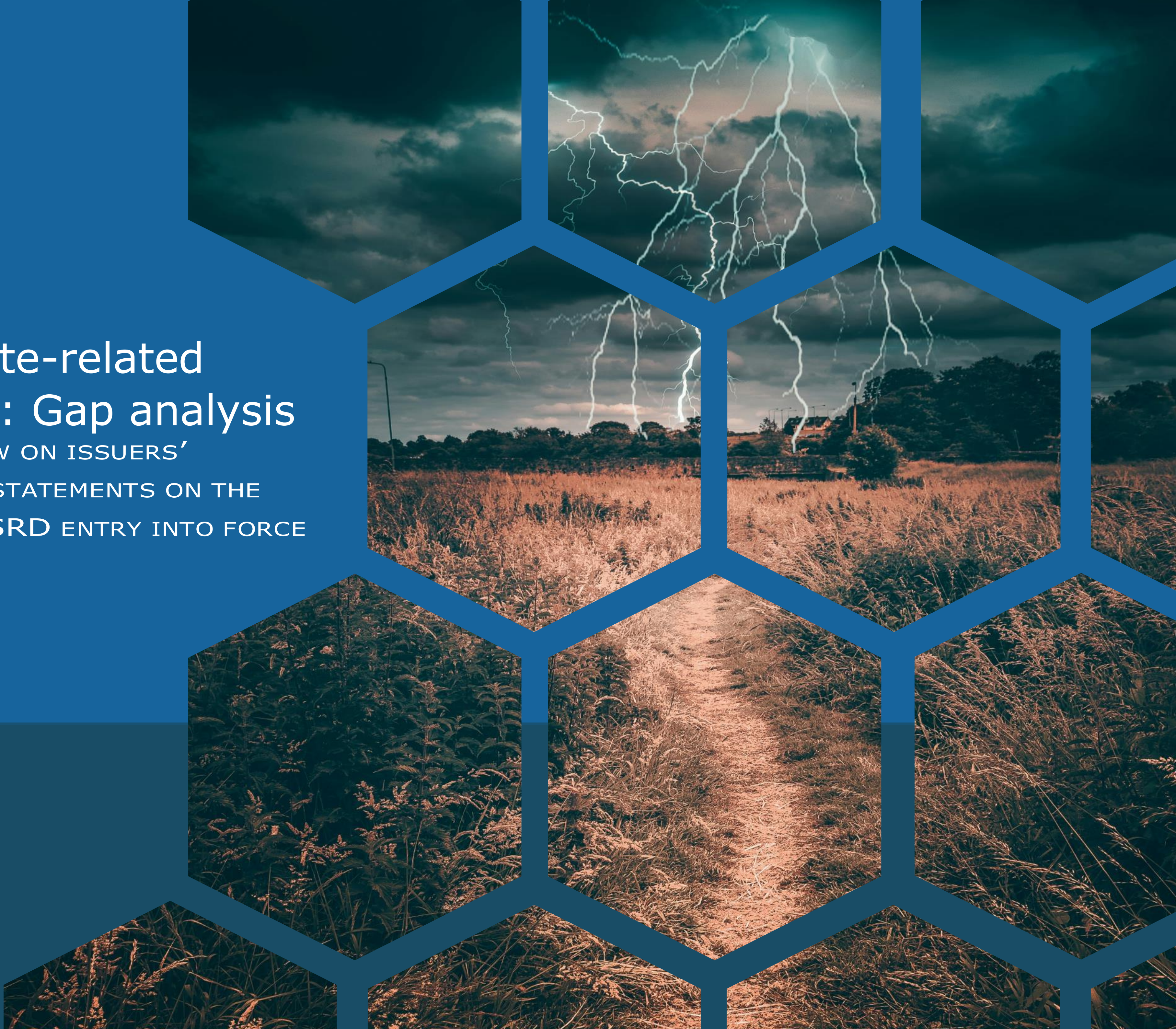
cssf

Commission de Surveillance du Secteur Financier

2022 climate-related disclosures: Gap analysis

Thematic review on issuers' sustainability statements on the verge of the CSRD entry into force

February 2024



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Background

The transition to a sustainable economy is one of the most important challenges facing our society today. This raises legitimate expectations about the evolution of the companies' business models towards more sustainable and resilient ones.

