Corporate sustainability reporting : Recent developments

Webinar of the Belgian and German Councils for Sustainable Development with the support of the EEAC Network

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Report

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Opening statements

The webinar was introduced by **François-Xavier de Donnea**, chairman of the FRDO-CFDD. He highlighted how environmental disclosures have become a critical component of the international talks on sustainable finance (G7 and IFRS) and how the EU and its member states were particularly well-prepared to play a leading role in these developments.

He explained how the EU is setting up the reporting framework that investors need for channeling financial resources to sustainable companies, but also reforms that make companies more accountable for their impacts on people and the environment, and added that this was particularly important for EU companies to implement the upcoming sustainable corporate governance legislation which is also high on the agenda of the Belgian Federal government. In that context, he said that promoting such a double materiality approach for sustainability reporting at the international level as well would make sense insofar as most European companies have an international value chain.

Arnau Queralt-Bassa, chairman of the EEAC network, welcomed the participants and underlined that the member councils of the network were taking great interest in the issue of sustainability reporting and sustainable corporate governance. He said that the member councils consider companies key actors for achieving the SDGs, but on the condition that reforms are undertaken, including to provide reliable and comparable sustainability information to their investors and other stakeholders. He added that companies that consider environmental and social aspects, while being in touch with their stakeholders regarding these matters, would be better able to identify economic risks arising from sustainability issues, and would therefore manage those risks more effectively. However he also emphasized that the extended mandatory reporting requirements under the proposed Corporate Sustainability Reporting Directive (CSRD) would entail additional costs for EU companies, which should not put too much burden on them.

Jean-Pascal van Ypersele, co-chair of the WG on Financing the transition of the FRDO-CFDD, said that one of the main challenges to finance the transition was the reporting gap, i.e. the discrepancy between sustainability information that companies report on and sustainability information that financial actors need for creating sustainable financial products. He made clear that the proposed CSRD aims at bridging this reporting gap by providing the framework for sustainability reporting standards that would make reliable, comparable and relevant data on sustainability risks, opportunities and impacts of companies available to financial actors. Thanks to the growth of sustainable financial products, sustainability reporting standards would therefore also enhance companies' access to capital. Furthermore, these standards would help companies to identify their own risks and opportunities related to sustainability matters and provide the basis for a better dialogue with their stakeholders, in particular facing the growing demands for their public accountability.

Part I - EU reforms for sustainability reporting

1. The Commission's proposal for a Corporate Sustainability Reporting Directive (CSRD) and the preparation of reporting standards

Malgorzata Feluch (EU Commission DG FISMA) presented the EU Commission's 21 April 2021 package which aims at improving the flows of money to sustainable activities, technologies and businesses and includes a proposal for a Corporate Sustainability Reporting Directive (CSRD).

Under the existing reporting requirements (Non-Financial Reporting Directive), both users and preparers face problems that will increase in the absence of new rules, including costs and administrative burdens. The CSRD proposal aims at ensuring that companies report relevant, comparable and reliable sustainability information needed by investors and other stakeholders. It extends the scope of reporting to all large companies and listed companies (excluding micros) and clarifies the issue of double materiality. The sustainability topics that are covered include governance and mirror other pieces of regulation such as the taxonomy, the European pillar of social rights and the initiative on sustainable corporate governance.

Companies should report the information in their management report in order to pull it on the same page as financial information and to ensure a link between the two. Assurance on the content will be required, starting with limited assurance and moving later on to reasonable assurance. The management report and the financial statement will be provided in a single electronic reporting format and information will be tagged. This will be fixed in the Commission's proposals on the EU single access point. The role of national supervisory authorities for listed companies is clarified and minimum sanctions are set up for non-listed companies.

Under existing reporting requirements, companies just disclose if they use a standard. Mandatory reporting standards are the key reform of the CSRD proposal. The European Financial reporting Advisory Group (EFRAG) is preparing a full reporting standard to be used by large companies. SMEs with securities listed on EU regulated markets will have to use a simplified standard which will be voluntary for all other SMEs. Although global standards are being developed, European standards are needed in order to ensure the implementation of European disclosure requirements on financial market participants and of the future corporate governance and due diligence legislation. However, the standards will be prepared in co-construction with global initiatives.

Under the taxonomy regulation, large companies are already required to report how and to what extent their activities are associated with environmental sustainable activities as defined under this regulation (art.8). The CSRD reporting regime will be consistent with that provision (same scope, same assurance requirements, and same digital format).

Malgorzata Feluch also gave an indicative timeline of the standard-setting process, assuming that co-legislators reach agreement on the CSRD by Q2 2022. A first set of standards to serve the needs of financial market participants subject to disclosure requirements as of 1 January 2022 would be adopted by the end of 2022. A second set of standards with complementary and sector-specific information and standards for SMEs would be adopted by the end of 2023. Therefore, the first sustainability reports of large companies for reporting year 2023 would be published in 2024.

2. Challenging statements and debate

2.1. Jean-Paul Servais (Chair of the FSMA) highlighted that sustainable finance was high on the agenda and that this agenda was a demand-driven one, pushed by the consumer. Therefore sustainable finance is not just an issue for sophisticated investors such as global banks, pension funds etc., but also for small savers. It will be a real challenge for companies because of the speed and of the higher and higher level of the reporting requirements.

Investors are not interested in a puzzle of regulations, but seek a comprehensive set of global standards worldwide. In his view this should not lead to competition between the Belgian, the EU and the international agendas. The EU is an excellent student and intends to cover a very large scope including not only the environment, but also social and human rights. However, all the countries do not have a similar priority. Therefore it makes sense to say that “the devil is in the detail”.

The FSMA conducted a study that was published on 16 June 2021 and indicates that in one year time, under the effect of the EU Sustainable Finance Disclosure Regulation (SFDR), the majority of UCITs (SICAV) labelled as green (https://www.fsma.be/en/news/belgian-investment-funds-evolve-toward-sustainability). Jean-Paul Servais said that this was good news but that supervision was still needed regarding these claims.

