

OSSERVATORIO ESG

Andrea Gasperini
Head of Sustainability Aiaf

Sonia Artuso
Financial Analyst CESGA, CIIA, CEFA

Date 15 July 2021 n. 136
<https://www.aiaf.it/osservatorio-esg>

andrea.gasperini@aiaf.it
sonia.artuso@aiaf.it



AIAF, Standard setter for Financial Analysis, with round 1000 members in Italy and, under the coordination of EFFAS “The European Federation of Financial Analysts Societies”, operating in 23 European countries with round 16000 members welcomes the opportunity to provide some feedback on the recent EU proposal to review the Non-Financial Reporting Directive (NFRD), renamed as the “Corporate Sustainability Reporting Directive” (CSRD) as of 21 April 2021.

AIAF FEEDBACK EU PROPOSAL CSRD

Introduction

We recognize that this proposal represents an important step towards harmonized sustainability reporting throughout Europe and supports, therefore, the EU mandate to EFRAG to initiate as soon as possible the technical work necessary to develop draft sustainability reporting standards and we would like to call attention in particular to the key aspects summarized below and expanded upon in the attachment which should be considered before the application of the new Directive¹.

1. Consistency

AIAF believes the most critical phase of CSRD and the upcoming EFRAG-standards is to secure consistency with other EU requirements for the financial sector - both for investment and financing activities and not only in terms of content, but also of timing and scope.

In our view, it is of extreme importance to guarantee full consistency between CSRD and the broader EU sustainable finance framework, which includes the Sustainable Finance Disclosure Regulation (SFDR) 2019/2088 and the Taxonomy Regulation (TR) 2020/852, but also adjacent legislation such as the Shareholders Rights Directive II, the scheduled reviews of MiFID and UCITS/AIFMD and the planned EU Sustainable Corporate Governance, hoping they can contribute significantly to improving sustainability in the economy. However, neither the timings nor the concepts of these different pieces of legislation are fully synchronized or aligned with one another.

Weak synchronization and synergy between different EU legislative initiatives associated with sustainability disclosures create a significant challenge for firms in both identifying and understanding the co-dependencies (or conflicts) between the differing disclosure expectations that will impact them.

Other sustainability initiatives that must be connected with CSRD are the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD) the European Central Bank (ECB) Guidelines on climate-related environmental risks and the changes proposed to Pillar 3 disclosures under the Capital Requirements Directive (CRD) and the Capital Requirements Regulation (CRR).

Even dialogues with international institutions must be brought forward as sustainable awakening and subsequent disclosure initiatives are pressing on all sides of the planet. With the Biden administration, the western side of the world has also awakened. We emphasize the importance of the EU international platform in this context and the importance of coordinating not only the standards, metrics and units of measurement of sustainable KPIs but also the different taxonomies that are taking shape (EU and China at the moment), and in the future we also expect UK and US.

The IFRS Foundation is currently working to coordinate, rationalize and harmonize the many existent non-financial reporting initiatives, create a core set of global metrics for non-financial information and also provide an effective connection between financial and non-financial reporting,

¹ Feedback from: AIAF - Associazione Italiana per l'Analisi Finanziaria
https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12129-Corporate-Sustainability-Reporting/F2662160_en, 13/07/2021

aiming to assess the aptitude of corporates to create profit and secure the future of people and the planet. The quickest progress could be made by building on the best of non-financial information frameworks and standards to facilitate a high-quality and consistent sustainability disclosures.

The consistency has to be assured at the double level of contents and timing to avoid administrative burden, reduce costs on companies and optimize the efforts of companies to comply with multiple legislations. As for the contents, it is essential to avoid duplication and redundant reporting and regarding the timing, the timelines of CSRD, SFDR and TR should be aligned.

2. Timeline

Companies should have sufficient time to prepare for new disclosure requirements. In this respect, AIAF notices that the timeline defined by the Commission and EFRAG is very ambitious and there is a high risk of not leaving enough time for companies to adapt their internal systems and procedures. If this is the case, a postponement of the adoption of the CSRD may be essential.

The timeline should be reconsidered in favor of practical adoption and the support of consultants and auditors who follow companies, especially SMEs, in the path with training and accompanying activities, useful as the costs for SMEs are significant and therefore they need help.

The core version of the EU Sustainability Reporting Standards needs to be published by 31 October 2022 and applied just two months later. In addition, another supplementary and sector-specific standard will be published by 31 October 2023. New reporting companies in particular need adequate time after the final standards have been adopted by the EC in order to carry out high-quality implementation.