To ensure transparent communication to their stakeholders on the aforementioned matter, since 2017, some sizeable issuers have been required to publish non-financial information under the NFRD. Starting from 2024 financial year, the CSRD will enter into force and issuers in its scope will have to report according to European Sustainability Reporting Standards (ESRS).

The new rules will ensure that investors and other stakeholders have access to the information they need to assess the impact of companies on people and the environment and to evaluate financial risks and opportunities arising from sustainability issues, including climate change.

[NB: "Non-financial" or "Sustainability" information is the terminology used respectively in the NFRD and CSRD. In this report, both terms are used without distinction.]

Objective of the review

In order to gain a preliminary understanding of the gap that remains to be addressed by issuers with regard to the transition from the NFRD to the CSRD, in terms of sustainability disclosures, the CSSF presents a snapshot of certain climate-related information as well as some more general related disclosures that issuers already publish. In addition, the CSSF takes the opportunity to issue some recommendations to the issuers concerned in light of certain of the new requirements that will come into force as from 2024 for publication in 2025.

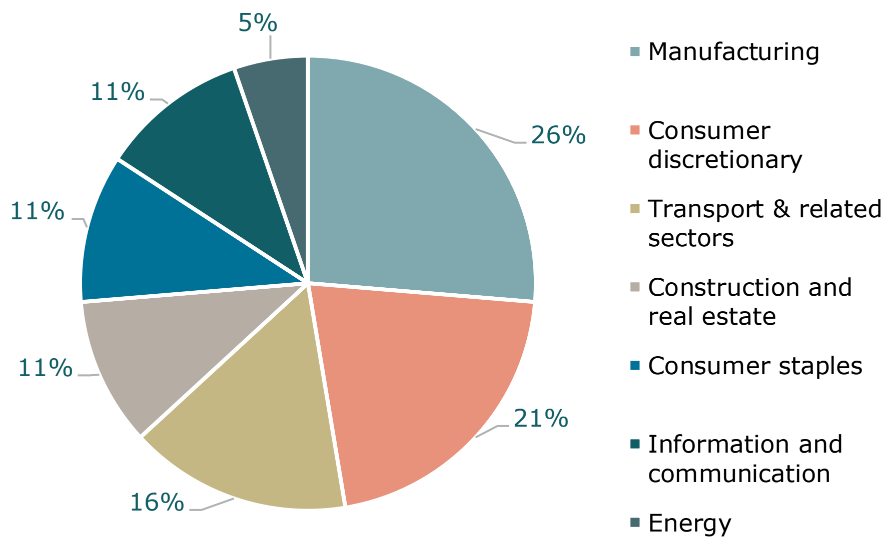
Given the prominence of the subject, this analysis focuses primarily on information relating to climate change.

Scope and methodology

The CSSF has therefore carried out a thematic review to examine the current reporting practices for 2022 for a selection of the largest issuers with a potential material impact of climate change under its supervision and falling within the scope of the NFRD.

The chart below outlines the sectors in which operate the issuers selected for the purpose of this report:

Sectors of activity in the sample



This thematic review mainly took the form of desktop research based on the published 2022 sustainability reports and data analysis. Only certain disclosure requirements (DR) of the ESRS 2 *General disclosures* and ESRS E1 *Climate change* standards have been considered. The report is by no means an exhaustive review of all CSRD/ESRS requirements.

A possible bias of this gap analysis is that current reporting practices are assessed against the backdrop of certain of the requirements of standards, which are not yet effective. Thus, the following findings should not be considered as an overall diagnostic of the selected issuers' preparedness to comply with CSRD/ESRS.

General disclosures

Scope of the sustainability statement

ESRS 2 BP-1

*The undertaking shall disclose the **general basis for preparation** of its sustainability statement.*

This matter should be of particular concern to issuers who will include their sustainability statement in their consolidated annual report. Indeed, users need to understand whether the scope of consolidation is the same as for the financial statements, and if not, what changes or exclusions apply and to what extent the sustainability statement covers the undertaking's upstream and downstream value chain.

In the sample of 2022 non-financial disclosures reviewed, the CSSF notes that fewer than half of the issuers have provided details on the reporting scope, and very few have explained the extent to which the information covers their value chains.

The CSSF encourages issuers to provide relevant details on the scope of consolidation and on the boundaries of the upstream and downstream value chain information in their future non-financial disclosures.