He added that another recent study of the FSMA concluded that progress was being made, but that there was room for improvement as far as non-financial reporting by Belgian listed companies was concerned (https://www.fsma.be/sites/default/files/media/files/2021-06/study48_en.pdf). For example, companies have a tendency to foreground favorable elements while devoting too little attention to less positive elements.

As a financial regulator, the FSMA supports the trust of the consumers in financial products that meet their preferences. Therefore, greenwashing is a negative objective for the FSMA, not only at the EU, but also at worldwide level. As evidenced by the recent statements of the G20, the Financial Stability Board and the G7, there is support for a demand driven baseline of global sustainability reporting standards for companies. Excellent students like the EU Commission should promote a co-construction approach with international initiatives. But the devil is in the detail and the objective is to avoid too high-level standards with issues related to consumers trust. Moreover, funds should manage the expectations of retail investors.

2.2. Aleksandra Palinska (Finance Watch) said she agreed with the statement that “the devil is in the detail”. Aversion to change, to new regulatory reporting requirements has to be put into perspective. Several scientific reports including those of the Intergovernmental Panel on Climate Change (IPCC) demonstrate that we are on the brink of environmental disasters that may trigger a new economic crisis and compromise financial stability.

Finance Watch is very supportive of the Commission’s proposal for a CSRD as a major step forward improving transparency. However, we should keep in mind that transparency is no substitute for real action on accountability. Sustainable finance can only deliver as long as it contains 3 pillars: 1° Transparency, 2° Sustainable corporate governance, i.e. a framework for incentives and obligations for companies to foster sustainability and 3° Mainstreaming sustainability into risk management of financial institutions, including through changes to capital requirements for banks and insurance companies.

Aleksandra Palinska pointed out that even if the scope of the CSRD is larger than the one of the NFRD (49.000 vs. 11.600 companies), the new directive would still cover less than 10% of European companies (large companies and listed SMEs) based on Eurostat data. With regards to environmental and social considerations, she added that reporting should be driven by the impact, rather than by the size of enterprises.

Neglecting sustainability risks whether by large, medium or small companies may lead to economic disruption and financial instability. This is quite well reflected in the EFRAG report that recommends to include SMEs in the EU sustainability reporting landscape in an inclusive and proportionate manner, having consideration to their more limited resources. Therefore, Finance Watch is of the opinion that SMEs or at least mid-size companies from high-risk sectors should be included in the scope of the mandatory sustainability-related reporting.

Finance Watch called for requiring a *reasonable assurance,* as financial and sustainability-related information should be on an equal footing. However, the Commission’s suggestion to require *limited assurance for the time being* and to conduct an assessment in three years after entry into force of the directive, seems reasonable given that sustainability reporting is still a developing area.

Regarding the EFRAG’s work on developing the standards, Finance Watch thinks that a fair representation of civil society organizations and academia should be ensured on a dedicated expert/stakeholder group that will support EFRAG.

The Commission’s draft delegated act for corporate disclosures under Article 8 of the Taxonomy Regulation published on 7 May 2021 (see pp.2-3 above) is an example that the devil may hide in the detail. An appropriate calibration of taxonomy-related disclosures is very important and will actually determine whether the taxonomy will deliver on its objective to prevent greenwashing.

To that end, Finance Watch calls for an external verification and board-level approval of all taxonomy-related disclosures, including of the CapEx and OpEx plans.

As far as disclosures by financial companies are concerned, Finance Watch is of the opinion that the KPI should provide a comprehensive view of all investments / all balance sheet assets, including their sovereign exposures. Furthermore, financial companies should disclose both separate and aggregate turnover and CapEx KPIs of their underlying investee companies because such a full picture is needed for end investors and to prevent greenwashing.

Jean-Pascal van Ypersele approved the need to avoid greenwashing highlighted by all the speakers and noted that different modalities for this appeared from their presentations.

2.3. Philippe Lambrecht (FEB-VBO) presented three challenges related to the draft CSRD:

1° The challenge of environmental, social and governance risks is not limited to businesses: states, consumers and citizens are also challenged;

2° In Europe, doubts might be expressed concerning the capacity of businesses to do additional reporting on top of the many layers of capital markets regulations that already apply to them;

3° Since 2014, Europe has lost about 2.000 listed companies. One of the reasons for this is that the challenge to comply with all these regulations is harder and harder.

Businesses ask 4 questions regarding the draft CSRD:

1° Is the CSRD worth the cost ?

According to the European Commission, the total estimated costs for preparers are EUR 1.200 million in one-off costs and EUR 3.600 million in annual recurring costs. This is much higher than the current recurring administrative costs of non-financial statements under the NFRD that are on average EUR 82.000 per year (according to the CEPS Study on the Non-Financial Reporting Directive).

2° Why include listed SMEs in the scope of mandatory reporting ?

With regard to the de-listing risk, why impose additional burdens on listed EU SMEs ? Why not facilitate a better international level playing field ?

Philippe Lambrecht pointed out that the real number of companies that would have to report under the CSRD would be much larger than 49.000 under the effect of group reporting and of national transpositions.

3° Will the CSRD improve corporate sustainability ?

The speaker said that it was difficult to answer this question insofar as the reporting standards are not yet defined. Therefore it is also difficult to have a clear idea of the benefits of the future standards. He added that there was no proof that the level of reporting required for stakeholders was necessary.

He noted that mandatory reporting under the mandatory IFRS standards had already led to difficulties for some SMEs. Furthermore, the obligation to include sustainability reporting in the management reports (removal of the flexibility clause for member states) is likely to have an impact on corporate governance.

4° Is there an independent and convincing study on the advantages of the single electronic reporting format ?

FEB-VBO fears a very demanding and complex additional layer in existing IT systems and is not convinced that the single electronic reporting format will reduce the demands for information insofar as non-EU stakeholders will not use it.

