cepAdhoc

28.05.2019

EU-Guidelines on Non-Financial Disclosure

Extending non-financial disclosure to climate change-related factors

Martina Anzini and Bert Van Roosebeke


© Shutterstock

In June 2019, the EU-Commission will publish final guidelines regarding the disclosure of climate related, non-financial information by large public interest companies. This cepAdhoc gives an overview of a draft version of the guidelines and analyses their legal value.

- According to the draft guidelines, all firms, including banks and insurance companies, will have to disclose five categories of information on climate change-related risks, opportunities and consequences of the company's activities.
- The Commission expects firms covered by the guidelines to disclose all climate related information, as it expects this information to constantly qualify as "material".
- The guidelines will be a non-binding, soft-law instrument. They can be taken into consideration by the national courts and the national bodies applying the provisions that transpose the Non-Financial Disclosure Directive, but there is no legal constraint to do so.
- Given the EU's regulatory efforts in fostering sustainable finance, the guidelines increase pressure on firms to disclose climate related information. The real impact of the guidelines will heavily depend upon the final version of both the guidelines and the EU-Regulation on sustainable taxonomy, which is still under negotiation.

Martina Anzini is analyst in the financial markets department at cep
Bert Van Roosebeke heads the financial markets department at cep
cep | Kaiser-Joseph-Strasse 266 | D-79098 Freiburg | Tel. +49 761 38693-107 | www.cep.eu | anzini@cep.eu

1 Introduction

In June 2017, the Commission issued guidelines on non-financial reporting.[1] In June 2019, the EU-Commission will publish a supplement to the existing guidelines regarding the disclosure by certain companies of non-financial information. The supplement will cover climate-related disclosure only. In the run-up, the Commission has conducted a consultation. This cep**Adhoc** summarises the draft guidelines as set forth in the consultation document and analyses their legal value once adopted.

2 The policy framework

2.1 The current framework

2.1.1 Scope and content

The Non-Financial Disclosure Directive [2014/95/EU][2] requires large "public interest entities"[3] with over 500 employees to disclose non-financial information relating to environmental, social and employee matters, respect for human rights, anti-corruption and bribery. The non-financial statement must include

(1) an outline of the entity's business model,

(2) the main non-financial risks produced by the economic activity of the undertaking

(3) the policies undertaken to handle non-financial issues,

(4) the results of these policies,

(5) the relevant "non-financial key performance indicators"[4,5].

Under Article 2 of the Accounting Directive [2013/34/EU][6] as amended by the Non-Financial Disclosure Directive, the Commission shall prepare non-binding guidelines on the methodology for reporting non-financial

[1] Communication from the Commission — Guidelines on non-financial reporting (methodology for reporting non-financial information), C/2017/4234.

[2] Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups.

[3] '[P]ublic-interest entities' means:
(a) listed companies, i.e. entities governed by the law of a Member State whose transferable securities are admitted to trading on a regulated market of any Member State within the meaning of point 14 of Article 4(1) of Directive 2004/39/EC;
(b) banks, i.e. credit institutions as defined in point 1 of Article 3(1) of Directive 2013/36/EU of the European Parliament and of the Council, other than those referred to in Article 2 of that Directive;
(c) insurers, i.e. insurance undertakings within the meaning of Article 2(1) of Directive 91/674/EEC; or
(d) entities designated by Member States as public-interest entities, for instance undertakings that are of significant public relevance because of the nature of their business, their size or the number of their employees (Article 2, para. 13, Directive 2006/43/EC of the European Parliament and of the Council of 17 May 2006 on statutory audits of annual accounts and consolidated accounts).

[4] Art. 1 (1), Directive on non-financial disclosure.

[5] Key performance indicators are „*indicator-based disclosures*"(see Communication from the Commission — Guidelines on non-financial reporting, C/2017/4234, p. 13).