Governance related to sustainability matters

ESRS 2 GOV-1

*The undertaking shall disclose the composition of the administrative, management and supervisory bodies, their **roles and responsibilities** and **access to expertise and skills** with regard to sustainability matters.*

Almost all issuers in the sample have provided at least some high-level information on the role and responsibilities of the management in relation to sustainability matters. However, the availability of expertise and skills necessary to oversee sustainability matters is hardly ever mentioned.

Issuers need to consider more thoroughly the role of boards and management in relation to sustainability matters and how to ensure that appropriate skills and expertise are available or will be developed in order to fulfil this role effectively.

ESRS 2 GOV-3

*The undertaking shall disclose information about the integration of its sustainability-related performance in **incentive schemes**.*

Less than half of the issuers under review have disclosed relevant information about achievement of sustainability objectives as part of their incentive schemes and remuneration policies for the management. It is worth noting that all the issuers that have done so, incorporate, to some extent, a link to greenhouse gas ("GHG") emission reduction targets in their incentive schemes.

For the others, either sustainability-related performance was clearly not a part of the remuneration policies, or the information provided was non-existent or insufficient to allow an assessment of whether such criteria were implemented by the issuers.

The CSSF urges issuers to provide more specific information on sustainability-related performance criteria when disclosing remuneration policies for members of the management.

ESRS 2 GOV-5

*The undertaking shall disclose the main features of **its risk management and internal control system** in relation to the sustainability reporting process.*

While risk management and internal control systems over financial reporting are generally fairly described, many of the issuers reviewed insufficiently address this topic for the sustainability reporting matters.

Issuers shall consider expanding their disclosures regarding risk management and internal controls in order to better factor sustainability matters.

Strategy and risk management of sustainability matters

ESRS 2 SBM-3

*The undertaking shall disclose its **material impacts, risks and opportunities** ("**IRO**") and how they interact with its strategy and business model.*

Most of the reviewed issuers have provided adequate disclosures of their material IRO and how they interact with their respective strategies and business models.

Several of the reviewed issuers have only partially addressed these reporting matters. Some of those issuers have only considered the outside-in aspect of the materiality in terms of IRO. Others have disclosed double materiality assessment matrices but have not established clear links to their respective strategies and business models. Some others have focused on risks and impacts but did not mention opportunities.

A small number of the reviewed issuers did not discuss these matters at all in their reports.

ESRS 2 IRO-1

*The undertaking shall disclose its **process to identify** its IRO and to **assess** which ones are material.*

Close to half of the reviewed issuers have disclosed their processes to identify and assess IRO in a satisfactory manner.

Several of the reviewed issuers have dealt with this disclosure topic partially. In many cases falling in this category the description of the materiality assessment process lacked details. In particular, the outcome of the materiality assessment has often been disclosed but not the process applied to arrive at it.

When carrying out their materiality assessment on sustainability topics, issuers are to consider the double materiality tenet. They should provide a comprehensive description of their materiality assessment process, including how it is integrated in their respective strategies and business models.

Climate change disclosures

Strategy and transition plan

ESRS E1-1

The undertaking shall disclose its ***transition plan*** *for climate change mitigation.*

In general, many of the reviewed issuers, whether disclosing commitments compatible with the Paris Agreement, or simply GHG emission reduction targets without explicit reference to the former, have not clearly stated that they have devised transition plans but have rather commented on various measures which they have taken.

Moreover, most of the reviewed issuers failed to adequately outline the investments and funding supporting the implementation of their transition plans. In addition, most issuers did not provide a qualitative assessment of the potential locked-in GHG emissions from key assets and products.

Issuers must develop and properly disclose their transition plans for climate change mitigation together with the progress towards achieving such transition plans and explain how the transition plans fit in their overall business strategies and financial planning.

The CSSF wishes to stress the importance of adequately disclosing the investments required and underlying funding needs for the implementations of issuers' transition plans.

Explaining the decarbonisation levers identified and key actions planned, including changes in products and services portfolio and the adoption of new technologies, is key for enabling the readers of the sustainability reports to understand issuers' transition plans.

The CSSF urges issuers not only to disclose their GHG emission reduction targets but also to show how these are compatible with limiting global warming to 1.5°C, in line with the Paris Agreement.

Finally, issuers, which do not have transition plans in place, should disclose whether and, if so, when, they intend to adopt such.

ESRS E1 DR related to ESRS 2 SBM-3

*The undertaking shall describe the **resilience of its strategy and business model** in relation to climate change.*

The majority of the issuers reviewed have not described the resilience of their strategy and business model in relation to climate change.