To conclude, Philippe Lambrecht said that FEB-VBO was not opposed to sustainable governance and sustainable reporting but that it asks to know what the cost of the CSRD will be for the businesses, how it will impact corporate governance and how an international level playing field with competitors will be maintained.

3. Specific issues and academic findings

Kerstin Lopatta (University of Hamburg) focused on four specific issues related to sustainability reporting and provided related academic research references.

3.1. Third party insurance of the reported sustainability information

The speaker commented on the upcoming changes of the CSRD: companies within the scope of the directive will be required to provide *limited assurance*, and the Commission has an option to mandate *reasonable assurance* at a later stage. These concepts are contrasted:

Limited assurance	Reasonable assurance
The assurance risk is acceptable	The level of verification is high
The assurance risk is greater than the risk expressed by a “reasonable opinion”	The assurance is not absolute due to possible limitations in the international control system
Conclusions are worded negatively	Conclusions are worded positively

Reasonable assurance implies that:

- On the <u>sustainability auditor</u> side: Know-how and manpower are required as the number of companies falling within the scope increases dramatically.
- On the <u>business</u> side: The costs and time required for preparation and implementation have to be considered from <u>a cost-benefit perspective</u>.

Academic research brings forward the following findings:

- <u>Mandatory audits</u> of management earnings forecasts lead to less positive bias and improvement in accuracy (Mc Conomy 1998).

- Reasonable assurance reduces the level of information asymmetry to a greater extent (Cuadrado-Ballesteros et al 2017; Fuhrmann et al 2017).
- and report users place more confidence in sustainability reports (Hodge et al 2009).

3.2. Publication of the reported sustainability information

Kerstin Lopatta sketched the upcoming changes of the CSRD:

- Sustainability information has to be part of the management report; the option of publishing the information in a separate report is eliminated (comp. above p.6).
- The financial statements and the management report will be published within 12 months of the balance sheet date.
- German listed companies have a period of 4 months to release their annual report (§ 325 HGB).
- The publication of the annual financial report will be made together with the independent auditor's opinion on the sustainability reporting (art.2 para (2) (b) of the CSRD proposal). Therefore we also have to focus on the timeliness here.

These changes entail a couple of challenges:

- The alignment of reporting and audit cycles for financial and environmental reporting;
- The requirement for consistency;
- The first-time implementation of reporting and assurance services for most companies.

Related academic research findings indicate that:

- The audit reporting lag and the timeliness of earnings announcements is associated with the underlying audit effort; the audit effort matters, but the more effort companies put in audit, the more time they need (Knechel and Payne 2001).
- The timeliness of annual reports is an important determinant of their usefulness (Givoly and Palmon 1982) and is indeed value relevant (Leventis et al 2014).
- The timeliness of earnings announcements is an accessible proxy for outsiders related to the internal information environment. The closer to the year-end date the announcement is made, the better the internal information environment should be (Gallemore and Labro 2015; Huang et al, 2020).

3.3. Small and medium-sized companies

The CSRD proposal brings forward the following changes:

- SMEs within the scope of the CSRD have to adopt a separate, proportionate and specific reporting standard;
- These requirements will apply three years after they apply to the other companies within the scope;
- Non-listed SMEs (outside the scope) may decide to adopt the standards on a voluntary basis.

This reporting can be motivated because:

- SMEs have the possibility to report information cost-efficiently to requests from stakeholders (such as corporate clients or banks);
- SMEs are able to attract additional investment and funding (such as investors), and
- SMEs can contribute to the transition to a sustainable economy.

Regarding *voluntary adoption of disclosure*, scientific research sets out that voluntary disclosure of non-financial information reduces information asymmetry and costs of capital (Dhaliwal et al, 2011).

As far as *assurance* is concerned, it was shown that private companies that maintain voluntary financial audits receive higher (lower) credit scores (interest rates) (Kim et al 2011; Minnis 2011; Dedman and Kausar 2012).

Kerstin Lopatta also gave a couple of insights related to the *mandatory vs. voluntary* disclosure:

- Voluntary disclosure is effective in reducing information asymmetry, but it cannot replace mandatory disclosure in solving information problems (Liao and Zhang 2013);
- 35,6% of all value added is attributable to SME companies in the EU in 2018 (Eurostat, National Statistical Offices, DIW Econ (2018/2019)).

In relation to this last statement, she raised the question of what proportion of the emissions are attributable to SMEs.

3.4. Standard-setting – Big picture

Kerstin Lopatta gave an overview of the current disclosure streams:

- The EFRAG is developing an EU reporting standard;
- The International Accounting Standards Board (IASB) is working on a set of IFRS sustainability standards;
- The Value Reporting Foundation Sustainability Accounting Standards Board (SASB) merged with the Integrated Reporting Council (IIRC) is US based but globally active;
- The International Platform for Sustainable Finance (IPSF) and its common ground taxonomy.

She also referred to academic research results about gender diversity:

- Board gender diversity affects positively CSR dimensions and women request more CSR information before taking investment decisions;
- Few firms address gender topics throughout their annual reports (Böttcher and Lopatta 2018).

She added a couple of references to current developments on diversity:

- The proportion of women in executive positions in the EU was in 2020 20 percent (Germany 13,5 percent) (Source: EIGE (2021));
- There is a lack of disclosure and transparency regarding diversity for lower management levels.

And she asked the question: Is it time for more sustainability expertise on boards, in addition to more women on boards ?

4. Discussion

4.1. Should SMEs be included in the scope of the CSRD ?

Malgorzata Feluch (EU Commission DG FISMA) summarized the diverse opinions expressed by the other speakers: Finance Watch supports the inclusion of SMEs from the high risk sectors, FEB-VBO highlights that the inclusion of SMEs creates additional burdens and results in delisting of companies from the regulated markets, and academic literature indicates that voluntary disclosure of non-financial information has advantages in terms of reducing information asymmetry, higher credit scores and lower interest rates.