In order to be able to respect the timetable for first time application, realistic sustainability reporting standards are needed, which should be announced in adequate time before first-time application. Implementation of the disclosure format and the contents of reporting to the Information Technology (IT) systems alone will require an extensive lead time. IT-based implementation must be completed before the start of the first reporting period beginning 1 January 2023.

The more granular is the information to be reported, the more work is required for the adoption and it is better to start with a few simple and clearly defined parameters. The digital disclosure format, including the tagging of sustainability reporting, will require further time for initial application. Based on the knowledge gained during the

application of the European Single Electronic Format (ESEF), a project of at least one year will be needed for the first-time tagging of report contents. Therefore, the reporting requirements must be known with a lead time of at least one year so that the reporting processes and reporting formats can be implemented before the first reporting period.

We hold necessary a full alignment on content, scope, application data, reporting frequency and transition period to allow financial and credit institutions the necessary time to access, assess and make use of the sustainability data. The disclosures of financial institutions depend on the availability of data published by their counterparties; accordingly, banks should start reporting in accordance with this Directive after at least one year has elapsed from the first disclosures made by non-financial companies.

3. Scope of application (small and medium-sized enterprises)

AIAF welcomes the proportionality of the CSRD for SMEs and supports an expansion of the scope which would cover 4,2 times the number of companies compared to the current directive coverage scope, but still, we have two concerns with this: i) timing, and ii) knowledge-gaps. About the scope, we agree with more companies reporting sustainability information to a common standard. In principle, users will benefit from better access to comparable, relevant and reliable sustainability information.

However, there is a risk that increasing the scope over a too short timeline may create a situation where there are more reporting companies but at a poorer quality of the data due to lack of understanding or time to recognize what it is they must disclose. While we appreciate the urgency of action related specifically to the climate, and ESG factors more generally, we think there may be some benefit allowing a revision of the short timeline. The point on timeline is mainly important considering there will be possibly arising knowledge-gaps among companies that now need to report according to an EU standard.

A balanced reporting standards for SMEs should be designed to help SMEs to meet information demands at corporate level, initially from credit institutions and larger supply chain partners and should also be useful to define a minimum set of information which can reasonably be expected from SMEs.

4. Mandate to EFRAG for EU Sustainability reporting standard

It is indisputable that the European Union has already a leading position in increasing sustainability standard levels and, therefore, AIAF welcomes the European Commission's mandate to EFRAG to initiate as soon as possible the technical work necessary to develop draft sustainability reporting standards.

We welcome the purpose to introduce a modular standard for sustainability reporting, that expands with granularity on various sustainable aspects for larger companies, while in the essential modules it must initially be both simpler and leaner for SME. In this manner creating comparable data for all European companies we support the intended introduction of a tailored reporting standard for small and medium-sized enterprises. However, we would like to point out that a number of international standards and frameworks for sustainability reporting already exist and EFRAG has an essential role to rationalize this landscape.

5. Option of a sustainability report separate from the management report

The management report shall give a true and fair view of assets, liabilities, financial position and profit or loss and also the FSB TCFD recommends that preparers of climate-related financial disclosures provide such disclosures in their mainstream annual financial filings. We agree that important financial and sustainability information must be disclosed in the management report but we do not consider mandatory to remove the possibility for Member States to allow companies to report the required information in a separate report that is not part of the management report.

We recognize the importance of ESG disclosures for investors, but other stakeholders would also be interested in this information and not many of them can easily understand a management report. Therefore from a technical point of view, we support the possibility of continuing to report sustainability information separately from the management report to avoid increasing its content, the risk of inadequate reporting of sustainability data due to time pressure and make more difficult to appoint a separate auditor for sustainability matters.

We think it is important to retain the companies' flexibility to tailor the disclosure of Sustainability information to their users and avoid information overload in the management report.

6. Double materiality

We agree with the proposed Directive which specifies the principle of double materiality, removing any ambiguity and clarifying that companies must report the information necessary to understand how sustainability issues have a direct impact on them and also the information necessary to understand the corporate impact on the ESG issues.

AIAF believes that in order to promote a standard for sustainability reporting needs to refer to a notion of double materiality that is capable of seizing both the impacts that ESG factors have on the reporting entities as well as the impacts that such entities have on the environment.

Such double perspective is the key for a complete representation of an entity's position and performance in the ESG area and the work that is already being performed in the EU should set concrete bases to the process of integrating double materiality in a European standard.