[6] Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC.

information, with a view to facilitating relevant, useful and comparable disclosure. In June 2017, the Commission fulfilled the above mandate by issuing guidelines on non-financial reporting.[7]

Such guidelines were not drafted with the ambition to establish a *unified* non-financial reporting framework. According to the Commission, international, EU-based or national reporting frameworks are equally viable options.[8] More in general, the Commission seems to think that a good deal of flexibility is crucial not to "stifle innovation in reporting practices"[9] as well as to ensure adaptability across the various businesses and sectors involved[10].

2.1.2 Materiality of information

Under the existing guidelines, information must be included in the non-financial report when *material*. A piece of information qualifies as such under Article 2(16), Accounting Directive, when its "omission or misstatement could reasonably be expected to influence decisions that users make on the basis of the financial statements of the undertaking". The Non-Financial Disclosure Directive specifies that materiality for the purpose of non-financial disclosure has to be established in reference to the contribution a specific piece of information can bring to the "understanding of the undertaking's development, performance, position and impact of its activity" [Article 1 (1), Non-Financial Disclosure Directive].

In the guidelines, the Commission provided the following non-exhaustive list of factors for deciding whether information is *material*:

(1) the business model, strategy and principal risks,

(2) the main sectoral issues,

(3) the interests and expectations of the relevant stakeholders[11],

(4) the impact of the activities on environmental, social and employee matters, respect for human rights, anti-corruption and bribery and

(5) public policy and regulatory factors.

For each point, the guidelines provide further details. For example, information regarding the undertaking's business model must be understood as a description of how the company "generates and preserves value through its products or services over the longer term"[12]. Accordingly, when describing their business model, companies may consider including disclosures concerning their business environment, their organisation and structure, the markets where they operate, their objectives and strategies and, finally, the main trends and factors that may affect their future development.

Any assessment on the materiality of information may evolve over time, as it mirrors the evolution of the

[7] Communication from the Commission — Guidelines on non-financial reporting (methodology for reporting non-financial information), C/2017/4234.

[8] "In providing this information, undertakings which are subject to this Directive may rely on national frameworks, Union-based frameworks such as the Eco-Management and Audit Scheme (EMAS), or inter-national frameworks such as the United Nations (UN) Global Compact, the Guiding Principles on Business and Human Rights implementing the UN "Protect, Respect and Remedy" Framework, the Organisation for Economic Co-operation and Development (OECD) Guidelines for Multinational Enterprises, the International Organisation for Standardisation's ISO 26000, the International Labour Organisation's Tripartite Declaration of principles concerning multinational enterprises and social policy, the Global Reporting Initiative, or other recognised international frameworks" (Recital 9, Non-Financial Disclosure Directive). Also, see Communication from the Commission — Guidelines on non-financial reporting (methodology for reporting non-financial information), C/2017/4234, pp. 3 – 4.

[9] Communication from the Commission — Guidelines on non-financial reporting, p. 3.

[10] Ibidem , p. 5.

[11] "As appropriate, this may include, among others: investors, workers, consumers, suppliers, customers, local communities, public authorities, vulnerable groups, social partners and civil society", Ibidem , p. 9.

[12] Ibidem, p. 10.

market context. Also, the guidelines attach great importance to both the governance arrangements and the processes that the companies use to perform the materiality test.

2.1.3 Thematic aspects

Material information can relate to a number of thematic aspects. Under Article 1, Non-Financial Disclosure Directive, disclosure shall regard, "as a minimum, environmental, social and employee matters, respect for human rights, anti-corruption and bribery matters".

The guidelines further clarify this provision by setting forth a non-exhaustive list of information to be considered for disclosure, classed by the thematic areas listed by Article 1. When it comes, for example, to environmental matters, companies are supposed to provide data concerning both the impacts of their operations on the environment and how environmental factors may affect its business. Disclosure can thus regard i.a. pollution prevention and control, use of energy, use and protection of natural resources and waste management.[13]

Concerning the recommended modalities of disclosure, the Commission specifies that information should be delivered in a fair, balanced and understandable fashion. For instance, including information that is not genuinely material and keeping the silence about significant circumstances relating to the context might prejudice the ability of the reader to understand the non-financial situation of the company.[14]

2.2 The new non-binding guidelines for non-financial disclosure

The Commission has entered the process to supplement the above guidelines with additional guidelines on climate-related disclosure. The new guidelines will be delivered by June 2019 as part of its sustainable finance action plan (see cepPolicyBrief)[15]. To this purpose, it has carried out a consultation[16].