She said that the public consultation undertaken by the Commission to prepare the draft CSRD had also reflected a diversity of opinions. For the financial sector and for the NGOs, it is important that SMEs report on their environmental and social impacts. For financial market participants, SMEs that do not provide the information may be excluded from green products and green loans. For SMEs, this will be costly and may be a barrier for listing.

The Commission tried to come up with a balanced approach in relation to this debate. Reporting will be mandatory for SMEs listed on the regulated markets, but they will be allowed to use a simplified and proportional standard. They will also have the opportunity to use full standards if they are advanced enough and want to attract more capital and more investors. Furthermore, technical support will be provided to non-listed SMEs for reporting on a voluntary basis and this will help them to attract capital.

Malgorzata Feluch added that the key question was whether the EFRAG would be able to come up with proportionate simplified standards for SMEs. “The devil is in the detail” makes full sense there.

Aleksandra Palinska addressed the issue of the “co-construction” of European and international standards. She agreed that sustainability-related standards at international level are needed as investments tend to be global, but she recalled the Commission’s emphasis on a specific EU sustainable finance framework that the EU standards must be aligned with. In Europe, we need to go faster and further than what could be achieved at international level.

With regard to the question on the cost of the reporting raised by the businesses, Aleksandra Palinska said that there was actually a simpler solution: oblige companies to follow stricter environmental and social rules. She recalled that the Commission’s option to start with transparency and disclosure was due to strong objections against any new direct regulatory obligations, including on environmental, social and governance matters. This includes the Commission's proposal on sustainable corporate governance, where in particular contemplated new requirements on directors duties and better alignment of remuneration on sustainability objectives, has faced backlash.

Finally, Aleksandra Palinska clarified that the EFRAG report does not suggest to actually include SMEs in the scope of mandatory reporting, but to include them in the sustainability reporting landscape in a proportionate and inclusive manner, as they are a major part of the economy and as they are confronted with sustainability-related risks and opportunities. Therefore the EFRAG report proposes to develop a bespoke standard for SMEs (pp. 6 and 28).

4.2. Good news show

Jean-Paul Servais highlighted that there is a large support for sustainability reporting. The concept of sustainability reporting is not controversial and a lot of self-regulatory initiatives exist (e.g. the Task Force on Climate-Related Disclosures chaired by Mike Bloomberg). He asked if the "good news show" could be combined with the binding standards proposed by the Commission and said that more difficult messages should be expected. In particular when it comes to impacts on the financial situation of a company, to the company's impact on the environment, and to the very important aspect of double materiality.

4.3. The devil is in the detail

Jean-Paul Servais commented again on "the devil is in the detail" idea. He encouraged the audience to read the full EFRAG report (300 pages) and insisted on the importance of technical aspects. He said that the development of a baseline of global sustainability reporting standards is expected to be developed by the Sustainability Standards Board (SSB) of the IFRS Foundation.

The challenge is the implementation of all this. We need proportionality and supervision. Switching to binding standards entails that we need to convey a message which is realistic, meaningful and supported with comparability tools. Information has to be available for users, but also for preparers. We need to be ready for that because it is already an issue for next year.

4.4. The magnitude of future obligations

Philippe Lambrecht added that we do not have to underestimate the huge effort of all this for the companies. What is disturbing for companies today is that they don't know what the magnitude is of their future obligations, including the reporting standards and the new due diligence and corporate governance framework.

5. Questions from the audience

5.1. Can we argue that there was no sufficient impact analysis so far ?

Malgorzata Feluch said that the cost-benefit argument was very crucial for any new regulation. She recalled that the CSRD was accompanied by a cost assessment that already covers a substantial amount of its impact. She clarified that the Commission doesn't have at this stage a global impact assessment insofar as the requirements on companies would be tailored to upcoming regulations, but that the EFRAG proposal for reporting standards would be accompanied by an additional cost-benefit analysis. An impact assessment is already available concerning the implementation of taxonomy-related disclosures under Article 8 of the Taxonomy regulation, and the initiative for Corporate Sustainable Governance will also be supported by a cost-benefits analysis.

The Commission understands the uncertainty for companies, but considers it as inherent in our move to a new environment which is highly uncertain for everybody, not only for companies.

Aleksandra Palinska further commented on the impact assessment issue. Finance Watch believes that actually the Commission did a great job with the CSRD proposal. We have to keep the objective in mind and remember that the consequences of inaction might be terrible. According to a study frequently referred to by MEP Sirpa Pietikäinen, inaction in the next couple of years is likely to result in huge economic and financial costs which would actually be a multiplication of the costs of Covid-19.

Kerstin Lopatta shared additional insights regarding the costs of reporting. For SMEs that have not implemented all these factors, the cost in the first year (including for the audit) is very high and will decrease over years, as companies get used to reporting. We should also keep in mind that standards will be dynamic because they will be assessed every 3 years. The technical screening criteria of the taxonomy regulation are also dynamic. They are tightened over time because the objective is to reach climate neutrality. Companies will also need a lot of expertise and will face really high costs.

5.2. Is there a list of SMEs from high-risk sectors or a list of what is included in these sectors ?

Regarding a list of high risk sectors, **Malgorzata Feluch** said that the Commission had not developed such a list because SMEs in high-risk sectors do not have different reporting obligations than other SMEs under the CSRD proposal. However she clarified that such a list was being looked at and might be developed for the sustainable governance initiative.

Aleksandra Palinska said that Finance Watch is pushing for including SMEs from these sectors in the scope of mandatory reporting under the CSRD. In this context, we need to define what a high-risk sector is. As the Commission said, this could be done in the context of the initiative on sustainable corporate governance, although it could be useful to link it properly with the CSRD.

Part II – Sustainability reporting in practice at the national level

1. Introduction

Brent Bleys, co-chair of the WG on Financing the transition of the FRDO-CFDD, introduced the session and clarified that the Commission's proposal for sustainability reporting standards does not start from scratch. For example, the Sustainability code, a German national initiative of the German Council for Sustainable Development (RNE) developed in 2010, assists companies in meeting statutory requirements and can, via its reporting requirements, offer guidance regarding the establishment of an integrated and credible sustainability management.

