ECSDA
European Central Securities Depositories Association

Brussels, 11 June 2020

ECSDA RESPONSE TO THE EUROPEAN COMMISSION CONSULTATION ON THE REVIEW OF THE NON-FINANCIAL REPORTING DIRECTIVE (NFRD)

Pease note that the consultation is in a form of a survey. Below are the questions, the related Commission's considerations and the responses to the questions which ECSDA found relevant for it to respond to.

ECSDA responses are provided in a light blue bold format.

1. QUALITY AND SCOPE OF NON-FINANCIAL INFORMATION TO BE DISCLOSED

Question 1.: To what extent do you agree or disagree with the following statements about possible problems with regard to non-financial reporting?

	1	2	3	4	5	Don't know
The lack of comparability of non-financial information reported by companies pursuant to the NFRD is a significant problem					**X**	
The limited reliability of non-financial information reported by companies pursuant to the NFRD is a significant problem					**X**	
Companies reporting pursuant to the NFRD do not disclose all relevant non-financial information needed by different user groups.					**X**	

(1= mostly disagree, 2= mostly disagree, 3= partially disagree and partially agree, 4= mostly agree, 5= totally agree)

Question 2.: Do you consider that companies reporting pursuant to the NFRD should be required to disclose information about other non-financial matters in addition to those currently set-out in Article 19a? ***Please specify (no more than three matters).***

ECSDA Response:

Other non-financial matter #1	**Define environmental matters on the basis of the six objectives set out in the taxonomy regulation, please see Q7**
Other non-financial matter #2	**The disclosure requirements should be aligned with those introduced via the taxonomy regulation article 8 on "Transparency of undertakings in non-financial statements" and specially streamlined with the upcoming delegated act specifying the**

	content and presentation of the information to be disclosed by companies in scope of the NFRD
Other non-financial matter #3	-

For each of the four non-financial matters identified in Article 19a of the Accounting Directive, and subject to the company's own materiality assessment, companies are required to disclose information about their business model, policies (including implemented due diligence processes), outcomes, risks and risk management (including risks linked to their business relationships), and key performance indicators (KPIs) relevant to the business.

Question 3.: Are there additional categories of non-financial information related to a company's governance and management procedures, including related metrics where relevant, (for example, scenario analyses, targets, more forward-looking information, or how the company aims to contribute to society through its business activities) that companies should disclose in order to enable users of their reports to understand the development, performance, position and impacts of the company? ***Please specify (no more than three).***

	Please specify which additional categories of non-financial information (no more than 3):
Additional category of non-financial information #1	**The Boards accountability for sustainability performance, including compensation.**
Additional category of non-financial information #2	**Specific actions around climate risk**
Additional category of non-financial information #3	**More link of KPIs to a company's core business**

In addition to the provisions of the NFRD, several other EU legislative acts require disclosures of sustainability-related information for financial sector entities:

- The Regulation on prudential requirements for credit institutions requires certain banks to disclose ESG risks as of 28 June 2022.
- The Regulation on sustainability- related disclosures in the financial services sector requires financial market participants to disclose their policies on the integration of sustainability risks in their investment decision- making process and the adverse impacts of investment decisions on sustainability factors, as of 10 March 2021.
- The Regulation establishing a framework to facilitate sustainable investment (the Sustainable Finance Taxonomy) creates new reporting obligations including for companies subject to the NFRD, starting in December 2021.

Question 5.: To what extent do you think that the current disclosure requirements of the NFRD ensure that investee companies report the information that financial sector companies will need to meet their new disclosure requirements?

ECSDA Response:

Not at all	To some extent but not much	To a reasonable extent	To a very great extent	Don't know
	X			

In order to ensure that the financial sector entities comply with the new disclosure requirements, laid down in the different pieces of legislation, in the most effective and efficient manner, there might be scope for better coherence between the different disclosure requirements and for better aligning the information required to investees and the one financial sector entities need to report themselves, e.g. as regards sustainability impacts.

Question 6.: How do you find the interaction between different pieces of legislation (You can provide as many answers as you want)

It works well	There is an overlap	There are gaps	There is a need to streamline	It does not work at all	Don't know
			X		

Question 7.: In order to ensure better alignment of reporting obligations of investees and investors, should the legal provisions related to non-financial reporting define environmental matters on the basis of the six objectives set-out in the taxonomy regulation: (1) climate change mitigation; (2) climate change adaptation; (3) sustainable use and protection of water and marine resources; (4) transition to a circular economy (5) pollution prevention and control; (6) protection and restoration of biodiversity and ecosystems?

Yes	No	Don't know
X		

Please provide any comments or explanations to justify your answers to questions 1 to 7.

