.1.1. A matter of risk and reward

Classic investment decisions are made as a result of comparing risk and rentability. A basic but vital fact of this is, that well diversified investments are more stable because a wide range of different companies are less likely to be affected by the same events in the same way. This idea also applies to sustainable investments: a narrow base of investment increases risk, making such investments less attractive overall. This becomes important if too large a portion of the economy is excluded from sustainable investments. The risk/reward calculus leads to two possibilities: either consumers accept undue risk in their investments in the name of sustainability, or sustainable investments will be unattractive to investors.

[5] https://www.europarl.europa.eu/doceo/document/TA-9-2020-0372_EN.html

[6] https://www.finance-watch.org/publication/joint-ngo-statement-on-the-corporate-sustainability-reporting-directive-formerly-nfrd/

[7] https://www.kuluttajaliitto.fi/blog/2021/05/17/lausunto-komission-ehdotuksesta-yritysten-kestavyysraportoinnista/

[8] EFRAG Final Report, P.70.

SMEs are also the most likely to exhibit substantial growth and the most plausible to benefit from additional financing options. Therefore, to make sustainable finance an attractive option, the investment universe must be as wide as possible.

3.1.2. A matter of granular and targeted information

As hinted at in section 2, reporting on group level may be insufficiently granular to satisfy the informational needs of investors, both professional and retail:

Collective reporting may obscure the sustainability risks of one company from investors if that particular business is especially prone to such risks. Leaving such possibilities open may also create an incentive to create exactly such structures to avoid reporting group-wide risks. Likewise, the same argument might also apply if one business in a group has a particularly strong environmental impact.

The CSRD proposal on sustainability objectives that companies must declare and report progress on, also mentioned in section 2, contains no provision that these objectives must be relevant to that company's risk profile. If this is left at the discretion of reporting entities it is an invitation to set irrelevant objectives, which are easy to achieve rather than valuable contributions to sustainability. Such cherry-picked reporting would create no value for market transparency.

3.2. Scope of what needs to be reported

The CSRD mentions that companies must report on the actual and possible impact of their supply chain, where appropriate. It is unclear what appropriate supply chain reporting may entail and how useful that information will be if the reporting company gets to choose what is appropriate to report and what is not.

Supply chain issues are also of very high importance to make the reported information accurate. Reporting on the 1.5 °C objective, for example, requires considering the climate footprint of all up- and downstream activities in the value chain to be accurate.

On the topic of the 1.5 °C objective: this objective has not been included in the mandatory reporting standards, meaning that the manner of reporting on alignment with the Paris Agreement will be left up to the reporting entities' discretion, as has already been noted by some stakeholders.[9] This may lead to reporting that leaves out relevant facts, frames them in a misleading way or reduces the reporting to barely useful standard phrases like: "XYZ strives to meet the the 1.5 °C objective in its daily business" which contains no relevant information at all.

3.3. Interaction of transparency and conduct regulation

While the proposal is highly promising in terms of increasing transparency on sustainable financial markets in the EU, there are inherent limits to the impact transparency focused approaches can have. Transparency is not a valid replacement for regulation.

Some of the disclosure obligations discussed above also require flanking enforcement measures or incentives to function adequately. For example, the reporting on corporate sustainability objectives would be much more effective if a flanking regulation existed, linking the achievement of such goals to executive remuneration. If a company pursues

[9] https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12129-Corporate-Sustainability-Reporting/F2322416_en

sustainability goals, but its executives are remunerated purely on financial criteria, then this creates a conflict of interest that can lead to greenwashing.

Sustainable finance is also commonly expected to have an impact on the "real" economy. However, this is unlikely to happen at large scale if sustainability information is not flanked by regulation and state action. Consumers are not responsible for - and not capable of – transforming the economy to a more sustainable state. If financial markets are expected to help transforming the economy, then financial industry and public entities must be disincentivised from investing in unsustainable businesses. Furthermore, taxation and subsidies must move away from benefiting unsustainable business structures. If these aspects are not considered together, it only changes who finances unsustainable activities, not what activity receives financing or at what price.

4. What needs to happen

- The most important change, is a further expansion of the scope of this Directive: All SMEs listed on European markets should be included, and the delay in the implementation of the reporting obligations for these businesses should be reduced. Furthermore, at the very least, all SMEs in high-impact sectors under European law need to be included, as these enterprises can have significantly more impact than some larger businesses in less critical branches.

- For the CSRD to be as consumer-friendly as possible, and to strengthen its transparency impact on European sustainable financial markets, a few amendments to the proposal should be adopted. These amendments should have the following effects.

- All unclear terminology, particularly concerning the "appropriate value chain reporting" need to be clarified. There should be clear and mandatory rules on the reporting of environmental and social impacts in the value chain to ensure that the reporting is comprehensive and not cherrypicked.

- The corporate sustainability objectives must be relevant to the reporting companies' sustainability risk profile, to ensure that these goals are not set as a marketing tool but rather as a commitment towards sustainable transition.

- The mandatory sustainability reporting standards are a lynchpin of this proposal. They must cover all aspects of sustainability reporting mandated by the CSRD. Namely, this must include reporting standards on the 1.5 °C objective.

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