At the moment, companies with a reporting obligation in Germany can use the Code to meet the current requirements of the CSR Directive Implementation Act (CSR-RUG). According to the defined scope in the CSRD, the number of companies with a sustainability reporting obligation would increase drastically in the EU. The German Sustainability Code and its guidelines can, amongst others, be used by companies to prepare themselves for the increasing reporting obligations.

Other countries have also implemented a Sustainability Code based on the German model, contextualized to their needs and systems. Romania is one example: They started the process of establishing the Romanian Sustainability Code in coordination with the German Council for Sustainable Development.

2. Sustainability reporting in Romania

Laszlo Borbely (State councilor, Department of Sustainable Development of the Government of Romania) reported that non-financial reporting by companies in Romania was only a formality until 2018. Nobody looked at these reports. The situation changed in 2018 under the effect of the EU Commission's guidelines on non-financial reporting published on 26 June 2017. But still just few companies made very clear reports.

Romania's Sustainable Development Strategy 2030 is based on an inter-institutional framework composed of:

- An Interdepartmental Committee for Sustainable Development headed by the Prime Minister, which reports on the progress made to the Parliament every year.
- A Consultative Council on Sustainable Development (academics and civil society representatives) affiliated with the EEAC Network.
- A Sustainable Development Network with hubs in every relevant public institution with *experts in sustainable development*. Within the "Sustainable Romania" project, financed from the European Social Fund (ESF) a national occupational standard for these experts

was developed. The ESF project aims to provide training courses to develop and improve key competencies for sustainable development.

- A Coalition for Sustainable Development supported by the Department of Sustainable Development when needed and gathering more than 50 entities of the civil society.

The Department of Sustainable Development is currently working on an Action Plan to implement the 2030 Strategy. With the support of the EU the Romanian Sustainability Code inspired by the German experience will be established. A consultant will be hired and information about the sustainability of companies will be published on a dedicated website.

The Department is also active at the EU level and supports the adoption of stricter reporting obligations for a greater amount of companies as soon as possible. The Department looks forward to the finalization of the European taxonomy as a manual for private companies to implement sustainability investments. The Department will keep using the Sustainability Code.

Laszlo Borbely gave insights regarding the reporting of non-financial information by companies in Romania since 2017. Although the number of reporting companies has been increasing, only 46 entities reported non-financial information on their websites, and only 3 of them submitted limited assurance reports in 2019.

He said that corporate sustainability reporting was important because companies and citizens need to be educated regarding sustainability and have a clear image of what they do. Citizens should also be able to know about the companies' degree of engagement and dedication for sustainable development. This will be very important in the coming 1 or 2 years already.

3. The German Sustainability Code

Isabelle Krahe (German Council for Sustainable Development) presented the German Sustainability Code developed in 2010, in the course of a multi-stakeholder process. The Code is a transparency standard and provides a user-friendly framework for sustainability reporting that can be used free of charge by organizations and companies of all sizes and legal forms.

The Code is structured with a set of 20 criteria using the comply-or-explain principle, which means that companies can't simply pick-and-choose certain criteria. They can either describe that they comply with the criteria, or give a reasoned explanation why it was not (yet) possible. The code can also be seen as a process standard because companies that are establishing a sustainability management system can, meanwhile, report on their progress.

In Germany, companies can use the code to meet the requirements of the current CSR Directive Implementation Act (CSR-RUG), but also to report on the core elements of the National Action Plan for Business and Human Rights. This is especially relevant in the context of the expected due diligence obligations on EU and German levels. SMEs that are part of the value chain of large companies are concerned by this and can use the Code for their sustainability reports.

Isabelle Krahe explains that the Code is not just a reporting framework, because its criteria also serve as a framework to establish a sustainability management system and reflect the company's sustainability achievements according to these criteria.

The number of companies using the code increased when non-financial reporting became mandatory for large quoted companies under the CSR-RUG in 2018. Since the scope of mandatory sustainability reporting could increase as suggested in the new CSRD proposal, the number of users might multiply. Currently, around 700 companies are using the code and 1.633 declarations (sustainability reports) have been published in the online public accessible database.

The speaker gave an overview of the sustainability concepts and aspects structured in the 4 main areas of the Code (concepts: strategy and process management; aspects: environment and society), including a set of 20 criteria (see power point presentation p.4). Those criteria are backed up by sets of indicators (choice between EFFAS or GRI SRS). GRIs criteria are internationally-oriented and EFFAS criteria allow companies to use different calculation methods.

Isabelle Krahe developed the implications of the CSRD proposal for the Sustainability Code:

1° Under the CSRD proposal, companies would disclose information about their business strategy for transition towards a sustainable and climate-neutral economy, on how the stakeholders interests are considered, on whether they use sustainability targets and monitor the progress towards achieving them. At first glance, the Sustainability Code already takes into account a large part of the suggested contents (see logos in power point p.5). When the code was developed, it was not strictly linked to the contents of the CSR-RUG, but it took the justification of this law as a basis. Therefore, the Sustainability Code went further than the legal requirements at that time. Two examples are 1° the double materiality (inside-out and outside-in perspective) identifying the main impacts in consultation with the relevant stakeholders, and 2° the role of board management in sustainability matters.

2° The Sustainability Code is a very user-friendly framework that can help companies to prepare themselves for increasing sustainability reporting requirements. Especially SMEs could use the Code during the envisaged 3 years phase-in period. The Code will continue to reflect current reporting requirements.

A study on the detailed compatibility of the German Sustainability Code with the CSRD proposal, the taxonomy and the SDGs on target level was commissioned and will be published by the end of 2021.

Prof. Dr. Alexander Bassen is a member of the German Council for Sustainable Development and was recently appointed as a member of the EFRAG Lab Project Task Force on Sustainability Reporting Standards.