The aim of the supplement is to integrate the recommendations published by the G20 Financial Stability Board's Task Force on Climate-Related Financial Disclosures ("TCFD") within the Non-Financial Disclosure framework. In doing so, the amendments should rely on the recommendations formulated by the European Commission's Technical Expert Group ("TEG") in its January 2019 report.

2.2.1 Scope

In its consultation, the Commission suggests guidelines that apply across all economic sectors, but also includes rules specifically designed for banks and insurance companies. This is motivated by their business having a significant peculiarity in the context of climate-sensitive non-financial disclosure: they both provide climate-related information (to depositors and investors) and use the information provided to them by non-financial undertakings[17].

This means that in the financial sector the relevance of climate related risks and opportunities cannot be assessed in reference to the activity carried out by the financial undertaking in isolation. Such analysis must properly reflect the mutual influence between the climate risk profile of the lender, investor, insurer or assets manager and the climate risk profile of the business activity that is financed/ensured, or of the managed assets.

[13] Ibidem, pp. 14 – 15.
[14] Ibidem, pp. 7 – 9.
[15] Namely, the initiative is mentioned under the Action 9 – section of the Action Plan for Sustainable Growth.
[16] Consultation document on the update of the non-binding guidelines on non-financial reporting, accessible at https://ec.europa.eu/info/consultations/finance-2019-non-financial-reporting-guidelines_en.
[17] Ibidem, p. 25.

This dynamic approach to climate related risks and opportunities is embodied into concrete suggestions concerning each and every item of disclosure (see below for an accurate review of the items of disclosure). For example, a relevant topic of disclosure concerning the business model of the financial undertaking could be how the assessment of climate-related risks are factored into relevant investment, lending and insurance underwriting strategies and how each strategy might in turn be affected by the transition to a lower-carbon economy[18].

Also, the draft of the Commission identifies specific circumstances that financial market actors are called to take into consideration while disclosing climate related data. For instance, the effects of such economic activities on Green House Gas emissions cannot be direct: such effects have to be monitored having regard to the fact that contribution to Green House Gas emissions in the financial sector only takes place by financing polluting undertakings. Even in this case, therefore, market actors active on the financial markets are called to a dynamic assessment of their own influence on climate change[19].

2.2.2 Content

Disclosures should include five items:

(1) climate change-related risks and opportunities affecting the company's business model and strategy (which, due to the necessary long term perspective, will need to be assessed making use of scenario analysis);

(2) the identification and management of climate change-related "principal risks" the company is both causing and exposed to – the latter risks being transition or physical risks affecting the financial performance of the company;

(3) climate risk-related arrangements regarding both corporate governance (i.e. whether the board and the managers are entrusted with specific responsibilities in this regard) and the due diligence process (e.g. the company's engagement with upstream and downstream partners to reduce negative impacts);

(4) the "outcome", i.e. where the company stands in respect to its self-established climate-related targets, e.g. the level of greenhouse gas emissions;

(5) key performance indicators ("KPI") on "principal risks", on the "outcomes" of self-set targets as well as (optionally) on sector-specific indicators, human capital, social issues or expenditures in research and development. KPIs are indicators that quantify the effects of economic activities on climate change. They allow for aggregation and comparability across companies in the same industry.

2.2.3 Disclosure regimes

The consultation document proposes a twofold climate-related disclosure regime for each of the five items. The distinction between the two kinds of reporting is the following:

(1) Type 1 disclosures are releases that a company "should consider" as regarding core factors for assessing its performance and its impact on the environment,

[18] Ibidem.
[19] Ibidem, p. 28.

(2) Type 2 disclosure concerns information that "may" be disclosed.