ECSDA Response:

We believe that markets are a key leveraging factor when it comes to critical societal challenges, such as climate change. We, therefore, support the Sustainable Finance agenda and the objectives of reorienting capital flows to sustainable investments, managing financial risk related to climate change and fostering transparency and 'long-termism' in financial and economic activity.

The review of the Non-Financial Reporting Directive should focus on increasing the quality and availability of non-financial data by strengthening and harmonizing provisions. For example, by making sure that legal provisions related to non-financial reporting define environmental matters on the basis of the six objectives set out in the taxonomy regulation and by developing an EU-wide ESG reporting standard. Rather than simply extending the reporting obligation for companies, the

definition of explicit ESG standards for companies under the NFRD is necessary to ensure that reliable, comparable and relevant non-financial information are disclosed.

Generally speaking, quality and comparability of companies' sustainability reporting under the current NFRD is not sufficient to understand their impacts, risks, or even their plans. Gaps in data, particularly regarding smaller and unlisted companies, as well as inconsistencies in the methods and a lack of validation (e.g. by the auditor), impede comprehensive integration of relevant and material sustainability factors into investment and/or credit processes.

In the context of the sustainable finance agenda, many new reporting requirements have been agreed in various files (Benchmarks, Disclosure, Taxonomy) and are now discussed within NFRD and Green Bonds. In this context, it is important to consider streamlining requirements of different reporting obligations to avoid creating parallel but slightly different disclosure requirements, which would risk introducing legal uncertainty and a disproportionate regulatory burden by creating additional work for companies. ECSDA, therefore, supports linking the taxonomy to the NFRD and believes there would be further scope to ensure companies only need to adhere to one set of reporting requirements related to sustainable finance.

Finally, with regard to question 5, our view is that the current reporting requirements are too fragmented and difficult to interpret – they also differ widely per country. It would be more efficient to have one set of clear, global standards.

2. STANDARDISATION

Question 8.: In your opinion, to what extent would a requirement on companies to apply a common standard for non-financial information resolve the problems identified?

Not at all	To some extent but not much	To a reasonable extent	To a very great extent	Don't know
			X	

Question 9.: In your opinion, is it necessary that a standard applied by a company under the scope of the Non-Financial Reporting Directive should include sector-specific elements?

Yes	No	Don't know
X		

A number of non-financial reporting frameworks and standards already exist. Some, including the standards of the Global Reporting Initiative (GRI), the framework of the International Integrated Reporting Council (IIRC), and the standards of the Sustainability Accounting Standards Board (SASB), aim to cover most or all relevant non-financial issues

Question 10.: To what extent would the application of one of the following standards or frameworks, applied on its own, resolve the problems identified while also enabling companies to comprehensively meet the current disclosure requirements of the Non- Financial Reporting Directive, taking into account the double-materiality perspective (See section 4)?

	1	2	3	4	Don't know
Global Reporting Initiative				X	

Sustainability Accounting Standards Board			X		
International Integrated Reporting Framework					
Another Framework standard *					

1= not at all, 2= to some extent but not much, 3= to a reasonable extent, 4= to a very great extent

*Please specify other framework or standard (no more than three, rating it/them from 1 to 4).

Question 11.: If there were to be a common European non-financial reporting standard applied by companies under the scope of the NFRD, to what extent do you think it would be important that such a standard should incorporate the principles and content of the following existing standards and frameworks:

	1	2	3	4	Don't know
Global reporting initiative				X	
Sustainability accounting standards Board				X	
International Integrated Reporting Framework				X	
Task force on climate-related financial disclosures				X	
UN guiding principles reporting framework (human rights)				X	
CDP				X	
Carbon disclosures standards board					
Organisation environmental standards board					
Organisation environmental Footprint					
Eco-management and audit scheme					
Another framework or standard *					

1= not at all, 2= to some extent but not much, 3= to a reasonable extent, 4= to a very great extent

Question 12.: If your organisation fully applies any non-financial reporting standard or framework when reporting under the provisions of the NFRD, please indicate the recurring annual cost of applying that standard or framework (including costs of retrieving, analysing and reporting the information).

Name of standard and reporting (max 3)	Estimated cost of application per year, excluding any one-off start-up costs
Global Reporting Initiative	
-	
-	

Question 16.: In light of these responses, to what extent do you agree that the body responsible for developing a European non-financial reporting standard should also have expertise in the field of financial reporting in order to ensure "connectivity" or integration between financial and non-financial information?

Not at all	To some extent but not much	To a reasonable extent	To a very great extent	Don't know
			X	

3. APPLICATION OF THE PRINCIPLE OF MATERIALITY

Question 21: Do you think that the definition of materiality set-out in Article 2(16) of the Accounting Directive is relevant for the purposes of determining which information is necessary to understand a company's development, performance and position?