The CSSF recommends issuers to start providing information regarding the resilience of their business model in relation to climate change, including climate scenario analyses.

Material IROs, policies and actions

ESRS E1 DR related to ESRS 2 IRO-1

*The undertaking shall describe the **process to identify and assess climate-related IRO**, including an explanation of how climate-related scenario analysis has been used.*

Most issuers from the sample have described their process to some extent, albeit often with a limited level of detail. Some issuers mentioned that the IRO identification and assessment process is still ongoing, whilst others did not outline the process *per se*, focusing their disclosures directly on its outcome.

In general, the reviewed issuers have predominantly concentrated on risk and impacts, with little or no mention of opportunities.

Thus, most of the issuers have included the description of impacts on climate change, in particular GHG emissions, even though few of those have elaborated on this matter.

With regard to **climate-related physical risks**, the majority of the reviewed issuers have neither identified such threats nor assessed how their assets and businesses activities could be affected. When they are mentioned, the most common physical risks considered high by some issuers include river or coastal flooding, landslides, wildfires, storms, extreme heat and cold, water scarcity & drought and hurricanes. However, it is regrettable that many issuers, which have provided disclosures to this effect, have not clearly distinguished between chronic and acute physical risks.

Finally, most of the reviewed issuers have not clearly flagged **climate-related transition events**, considering at least one climate scenario consistent with limiting global warming to 1.5°C. Among the risks falling into this category, the disclosures of the reviewed issuers often mentioned the cost of transition to low-carbon economy, such as the costs of carbon credits and green energy, the investments required to upgrade assets, product obsolescence and the cost of production induced by the shift in consumer preferences towards green products.

Regrettably, a large majority of the reviewed issuers have not had recourse to climate-related scenarios in the context of physical and transition risk identification and assessment.

Issuers are encouraged to:

- ***strengthen their process to identify and assess climate-related IRO;***

- ***in particular, use science-based climate-related scenario analysis to inform the identification and assessment of physical and transition risks and opportunities over the short-, medium- and long-term time horizons;***
- ***enhance their disclosures of the aforementioned process, in addition to communicating on the outcome of applying it, so that the readers of the sustainability report could gain an in-depth understanding of how issuers arrive at the disclosed conclusions.***

ESRS E1-2

*The undertaking shall describe its **policies** adopted to manage its **material IROs related to climate change mitigation and adaptation**.*

Several of the reviewed issuers have provided adequate disclosures of their policies adopted to manage their material IRO related to climate change mitigation and adaptation. Based on our review, such policies are often centred on minimising carbon footprint via alternative raw materials, carbon capture and storage, internal carbon pricing schemes, recycling, energy efficiency, renewable energy (self-produced or purchased via Power Purchase Agreements), electrification of vehicle fleet, etc. Innovation is often presented as the cornerstone of successfully implementing such policies.

Other issuers have discussed briefly various measures taken but without systematically describing how such measures are embedded in well-defined policies.

The CSSF highlights the importance of disclosing policies adopted to manage material IROs related to climate change mitigation and adaptation and of explaining how measures taken in this context fit in such policies.

ESRS E1-3

*The undertaking shall disclose its climate change mitigation and adaptation **actions and the resources allocated** for their implementation.*

The majority of the reviewed issuers have not provided detailed disclosures on climate change mitigation and adaptation actions and the related resources. Regrettably, a large majority of issuers have not disclosed quantitative and qualitative information regarding the progress of actions or action plans disclosed in prior periods. The trend is further exacerbated in terms of providing information on the financial resources allocated to the implementation of actions plans, as the vast majority of the reviewed issuers have not addressed this topic.

Issuers should be conscious of the importance of disclosing their climate change mitigation and adaptation actions and the resources allocated (Capex and Opex) for their implementation.

Metrics and targets

ESRS E1-4

*The undertaking shall disclose the **climate-related targets** it has set, notably whether and how it has set GHG emissions reduction targets and/or any other targets to manage material climate-related IRO.*

Most issuers reviewed have mentioned having adopted and implemented objectives relating to climate change mitigation and adaptation. Issuers who have not provided such information do not seem to have valid reasons for not being concerned by reducing emissions, particularly as they belong to industries considered to be relatively polluting:


Agricultural producers


Transportation & Logistics


Automotive

Also, it is noticeable that almost all issuers have provided only high-level or too generic disclosures, which is detrimental to gaining a better understanding of how such targets are set, under which scenarios, and how issuers concretely intend to reach them. The more ambitious the targets disclosed, the more important detailed explanations will be for users of the sustainability statements.