Double materiality is better placed to render a fair reporting able to meet a wider range of stakeholders' expectations particularly on the investors' side. It provides a more accurate picture of how companies are affecting the environment/community in which they operate and on the other hand, offers the opportunity for companies to demonstrate to investors how they are embedding non-financial elements into their business models in a sustainable and successful way.

It should also be considered that the company operates in a specific economic-political context and the same concept of double materiality evolves with the change of this context. The notion of a dynamic materiality is already beginning to be established and this will allow to define both a standard but also the ability to grasp the peculiarity of the context in which the company operates.

7. Digital format and machine-readable data

Adopting a common digital language to consolidate technical content of the standard reporting is essential to make the interoperable building blocks more easily accessible through a digital language but reporting entities will likely need some guidance on this process.

Digitalization of sustainability reporting should be undertaken in a holistic manner with electronic filings foreseen in other legislations and should not be in conflict with existing electronic filing regimes in member states and there are still opportunities for improvement to harmonize electronic filing in the EU.

The present proposal contains a requirement to use a standardized machine-readable digital format established by Delegated Regulation (EU) 2018/815.

Tagging the data in the ESEF format sets challenges even for large capital market-oriented companies and, especially if the scope of application of NFRD is extended, although the motivation to use machine-readable digital ESG data is understandable, the possibility to mitigate the costs, find external service providers, offer practicable solutions and companies must be supported in the implementation and the experience of XBRL Europe could be useful. On the contrary, electronic tagging involves a great deal of effort and considerable costs.

We notice that tagging of the sustainability report is not a prerequisite for the introduction of a European Single Access Point, which is also mentioned in the Commission staff working document impact assessment accompanying the CSRD, the documents are today already submitted to ESAP in standard file formats to various registries and can be sufficiently evaluated in these file formats.

These obligations, in the first adoption, should be limited to all undertakings listed on regulated markets, both for reasons of proportionality and in line with the ESEF provisions and gradually be mandatory for small and medium-sized enterprises.

8. Requirements for success

For this reform to be a success, it is helpful to improve the Board's responsibilities and the level of management responsibility should be the same for financial and sustainability information.

We hold necessary to prioritize a specific integration of TCFD risks and opportunities recommendations into the standard: the integration is particularly relevant for climate change, where the TCFD recommendations have achieved considerable momentum towards becoming a standard and has attracted great support from investors, companies, regulators, policy makers and civil society.

It is important that the use of scenarios will be implemented as quickly as possible to get to net carbon as required by, but not only, the recent European EU climate law and consistent data and tools are needed (i.e. scope 3)

ANNEX I

European commission references

- DIRECTIVE 2014/95/EU OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups 15.11.2014
- INFORMATION FROM EUROPEAN UNION INSTITUTIONS, BODIES, OFFICES AND AGENCIES EUROPEAN COMMISSION COMMUNICATION FROM THE COMMISSION Guidelines on non-financial reporting (methodology for reporting non-financial information) (2017/C 215/01) 5.7.2017
- INFORMATION FROM EUROPEAN UNION INSTITUTIONS, BODIES, OFFICES AND AGENCIES EUROPEAN COMMISSION COMMUNICATION FROM THE COMMISSION Guidelines on non-financial reporting: Supplement on reporting climate-related information (2019/C 209/01 20.6.2019
- European Reporting Lab@EFRAG Final report: proposals for a relevant and dynamic EU sustainability reporting standard setting. February 2021
- COMMISSION STAFF WORKING DOCUMENT Fitness Check on the EU framework for public reporting by companies Accompanying the document Report from the Commission to the European Parliament, the Council and the European Economic and Social Committee on the review clauses in Directives 2013/34/EU, 2014/95/EU, and 2013/50/EU, COM(2021) 199 final Brussels, 21.4.2021
- REPORT FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT, THE COUNCIL AND THE EUROPEAN ECONOMIC AND SOCIAL COMMITTEE on the review clauses in Directives 2013/34/EU, 2014/95/EU, and 2013/50/EU COM(2021) 199 final Brussels, 21.4.2021
- European Commission, Study on the Non-Financial Reporting Directive Final report 2021-04-08
- Proposal for a Directive of the European Parliament and of the Council amending Directive 2013/34/EU, Directive 2004/109/EC, Directive 2006/43/EC and Regulation (EU) No 537/2014, as regards corporate sustainability reporting COM/2021/189 final Brussels, 21.4.2021