Not at all	To some extent but not much	To a reasonable extent	To a very great extent	Don't know
		X		

Question 24.: Should companies reporting under the NFRD be required to disclose their materiality assessment process?

Yes	No	Don't know
X		

Please provide any comments or explanations to justify your answers to questions 21 to 24.

ECSDA Response:

As a first point, we would like to stress the importance of aligning the concepts of double materiality with the provisions on principal adverse sustainability impact disclosures in the sustainable finance disclosure regulation. The sustainability risk concept should also be aligned with the disclosure regulation and the obligations on financial market participants in this regard.
Ideally, we would suggest that details on the determination of materiality are to be fleshed out with respect to the double materiality requirements. This is to be done in view of increasing transparency by way of an assessment of all the topics addressed in the NFRD for companies while simultaneously strengthening and easing the implementation of the "comply or explain" requirement which companies must satisfy. This would also result in greater clarity as to the requirements governing audit criteria and audit depth.
For users to understand the materiality assessment performed, issuers should disclose how the following aspects were taken into account: The information needs of different stakeholders and their relative importance, the selection of relevant time horizons and the probabilities associated with financial and non-financial impacts.
Furthermore, a concretization of the risk concept used against the backdrop of different stakeholder expectations (among them shareholders and civil society) is necessary relative to the material risks. Given different definitions of the concept of risk in correlation with the given application context, so far there has been a lack of clarity in corporate reporting. This has led to the risk of misinterpretations on the part of report preparers and users alike. Based on both the requirements and their experience in financial reporting, so far reporting companies have taken the concept of risk to mean deviations from plans and/or targets (outside-in perspective). In contrast, growing numbers of report users are also interested in assessments of the external risks in the sense of negative effects on people and the environment and/or climate (inside-out perspective).

4. ASSURANCE

Question 25.: Given that non-financial information is increasingly important to investors and other users, are the current differences in the assurance requirements between financial and non-financial information justifiable and appropriate?

Not at all	To some extent but not much	To a reasonable extent	To a very great extent	Don't know
	X			

5. DIGITISATION

Question 33.: To what extent do you agree or disagree with the following statements regarding digitalisation of non-financial information?

	1	2	3	4	Don't know
It would be useful to require the tagging of reports containing non-financial information to make them machine-readable.				X	
The tagging of non-financial information would only be possible if reporting is done against standards.				X	
All reports containing non-financial information should be available through a single access point.					

(1= totally disagree, 2= mostly disagree, 3= partially disagree and partially agree, 4= mostly agree, 5= totally agree)

Question 35.: Please provide any other comments you may have regarding the digitalisation of sustainability information:

ECSDA Response:

One of the biggest market challenges for Sustainable Finance is investors' access to reliable, comparable data to be able to make their impact on investment decisions. Having a standard that is also easily digitalized will facilitate their investment decisions and help grow the Sustainable Finance market.

We believe that digitalisation could help to expand and improve the reporting. The handling of science-based targets, climate stress tests, scenario analyses and disclosure by financial institutions of the compatibility of their portfolios with the reduction targets of the Paris Agreement on Climate Change will possibly be easier. This kind of forward-looking sustainability data is an important prerequisite for improved assessments of the risks and opportunities associated with the future viability of companies and their external effects on the environment.

Please provide any comments or explanations to justify your answers to questions 33 to 35.

ECSDA Response:
As a first point, we would like to highlight the importance of any extension of ESEF to NFRD should be subject to a proper impact assessment as the benefits of data analysis must be in line with the additional effort for issuers.

That being stated, ECSDA believes that digitisation is the key to enabling a broad and efficient use of non-financial data. Potential users of non-financial data would not be able to gather such data from classic, non-digital sources like annual reports – at least not efficiently and reliably.
From a report users' perspective, there are (in part considerable) obstacles to obtaining sustainability data. This requires taking steps which make it easier for them to sort through and process relevant sustainability data. At the same time, however, there should be no disproportionate burden on report preparers.

We recommend the incremental introduction of a standardised, digitised reporting format (e.g. XBRL) for fulfilling the sustainability reporting obligation in the EU as an additional measure. It serves first to match sustainability and financial reporting in respect of the format used. It also serves to improve the flow of information between companies and financial market players/databases and, in the long term, to make sustainability data a standard component of companies' (financial) reporting.

