OSSERVATORIO ESG

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Standard setter per l'analisi finanziaria

In its Communication on the European Green Deal, the European commission committed to review the Non-Financial Reporting Directive in 2020, as part of the strategy to strengthen the foundations for sustainable investment. Meeting the objectives of the European Green Deal will require additional investments across all sectors of the economy. The review of the NFRD is part of the effort to scale up sustainable finance by improving transparency.

PUBLIC CONSULTATION ON THE REVISION OF THE NFRD 2014/95/UE

Introduction

The Non-Financial Reporting Directive – NFRD – (Directive 2014/95/EU) is an amendment to the Accounting Directive (Directive 2013/34/EU). It requires certain large companies to include a non-financial statement as part of their annual public reporting obligations.

In 2017, as required by the Directive, the Commission published non-binding guidelines for companies on how to report non-financial information. In June 2019, as part of the Sustainable Finance Action Plan, the Commission published additional guidelines on reporting climate-related information, which integrate the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD).

The Commission services launched 20 February 2020 an open public consultation to gather stakeholder views on possible revisions of the NFRD provisions and in the second quarter of the year 2020. Aiaf actively participated in the consultation and seven of its members were involved in the task force created to deal with the issue. The main considerations are presented below.

1. **Quality and scope of non-financial information to be disclosed**

   The feedback received from the online public consultation on corporate reporting carried out in 2018 suggests that there are some significant problems regarding the non-financial information currently disclosed by companies pursuant to NFRD. Likewise, ESMA's 2018 Activity Report gathers evidence that there is significant room for improvement in the disclosure practices.

Additional categories of non-financial information

1.1. For climate information it should be explicitly stated: it requires a clear and understandable link between current NFRD and the two EU different Guidelines on non-financial reporting (2017/C 215/01 and 2019/C4490 final), the UN SDGs, the Paris Agreement and the TCFD recommendations. This ambiguity, however, has created uncertainties for preparers and inconsistencies in reporting practice when comparing disclosures and in some cases has resulted in a lower rate of climate disclosure. We believe a standard and defined metrics are needed, and a clear alignment with current standards and frameworks is required. We refer in particular to:

- Global Reporting Initiative (GRI),
- Climate Disclosure Project (CDP),
- Climate Disclosure Standards Board (CDSB),
- Sustainability Accounting Standards Board SASB
- International Integrated Reporting Council (IIRC)
- TCFD Recommendations
- EMAS guidelines
- United Nations Guiding Principles on Business and Human Rights (UNGPs)
- OECD Guidelines for multinational enterprises
- Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy (MNE Declaration)
- ISO 26000 – Social Responsibility

An alignment is required with the proposal of EU Taxonomy regulation (march 2020), the ESAs' joint Consultation Paper on ESG Disclosures (JC 23 April 2020) and the Regulation on sustainability-related disclosures in the financial services sector (SFRD or Regulation (EU) 2019/2088).

Moreover

1.2. No new sustainability factor is needed at the moment, but uniform applicability must be guaranteed within the existing ones.

1.3. Dynamic Materiality and continuous update are necessary and the International Platform on sustainable finance (IPSF) involvement may be crucial.

1.4. It is now important to strengthen the framework, to make sure the gaps are filled, and to have actions in line with the European Green Deal. In addition, harmonization between the regulations (such as (EU) 2019/2088, EU taxonomy for sustainable activities and European Climate Law) must be provided, this to ensure credibility and effectiveness.

1.5. The required standards must be consistent, comparable by sector and along the time horizon and data assurance may be considered in the future, to avoid the proliferation of estimates from different external providers, different approaches that can undermine the stability of the market itself.

1.6. An urgent action on the social dimension definition is required as COVID-19 emergency remarked. We consider useful a definition of a social due diligence, that each operator must promptly follow with clear references in the standards and possibly in indicators to be reported.

1.7. Supply chain due diligence with defined standards and indicators is necessary in order to have scope 3 or scope 4 or other very difficult data to compute.

Additional categories of non-financial information

1.8. Scenario analysis standards and clear connection with ESG risks are required. We believe necessary the ECB's guidelines on climate-related and environmental risks include also other ESG risks in all the economic sectors. This is crucial to integrate ESG risk evaluation in the credit issues.

1.9. Furthermore, new indicators may be useful: CAPEX, OPEX and % of Revenues from sustainable activities, in line with ICMA memorandum on EU Taxonomy.

New disclosure requirements

1.10. We believe that the NFRD is the basis of the disclosure requested in Regulation 2019/2088 (SFRD), but at the moment many things are unclear and undefined. Regulations are complex and need harmonization.

Environmental matters based on the six objectives set out in the taxonomy regulation

1.11. It is necessary to explain well that there are four other criteria: *i*) Do Not Significant Harm (DNSH), *ii*) substantial contribution, *iii*) technical criteria and *iv*) social minimum safeguard. That is why social requirements and technical criteria are necessary for the implementation.

Other non-financial information

1.12. The revision of the NFRD should be the occasion to enlarge the scope of the document and to include all non-financial information possible to satisfy the growing requests from all stakeholders and in particular investors and financial analysts. In that regard, the document should provide all information on the value creation process, better assessment of business sustainability in the mid-long term, by highlighting all value drivers and their interrelations. It would be necessary to emphasise the strategic relevance of data: Intangible Assets, Long term value creation strategies and processes. Greater details are needed to explain the link among strategies, business model and value creation drivers.