Although the text is silent on this, the question whether the information is *material* seems to be the essential criterion for understanding whether type 1 or a type 2 disclosure will apply. When information does not qualify as type 1 disclosure, it may be either treated as type 2 disclosure or left out. The Commission proposes that, while considering the alternative between a type 2 disclosure or no disclosure at all, the company should rely upon factors such as "the size of climate-related risks and opportunities that the company identifies"[20].

2.2.4 Material Information

The Commission explained that it sees disclosure regarding climate change as a subsection of disclosure in environmental matters[21]. The latter was qualified as a thematic aspect of disclosure in the existing guidelines[22]. Accordingly, the concept of materiality applicable to environmental disclosure in the existing guidelines will also apply to the new ones.

Namely, materiality in environmental matters can be:

(1) "financial" (i.e. concerning the impact of climate change on the performance of an undertaking)[23] or

(2) "environmental and social" (i.e. concerning the impact of the economic activity carried out by the undertaking on the climate)[24].

The Commission assumes that, due to climate change currently being a rather pervasive issue, information concerning climate will almost inevitably qualify as material. However, should the company think otherwise, it will need to provide a statement explaining why it holds climate not to be material[25].

2.2.5 Climate-related risks and opportunities

The consultation papers clarifies that, when reference is made to climate-related risks that affect the performance of a company, both transition[26] and physical[27] risks must be explicitly mentioned. While the incidence of the transition risks on the business that produces them is more certain, physical risks affect all companies irrespectively of their specific contribution to climate change[28]. Also, companies should report about the natural, human and social capital (or resources) they rely on for the purpose of carrying on their activity, whose loss constitute a climate-related risk[29].

Besides climate-related risks, adaptation to and mitigation of climate change also affect the performance of companies. Accordingly, the ability of companies to successfully face transition and turn risks into a business opportunity will need to be taken into account while drafting the disclosure report[30].

---

[20] Ibidem, p. 8.
[21] Ibidem, p. 7.
[22] Guidelines, para. 4.6 (a), p. 14.
[23] Consultation document on the update of the non-binding guidelines on non-financial reporting, p. 7.
[24] Ibidem, p. 7. "These two risk perspectives are increasingly likely to overlap. As markets and public policies evolve in response to climate change, the positive and/or negative impacts of a company on the climate will increasingly translate into business opportunities and/or risks that are financially material" (Ibidem).
[25] Ibidem, p. 8.
[26] "Transition risks are risks to the company that arise from the transition to a low-carbon and climate-resilient economy" (ibidem, p. 9).
[27] "Physical risks are risks to the company that arise from the physical effects of climate change" (ibidem, p. 10).
[28] Ibidem, p. 10.
[29] Ibidem, p. 10.
[30] Ibidem, p. 10 – 11.

3 Nature and legal value of the new guidelines

From a formal point of view, the new guidelines, like the guidelines they seek to supplement, will probably be embodied in a Communication from the Commission. Also, they will likely be published in the 'C' series of the Official Journal of the European Union which, by contrast with the 'L' series of the Official Journal, is not intended for the publication of legally binding measures, but only of information, recommendations and opinions concerning the European Union[31]. Those elements are, however, not conclusive in order to ascertain the nature and legal value of the guidelines[32].

Looking at the current text, however, it can be safely assumed that they will be a non-binding, soft-law instrument. Besides being expressly stated in the draft[33], this is in line with their declared function, which is to clarify the interpretation of the Non-Financial Disclosure Directive for the benefits of market actors[34], "with a view to facilitating relevant, useful and comparable disclosure of […] [climate related] information by the undertakings" (Article 2, Non-Financial Disclosure Directive). It is also consistent with the non-imperative and conditional formulation of their provisions: instead of setting positive rules, the draft guidelines define concepts that are key to climate-related disclosure and provide general criteria as to how to select data to disclose, while also encouraging undertakings to eventually "further improve climate-related reporting beyond the content of [the] guidelines"[35].

The non-binding nature of the soft-law instruments does not, in principle, prevent them from deploying different legal effects. This seems, however, not to be the case according to the most recent case law.