6. STRUCTURE AND LOCATION OF NON-FINANCIAL INFORMATION

Question 36.: Other consequences may arise from the publication of the non-financial statement as part of a separate report. To what extent do you agree with the following statements:

	1	2	3	4	5	Don't know
The option to publish the non-financial statement as part of a separate report creates a significant problem because the non-financial information reported by companies is hard to find (e.g: it may increase search costs for investors, analysts, ratings agencies and data aggregators).				X		
The publication of financial and non-financial information in different reports creates the perception that the information reported in the separate report is of secondary importance and does not necessarily have implications in the performance of the company				X		

[1= not at all, 5= to a very great extent]

Question 37.: Do you believe that companies should be required to disclose all necessary non-financial information in the management report?

Yes	No	Don't know
X		

Question 38.: If companies are allowed to publish the required non-financial information in a report that is separate from the management report, to what extent do you agree with the following approaches?

	1	2	3	4	5	Don't know
Legislation should be amended to ensure proper supervision of information published in separate reports.					X	
Legislation should be amended to require companies to file the separate report with Officially Appointed Mechanisms (OAMs).						
Legislation should be amended to ensure the same publication date for management report and the separate report.				X		

(1= totally disagree, 2= mostly disagree, 3= partially disagree and partially agree, 4= mostly agree, 5= totally agree)

Please provide any comments regarding the location of reported non-financial information.

ECSDA Response:
The form and structure of the presentation of non-financial information is uneven among companies. By default, sustainability-related information should be provided in a company's mainstream annual report, but the NFRD allows Member States to soften this requirement. This results in a split practice with many firms prioritizing a separate report which makes it hard for investors and other users to find relevant information even when it is reported. We, therefore, recommend to make reporting in the management report mandatory by removing the exemption to allow the non-financial statement to be reported outside the management report. We, however, understand that the work of properly integrating financial and non-financial reporting should not be underestimated, as it could result in additional costs and complexities for many companies.

Please provide any comments or explanations to justify your answers to questions 36 to 39.

ECSDA Response:
In addition to our comment above (Q 38.1), greater standardisation of the time and place of disclosures of sustainability data should be considered over the next few years, as this would enhance the comparability of sustainability data (e.g. in connection with the selected audit depth). This concerns the desirable, simultaneous and, in the best case, the integrated publication of both financial and sustainability data and/or the greater integration over time of sustainability data into companies' business and financial reporting.

According to the latest study on the current ESG Reporting of companies listed in the DAX index family, 49% of the issuers which are affected by the CSR RUG locate their NFE in the sustainability report, while 47% locate it in the (group) management report or as a separate report in the annual report outside the (group) management report.

7. PERSONAL SCOPE (WHICH COMPANIES SHOULD DISCLOSE)

8. SIMPLIFICATION AND REDUCTION OF ADMINISTRATIVE BURDENS FOR COMPANIES

The majority of Member States have transposed the NFRD requirements into national legislation making very few changes to the wording of the legal provisions. Therefore, in the majority of the national legal frameworks, companies are required to comply with national legislation that is quite high level, not very prescriptive and do not require the use of any particular reporting standard.

Question 45.: To what extent do you agree with the following statements?

	1	2	3	4	5	Don't know
Companies reporting pursuant to the NFRD face uncertainty and complexity when deciding what non- financial information to report, and how and where to report such information.					X	
Companies are under pressure to respond to individual demands for non-financial information from sustainability rating agencies, data providers and civil society, irrespective of the information that they publish as a result of the NFRD.					X	
Companies reporting pursuant to the NFRD have difficulty in getting the information they need from business partners, including suppliers, in order to meet their disclosure requirements.			X			

(1= totally disagree, 2= mostly disagree, 3= partially disagree and partially agree, 4= mostly agree, 5= totally agree)

Please provide any comments or explanations to justify your answers to questions 44 to 45.

ECSDA Response:

Companies face difficulties in reporting under the NFRD due to the following three reasons:

1. Companies, notably SMEs, are constrained by resources to gather, analyse and report the non-financial information requested by the NFRD.
2. The NFRD disclosure framework lacks specificity and clarity. Companies are left to determine which type of information they should be disclosing and how to calculate the indicators that are sought from financial market participants. Companies would like clear standards to help them maneuver in their disclosure of non-financial information.
3. The NFRD provides companies with guidelines on the elements to disclose, however, it is not necessarily clear for companies how to format the non-financial information to meet the financial market participants' expectations.

It is also important to note that companies face questions from financial market participants on their activities and possible links to their non-financial information. Companies are under pressure to respond to individual demands with elements of answers that cannot be provided under the current NFRD reporting framework.

In addition, companies reporting pursuant to the NFRD have difficulty in getting the information they need from business partners, including suppliers, in order to meet their disclosure requirements as it is difficult to get information from suppliers in the company's supply chain when the former are not covered by the NFRD.