2. Standardisation

A requirement that all companies falling within the scope of the NFRD, with a common non-financial reporting standard, may help to address some of the problems identified in section 1 (comparability, reliability and relevance).

A new European non-financial reporting standard

All the actions of the EU Green Deal are interconnected. Consequently, attention is needed for the SFRD that requires reporting on sustainability in the financial services sector, and the urgency to improve the communication of non-financial information by companies and financial institutions. It is difficult for investors to find non-financial information and many of those reported are not considered sufficiently reliable and relevant. Non-Financial Reporting Directive is crucial to solve and link the previous two actions, a revision is appropriate and necessary to refer to clear standard reporting. It is important to refer to existing international frameworks in line with WEF paper "Toward Common Metrics and Consistent Reporting of Sustainable Value Creation" and any European solution must be a global solution to create a standard reporting that can be applicable globally, too.

2.1. *Need for a standard for reporting non-financial information*: The Council of the European Union clearly indicated a *need for a standard for reporting non-financial information* in the meeting of 5 December 2019.

2.2. *Current reporting standards*: There are many existing bodies and standards, frameworks and metrics already developed, that have achieved considerable attention with very accurate work including CDP, CDSB, GRI, IIRC, SASB, TCFD to refer to.

2.3. *Need for standard metrics*: With respect to the standardization of metrics pending the effective recognition of best practices in the identification of E, S and G data. It is useful to consider the work done by the initiative of the World Federation of Exchanges (WFE) together with the UN Sustainable Stock Exchanges (UN SSE) in creating the Model Guidance on Reporting ESG information.

2.4. *TCFD risks and opportunities recommendations*: We suggest prioritizing a specific integration, such as the TCFD framework, into the standard. This issue is particularly stark for climate change, where the TCFD recommendations have achieved considerable momentum towards becoming a standard. Indeed, Mark Carney is attending the next COP26 intending to make TCFD mandatory. TCFD has attracted great support from investors, companies, regulators, policy makers and civil society. But TCFD's value as a standard will be enhanced by achieving consistent measurement and metrics, by deciding on how to measure and to report on emissions by scope, energy intensity or water shortage in areas of high stress and by standardizing procedure for the scenario analysis.

2.5. *Key stakeholder groups with an interest in and contributing to the elaboration of financial reporting standards*: Participants must have credibility, authoritative leadership, political relevance, legislative enforcement and support of current large players and multi-stakeholder engagement.

Also input from investors on materiality information is important. Continued research around sustainability, ESG and their internal and external impacts can improve understanding between companies, investors, and regulators. Other key stakeholder are preparers and investors, accounting profession, auditors and chartered accountants, stock exchanges, insurance companies, corporate and investor initiatives, initiatives outside of the EU.

2.6. *Support the new standard*:

a. Among the main initiatives included in the EU Action Plan of March 2018, the European commission has indicated to the European Financial Reporting Advisory Group (EFRAG) to set up a European Corporate Reporting Lab@EFRAG whose goal is to encourage innovation and development of best practices in corporate reporting, including environmental accounting. In this Lab, companies and investors can share best practices on sustainability reporting, such as climate communication in line with the recommendations of TCFD.

b. As indicated by Accountancy Europe in order to address financial and non-financial information reporting globally, the IFRS Foundation would be restructured to become an enhanced body with a broader corporate reporting mandate as well as a broader responsibility.

5. Digitisation

The EU has introduced a harmonised electronic format for reporting under the Transparency Directive (26). With effect from 1 January 2020 listed companies in the EU shall report their annual financial reports in XHTML (audited financial statements, management report and issuer's responsibility statements). Additionally, if the consolidated financial statements are prepared in IFRS, the XHTML document should also be tagged using iXBRL elements specified in the ESEF taxonomy.

Digital Reporting

5.1. Every major securities regulator, including ESMA, the SEC, the JFSA, and all the others, who have moved or are currently shifting financial reporting onto a digital footing, have chosen to use the Inline XBRL for reporting. Digital reports can simplify, also for EU Sustainable Taxonomy, review and expand the universal controls for auditors to audit and/or assurance purposes. Professionals in this field should be thinking of the many ways digital reports can enhance their roles as a new era of interconnected reporting is arriving.

Ensuring that also non-financial information is available in a digital format

5.2. *Benefits for investors and analysts*: allows the information to be machine-readable and is expected to ensure the investors and financial analysts a broad number of benefits, including cost saving for users of financial reports, greater speed, reliability and accuracy of data handling, improved analysis, and better quality of information for the decision-makers.

5.3. *EU Sustainable Finance*: the use of the standard XBRL taxonomies would operate not only in technical terms, but potentially also in conceptual terms, favouring i) the standardization of non-financial information (NFRD - 2014/95/EU), ii) to achieve the climate change mitigation and adaptation objectives (EU Taxonomy – Technical Report March 2020) and iii) the adoption of new climate Benchmarks (EU September 2019).

5.4. *Standardisation*: the definition of a digital standard must be related to the request of a non-financial reporting standard (section 2.Standardisation) and attention must be paid to the recommendations of the TCFD to manage climate risks and opportunities.