The CSSF encourages issuers to provide relevant detail on the climate-related targets they have adopted in their future sustainable disclosures, by notably disclosing the following information:

- ***the defined GHG emission reduction targets (for Scope 1, 2 and 3) for 2030 (and, if available, for 2050) in absolute value and, if deemed meaningful, in intensity value, including an explanation on how the consistency of these targets with the GHG inventory boundaries is ensured;***
- ***the baseline value and base year from which progress is measured;***
- ***the methodologies and significant assumptions used to define targets, including where applicable, the selected scenario, data sources, alignment with national, EU or international policy goals and how the targets consider the wider context of sustainable development and/or local situation in which impacts take place;***
- ***whether the targets related to environmental matters are based on conclusive scientific evidence.***

ESRS E1-5

The undertaking shall provide information on its ***energy consumption and mix****, including the total energy consumption in MWh related to own operations.*

Existing quantitative energy consumption disclosure requirements are generally met by issuers reviewed when considering KPIs such as:

- energy performance and improvements in energy performance;
- energy consumption from non-renewable sources and energy intensity.

However, it is worth pointing out that, when providing this type of information, issuers' disclosures still lack the level of details which will be required by the CSRD/ESRS.

The CSSF urges issuers to provide far more granular metrics related to their energy consumption by notably disaggregating by sources (fossil, nuclear…) and indicate the share of renewable energy in their overall energy mix.

Issuers operating in sectors with a high impact on the climate should already be aware that they will have to provide even more specific quantitative information, notably a disaggregation of their total energy consumption from fossil sources, indication about the share of renewable energy and non-renewable energy in their overall energy production and specific information on the energy intensity based on net revenue.

ESRS E1-6

The undertaking shall disclose its gross Scope 1 GHG emissions, gross Scope 2 GHG emissions, gross Scope 3 GHG emissions and total GHG emissions as well as its GHG emissions intensity based on net revenue.

In general, most issuers have adequately met the disclosure requirements for:

- gross Scope 1 GHG emissions, measured in metric tonnes of CO2 equivalent and the percentage from regulated emissions trading schemes;
- gross Scope 2 emissions, in metric tonnes of CO2eq, covering both location-based and market-based emissions;
- gross Scope 3 emissions, in metric tonnes of CO2eq specifying each significant Scope 3 category.

Nevertheless, issuers will be obligated to disclose their GHG emissions intensity, calculated as the ratio of GHG emissions to net revenue. Unfortunately, a significant portion of issuers failed to provide the necessary data. In some cases, the disclosure was incomplete due to inaccuracies in reconciling the net revenue with the appropriate line items or notes in the financial statements.

The CSSF would like to remind issuers that this disclosure is crucial for measuring progress toward reducing GHG emissions, understanding climate-related transition risks, and ensuring comparability between reporting periods.

ESRS E1-7

The undertaking shall disclose the GHG removals and storage in metric tonnes of CO2eq resulting from projects it may have developed in its own operations, or contributed to in its upstream and downstream value chain; and the amount of GHG emission reductions or removals from climate change mitigation projects outside its value chain it has financed or intends to finance through any purchase of carbon credits.

It is noteworthy that only a minority of issuers have provided the above-mentioned information. The absence of this information does not always make it possible to understand whether or not the issuer has entered into GHG removals and storage projects (notably through the purchase of carbon credits).

The CSSF would like to emphasise the significance of this disclosure in order to understand the undertaking's efforts to permanently remove GHG and assessing the quality of carbon credits for potential GHG neutrality claims.