4. The Sustainability Code in Romania

Adriana Gatu (Department of Sustainable Development, Government of Romania) explained that the national adaptation of the German Sustainability Code is a part of the European Social Fund project "*Sustainable Romania – Development of the strategic and institutional framework for the implementation of Romania's Sustainable Development Strategy 2030*". The Code will be part of the monitoring mechanism to follow the progress in the implementation of this strategy. An external consulting team will translate the Code for Romania and organize training workshops. An online platform will be created.

The national adaptation of the Sustainability Code will take the EU developments of the CSRD into account and will run in dialogue with the stakeholders. It will set up the methodological norms for applying sustainability reporting legislation. Adriana Gatu added that such norms were lacking in Romania. She also specified that any form of organization not subject to the reporting obligation would be able to apply the Romanian Sustainability Code on a voluntary basis.

5. Questions from the audience

5.1. Is there a learning process to use the Sustainability Code ? Can the Code be a learning process for other reporting frameworks ?

Isabelle Krahe explained that the German Sustainability Code cannot simply be copy-pasted in other countries because of their specific stakeholders and company types. For example, in Germany, there is a huge number of SMEs which have a strong impact.

She added that companies do not need sustainability experts to start implementing the Code. The comply-or-explain principle helps them to start with a reduced number of criteria. The Code already includes indicators used by international reporting standards (eg. the Global Reporting Initiative Sustainability Reporting Standards - GRI SRS) that are more complex and can therefore be used by companies that consider to use them at a later stage.

She also recalled that certain indicators can only be used on the condition that the corresponding data are available to the company. Companies that will be obliged to report under the CSRD could already start looking at the data that they will need to comply with the reporting standard.

5.2. What is the role of auditing ?

The German Sustainability Code team does not audit the contents of companies reports. A pool of consultants checks the reports formally (for example: do they respond to all the criteria according to the comply-or-explain principle and is there a criteria for which no information is provided ?). "Nudging questions" can be asked to improve the contents of the reports.

Reporting companies have the option to contract with audit companies but it is not an obligation.

Under the CSRD, the assurance of sustainability reports will be mandatory.

5.3. Could there a trade-off between the binding character of reporting standards and their ambition ? How useful the Code would be once we have the EU standards in place ?

Isabelle Krahe suggested that if the EU standards would remain basic, the option of having a voluntary standard which would be more ambitious (a "gold standard") might still be considered. But this will depend on how the EU standards will look like. Through the participation of a member of the German Council for Sustainable Development in the EFRAG Task Force, the experience of the Sustainability Code can feed the elaboration of the European standards. For example, the experience shows that sustainability risks is an issue that is a bit lagging behind in companies reports. Coherence and connectivity between reporting systems applicable to different categories of companies (SMEs reporting on a voluntary basis, or phasing-in mandatory reporting) should be looked for.

5.4. What is the link between the CSRD and due diligence ?

Isabelle Krahe clarified that the Sustainability Code had also a role in the implementation of the German National Action Plan on Business and Human Rights. The code includes a specific focus on due diligence, and companies have an option to report on it according the core elements of this action plan. She added that SMEs that are not obliged to report because of their size are still an important actor in the value chains because of the upcoming regulations on due diligence. SMEs that are suppliers of large companies would also have to comply with a certain list of criteria concerning due diligence. The value chain would extend the scope of due diligence.

5.5.What are the barriers to sustainability reporting in Romania ?

Adriana Gatu reported on a couple of challenges for sustainability reporting in Romania:

- Local companies are not well-informed about the existence of various standards that can be used.
- Companies do not have a full knowledge of the taxonomy package and how criteria will develop over time.
- A company invests more in CSR if the CEO and the board members are convinced that it is the good direction and are constantly looking for solutions to find a balance between profitability and sustainable development. If the CEO does not attach importance to sustainable development, the initiatives move slowly and tend to be rather philanthropic.
- The lack of implementation of international reporting standards which would help companies to improve the results of their CSR projects and would ensure sustainability and buy-in from investors and the local community.

The National Bank of Romania has launched the report of the CNSM Working Group (National Committee for Macroprudential Supervision) to support green financing. The report includes information on the transparency of companies and institutions (implementation of the NFRD Directive in Romania) and recommendations to improve the general ESG-reporting framework. IT also refers to the international trends in the field of non-financial reporting standards.

6. How to address the growing requests for sustainability information from SMEs ?

Luc Hendrickx (SMEunited) presented SMEunited, the association of crafts and SMEs in Europe. SMEunited is represented both in the EU Platform on Sustainable Finance and in the EFRAG Project Task Force – European Sustainability Reporting Standard. He gave an overview of the history of Corporate Social Responsibility (CSR) at EU level, from the Green paper "Promoting a European framework for Corporate Social Responsibility" of 2001 and the European Multistakeholder Forum on CSR (2002-2015) to the Non-Financial Reporting Directive (NFRD) (2014) and the current proposal for a Corporate Sustainability Reporting Directive (CSRD). SMEunited was involved in the process since the beginning on a very active and constructive way. There is a move from CSR to "sustainability information". In 2019, the EU Green Deal, the Council conclusions on the Capital Markets Union and the draft Taxonomy Regulation highlighted the need for reliable and comparable non-financial reporting by (some) companies.

Luc Hendrickx challenged the Commission's arguments for the review of the NFRD:

- Regarding the lack of comparability of non-financial information, he asked if that information is by definition comparable;
- Regarding the problem that companies do not report information that matter for users, or information that they can use, he said that the Commission paid too much attention to the conceived problems of the users, and not enough to the preparers. The directive proposal will not help to solve the preparers' problems.

The proposal's scope includes all companies with more than 250 employees and listed SMEs. We have to keep in mind that the scope can be extended by the EU Parliament and by the Council and that goldplating is then a risk.

The speaker noted that the proposal was clarifying the double materiality principle and said that it was a very important one.