In *Grimaldi*, the CJEU was asked, in the context of a reference for a preliminary ruling, to rule about whether, in the absence of any national measure to implement it, a recommendation can confer on individuals rights upon which they may rely before national courts. The CJEU answered that, while the answer is in the negative[36], such measures cannot be regarded as having no legal effect. Indeed, national judges "are bound to take recommendations into consideration in order to decide disputes submitted to them, in particular where […] they are designed to supplement binding Community provisions"[37].

This statement, albeit potentially relevant for our case[38], does not seem of any concrete significance for the legal regime of guidelines.

In the case-law following Grimaldi, the Court has consistently refused to recognise any punctual obligations

[31] The CJEU has often considered this last formal element for assessing whether an instrument is binding (i.e. imposes obligations) *vis à vis* individuals (see judgment of the Court of 12 May 2011, Polska Telefonia Cyfrowa, C‑410/09, EU:C:2011:294, para. 35) and Member States (see judgment of 20 January 2016, DHL Express (Italy) and DHL Global Forwarding (Italy), C-428/14, EU:C:2016:27, para. 34).

[32] While verifying whether an act is challengeable, the CJEU is not bound to the form chosen by its author. Indeed, the choice of the form cannot, according to settled case-law, alter the nature of a measure, so that it must be ascertained whether its content is wholly consistent with the form attributed to it (see judgment of the Court of 13 December 1989, Grimaldi v Fonds des maladies professionnelles, C-322/88, EU:C:1989:646, paragraph 14; order of the General Court of 27 October 2015, Belgium v Commission, T-721/14, EU:T:2015:829, para. 20).

[33] See the draft title.

[34] "These guidelines are intended for use by companies that fall under the scope of the Non-Financial Reporting Directive. However, they may also be useful for other companies that wish to disclose climate-related information" (Communication from the Commission — Guidelines on non-financial reporting, p. 6).

[35] Guidelines, p. 6.

[36] The CJEU specified that this rule applies to recommendations if they are *real recommendations* (i.e. their substance corresponds to their legal form).

[37] See judgments in Grimaldi, C‑322/88, EU:C:1989:646, para. 18, and Altair Chimica, C‑207/01, EU:C:2003:451, para. 41)
C-410/13 para. 64, 65

[38] The new guidelines are ultimately designed to supplement binding community provisions (i.e. the Non Financial Disclosure Directive).

laying on national judges in respect to Commission`s soft law instruments that, as in the case at hand, are not intended to be binding on the authorities and the courts of the Member States. Accordingly, it has identified no consequence attached to their disregard[39]. Therefore, notwithstanding the principle incidentally affirmed by the Court in *Grimaldi*, according to the current scenario, the indications provided by the guidelines as to the interpretation the Non-Financial Disclosure Directive *can* be taken into consideration by the national courts and the national bodies charged with the task to apply the national legislation transposing the Directive, but there is no legal constraint to do so.

4 Consistency of the new guidelines with the EU's sustainable finance agenda

Even though legally non-binding, the new guidelines on climate related disclosure may have a considerable impact, given the EU's efforts in fostering sustainable finance. With the regulation on sustainability disclosure, addressed to financial actors (see cep**Adhoc**) and the EU-Taxonomy – still under negotiation – defining "sustainability" (see cep**Adhoc**), pressure mounts on actors of the real economy to disclose information regarding climate related consequences of their activity not only to customers but also to potential investors. It remains to be seen if the guidelines will provide valuable additional information for assessing whether an economic activity qualifies as "sustainable" according the EU-Taxonomy. This will depend upon the final version of both the guidelines and the taxonomy.

[39] See judgment of 13 December 2012, Expedia, C‑226/11, EU:C:2012:795, paragraph 31. In that case the Court did not uphold the approach taken by A.G. Kokott in her Opinion, suggesting that national authorities and courts must consider the Commission's assessment (embodied, in that case, in a Commission's competition notice) of what constitutes an appreciable restriction of competition. In A.G. Kokott's view such consideration should consist in providing reasons for any divergence. Moreover, the motivation must be such as to allow the judicial review of the choice (C‑226/11, EU:C:2012:544, paragraph 38 - 39).