Assurance statement

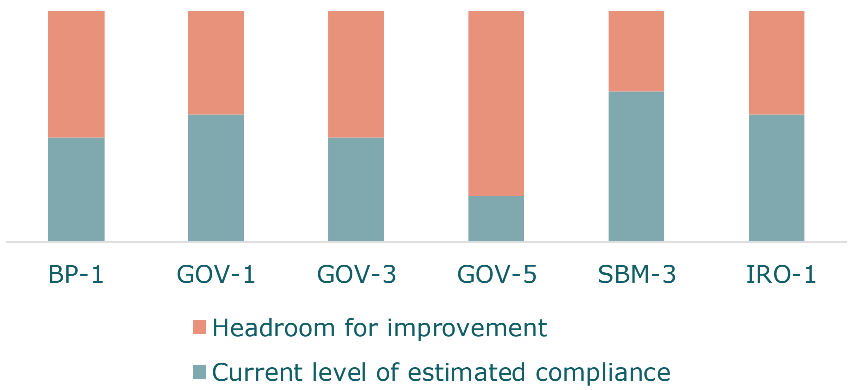
A limited assurance statement will be required for the sustainability information published under the CSRD.

Some issuers already present a limited assurance statement on all or part of their non-financial information from their statutory auditor, from another auditor or more infrequently from another independent assurance provider. All assurance statements that the CSSF reviewed were made in accordance with the International Standard on Assurance Engagements (ISAE) 3000 revised.

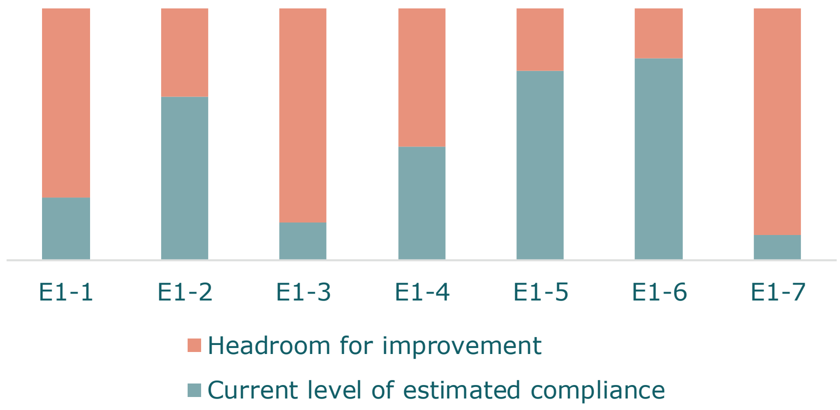
Closing remarks

The CSSF review ambitioned to shed light on the gap that remains between current non-financial disclosures and the future CSRD requirements. The two figures below show, for the reviewed disclosure requirements of the ESRS 2 and ESRS E1 standards, the current level of estimated compliance observed by the CSSF and the respective headroom for improvement.

General disclosures



Climate change disclosures



Issuers should be mindful that the new reporting requirements under CSRD/ESRS are far more granular and extensive than those of the NFRD (underlying guidelines of the European Commission). Notably, stakeholders expect entity-specific disclosures on transition plans as well as climate-related targets, actions and progress.

2024 Priorities

In its Communiqué dated 8 January 2024 on the priorities set for the 2024 enforcement campaign, the CSSF indicated that it will continue to ensure that the reporting requirements of the NFRD as transposed by the law of 23 July 2016 are complied with. Moreover, the CSSF exhorts issuers to continue to prepare for the entry into force of the CSRD and the related ESRS by adapting comprehensively and timely their organisations, policies, internal controls and procedures. The CSSF expects to find substantial progress and good practices on the issuers' 2023 non-financial disclosure in preparation of the introduction of the CSRD.

Looking ahead

While the first companies that will have to apply the ESRS in financial year 2024, for reports published in 2025, are those that report today under the NFRD (with the addition of large listed EU subsidiaries of listed parents, exempted under the NFRD), the scope of entities concerned will increase in subsequent years:

- Large non-listed EU companies and parent companies of large groups, along with large non-EU companies listed on an EU regulated market, need to begin reporting in 2026 for financial year 2025;
- Listed SMEs will have to report as from 2027 for financial year 2026, with a further possibility of voluntary opt-out for a further two years. They will be able to report according to separate, proportionate standards;
- Non-EU companies with significant EU subsidiaries or a branch in the EU are required to report from 2029 for financial year starting on or after January 1, 2028.

Moreover, sector-specific standards will later supplement the first set of standards published in 2023. Last October, the European Commission proposed a 2-year delay of the date of adoption of this second set of ESRS, therefore now required from 2026. For various sectors, they will enhance the mandatory disclosures already defined with sector-specific information and key figures.

Finally, the CSSF reminds that issuers should take all necessary measures to keep themselves informed on the transposition of the CSRD into Luxemburgish law, which should occur by 6 July 2024.

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