He added that a specific reporting standard for SMEs would be set up. SMEunited supports the idea of such a voluntary standard, reflecting the needs of SMEs' specific stakeholders, that are completely different from those of larger companies. However, for SMEunited, the CSRD proposal entails that standards for large companies will have a "trickle-down effect" on SMEs. In other words, SMEs will have to report at the request of larger enterprises that are their clients, but according to their own standards. The whole idea of a proportionate treatment of SMEs will not be respected by the market. Therefore, the exemption of SMEs is a fake. The problem is aggravated by the fact that it will appear as soon as large companies will be obliged to report (reporting year 2023) while listed SMEs will have three years more.

The risk that large companies will not accept SMEs' specific sustainability reporting is identified in the Commission's impact assessment, but the directive proposal does nothing to prevent it. In addition, there is no budget for SME support nor for awareness-raising.

Therefore, reporting will not benefit to the SMEs nor to their stakeholders. Furthermore, the SME-specific standard will be tailored for listed SMEs, that are relatively few in number and work on a completely different manner than unlisted SMEs. They also have more resources.

The mere compliance with existing regulations (permits and other administrative formalities) is already more expensive for small enterprises than for bigger ones. According to SMEunited, the overall cost of the CSRD for SMEs will be between EUR 10 and 200 billion per year. New assurance requirements and the external expertise that is needed to comply with the new reporting standards increase the costs for SMEs.

SMEunited insists on the proportionality principle and on the "think small first" principle. A self-standing standard for SMEs, one that does not simply downgrade the standard for large companies, is needed (cf. the bad experience of the IFRS standard for SMEs) (EFRAG report, p.53, point 174). In addition, standards should allow to use available information (bills, audits) and should always remain voluntary.

7. The need for sustainability information in the Belgian financial sector

Tom Van den Berghe (Febelfin) started his presentation by pointing out that as "entities", financial companies were also subject to ESG data reporting. But of course, financial institutions to be able to report on their ESG levels need the information from the companies they finance, with the trickle-down effect that the previous speaker was talking about.

Tom Van den Berghe gave an overview of the legal framework. There's a whole range of EU initiatives that are mostly focused on reporting and disclosure, and many of them set up disclosure requirements for the financial sector. They can be classified in 3 pillars with different objectives:

1° Reorienting capital towards sustainable economic activities (e.g. the taxonomy) with the aim ultimately to improve financial solutions for sustainable projects;

2° Disclosing the sustainability of business, also to provide more transparency about positive and negative impacts of financial institutions;

3° Managing sustainability risks, and more concretely climate risks, that could have a very important impact on the sustainability of financial institutions. The specific reporting requirements for financial institutions imply that they have specific data needs to be able to do that reporting.

One of the impacts of these initiatives is that the financing of some activities and of some companies will become more attractive for financial institutions. As a result, other activities/companies might become less attractive.

The speaker gave an overview of the different EU regulations applicable to financial institutions including what type of ESG data these regulations respectively ask financial institutions to provide (slide 7).

Financial institutions are both users and preparers of ESG data. They have to provide ESG data for their own business but they also need and use date form companies that they finance. To this extent they rely on corporate reporting. Tom Van den Berghe gave a few examples of this:

- Financial institutions need to report on the taxonomy alignment of their balance sheet (their so-called "green asset ratio") (art. 8 of the Taxonomy Regulation). To be able to do that, they need to know the taxonomy alignment of the companies (CapEx, OpEx and turnover) they finance via credits or investments (slide 9).
- Asset managers need to report on how they deal with their "principal adverse impacts" (PAIs) (art.4 of the Disclosure Regulation). These are the negative ESG impacts of investments in certain companies or sectors. To be able to report on this, they need information on these companies adverse impacts (e.g. tons of CO_2 emissions, impacts on species and deforestation, on child labour, on human rights, etc.) and policies to address such adverse impacts.
- Financial institutions need to report on climate and environmental risks and do stress-tests. To be able to do that, they need climate-related indicators from companies, such as their carbon intensity.
- Financial institutions need to report on the impact of sustainability risks, mostly climate-related, on the value of their collaterals such as mortgages, because that impact determines the potential risks they run due to climate change. Therefore they need a view on the energy efficiency of the buildings included in their mortgages.

Data gathering poses a number of challenges for financial institutions:

- The data need to be available, but they are not always reported. They are mostly reported by large companies but very scarcely by SMEs and certainly not by unlisted SMEs. There's a number of data sources from external ESG agencies, but the information given is not always coherent and is sometimes contradictory. It's quality is quite variable.
- The format of ESG data can also be very diverse. It is not always standardized, usable and digitalized in an automated fashion.
- SMEs, who are a very large part of Belgian banks clients, represent a very specific challenge. They have a very important role in determining the sustainability risks and the sustainability impacts of the Belgian banks, but they are not subject to most EU disclosure requirements. There is really a very big gap here.

Tom Van den Berghe made further comments about the impacts of the EU sustainable finance initiatives on companies. Financial institutions need ESG information from companies to fulfil their own disclosure requirements and prudential requirements. Therefore it is expected that companies, including SMEs under the "trickle-down effect", will be asked by financial institutions to report on their ESG policies, whether they are in the scope of mandatory reporting or not.

Companies asking for a credit or for an investment will be asked by their banks to provide information on their ESG policies, on the management of their supply chains, and on their alignment with the taxonomy.

The speaker also commented on the impacts of the EU sustainable finance initiatives on corporate financing. He said that the overall objectives of these regulations were positive insofar as they intend at orienting more capital towards the green economy, but also had a side effect: when more money goes to the green economy, the non-green economy becomes less attractive. In particular when the taxonomy will be extended to a "brown taxonomy". Banks will use the taxonomy not only for investments, but also for lending. They may voluntarily use the taxonomy in lending activities. Of course, taxonomy alignment is not the only element in credit and lending decisions. There are a lot of financial criteria too, but in any case the importance of ESG reporting by companies can't be underestimated and companies should be aware of that evolution.

8. Questions from the audience

8.1. Does the CSRD proposal pay too much attention to the users of sustainability information, to the detriment of preparers ?

A participant said that reporting requirements even on SMEs do not only stem from the CSRD proposal but also reflect a requirement from the financial sector which is already obliged to disclose a lot of sustainability information, and also from the public at large which is anxious about pollution, climate change, the loss of biodiversity. The society itself asks for sustainability information. The participant referred to the explanatory memorandum of the CSRD proposal pointing out that the standards for sustainability reporting would actually support the companies in addressing the requests from the financial sector and from society (pp. 3 and 4 of the explanatory memorandum).

Luc Hendrickx clarified that SMEunited has been paying important attention to non-financial reporting and disclosure by SMEs since the start of the related European processes in 2001. For SMEunited, sustainability reporting is in the first place a management tool for enterprises, because entrepreneurs should be able to take decisions on the basis of sustainability information. However SMEs should remain free to decide how they communicate that information. In general, this kind of information can be found easily because the SME manager can be contacted directly. In contrast, the structure of large companies is more complex and this may be a problem for their accountability, but this problem should not be generalised to the SMEs.

SMEunited has been promoting better sustainability reporting by SMEs, not through mandatory reporting standards, but in the manner that they consider as the most appropriate to their specific stakeholders.

8.2. How can we solve the ESG data gap from SMEs in Belgium when sustainability reporting standards will enter into force for large companies ?

For Luc Hendrickx, the standards that will be developed can be a reporting tool for SMEs, but 1° on a voluntary basis, and 2° on the condition that they are adapted to the capacities of SMEs. Most reporting standards, like the GRI for example, are developed for larger companies and can't be translated for small enterprises.

In addition the cost for using such reporting standards is very high. A simplified GRI reporting has been adopted by some Belgian SMEs, but the cost for this in 2011 was between € 20.000 and 25.000 for a small company of 10 employees. For the ISO 14000 the costs for certification are € 20.000, and this does not include the personnel costs. This is more than what some companies have received during the Covid crisis to be able to survive.

SMEunited fully supports the Green Deal, but thinks that the tools to be used need to be adapted to the capacities of SMEs. Reporting will not support a sustainable economy. Reports that nobody reads are not helpful. As a matter of pragmatism, incentives should be preferred, to improve companies' functioning, to improve circular economy and sustainability.

8.3. Is sustainability reporting relevant for all SMEs ?

Luc Hendrickx said that, according to the state of play today, sustainability reporting would only be needed for SMEs asking for a green financing (loan or investment), because financial institutions selling green products can only do so on the basis of the information that they receive from the SMEs financed by these products. But sustainability information would not be requested from SMEs for a classic type of financing.

According to Tom Van den Berghe, this should be qualified from the moment financial institutions take sustainability risks into account, not only when they finance high-risk activities (transport, agriculture, construction), but also when they have to assess the exposure of their mortgage portfolios to climate change, for example (see the circular letter of the Belgian National Bank of 8 December 2020). There are different areas in which ESG information is required and the type of information will differ from SME to SME, but all companies, including SMEs, should be prepared and not surprised if they get questions related to ESG, climate change, energy efficiency, etc., when they ask for loans, next to the traditional questions.

8.4. How can we raise SMEs' awareness of the importance of ESG information ?

A participant said that SMEs' awareness of the importance of ESG information in Belgium was nearly zero and asked what could be done to raise it.
Luc Hendrickx pointed at the lack of support from public institutions to assist SMEs dealing with third country companies to ensure that minimum standards are respected, for example in terms of human rights. The EU Commission, the International Labour Organization (ILO), the embassies could do better in this regard. A Belgian SME's entrepreneur does not have the means to check

all this. ESG information need to be translated in understandable language and concrete examples.

8.5. How can banks support SMEs for sustainability reporting ?

Tom Van den Berghe said that the SMEs' awareness of the importance of sustainability reporting could be improved. For Febelfin, this is first and foremost a task for companies and federations, but Febelfin as a very important stakeholder could also maybe take an initiative.

8.6. What is the position of Febelfin regarding the CSRD proposal's timing for the application of sustainability standards ?

The CSRD proposal provides that reporting standards for large companies will apply from reporting year 2023 onwards for large companies, and from reporting year 2024 onwards for listed SMEs. For Febelfin, this entails a timing mismatch because the disclosure obligations of the financial sector have entered into force since 10 March 2021 (Art.20 of the Disclosure Regulation). There is still a reporting gap. Until 2023 and 2024, financial institutions need to see what they can do.

8.7. Should sustainability reporting standards also apply to public services ?

Tom Van den Berghe thinks that public services should give the example. For Luc Hendricks, this would help public services to realize that sustainability reporting is difficult.
A participant points out that the taxonomy regulation might already support greater transparency of public services because green funds on the financial market will have to disclose their degree of alignment with the taxonomy (art.5 and 6 of the Taxonomy Regulation). Bank's green bonds and other sovereign exposures will be taken into account to calculate that degree of alignment (Draft RTS with regard to the content and presentation of sustainability disclosures pursuant to Article 8(4), 9(6) and 11(5) of Regulation (EU) 2019/2088, p.9).

Conclusions of the webinar

Brent Bleys thanked all the speakers for their presentations and insights, on behalf of the members of the Working Group on Financing the Transition of the FRDO-CFDD. He said that the disclosure requirement for financial institutions was an interesting approach of sustainability reporting and that it might be something worthwhile to take up for a further seminar. He added that companies whether they are large or small should be monitoring their CO_2 emissions, just to anticipate on what the Green Deal might entail in the coming years. Data gathering is not just for companies to report to someone else, but for companies to be "future-proof" or "future-fit". He said the situation in the Belgian logistics sector two years ago was a rather surprising example, since some companies did not know their CO_2 emissions while other companies did. Within a same sector the awareness of sustainability issues varies from one company to another.