BETTER FINANCE
The European Federation of Investors and Financial Services Users
Fédération Européenne des Épargnants et Usagers des Services Financiers

Ref: Review of the non-financial reporting directive (NFRD)

Link to consultation: https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12129-Revision-of-Non-Financial-Reporting-Directive/public-consultation

BETTER FINANCE Response

Executive Summary

Quality and scope of non-financial information to be disclosed	BETTER FINANCE welcomes this initiative of the European Commission (EC) to review the non-financial reporting directive. Currently, there are significant problems regarding the non-financial information disclosed by companies pursuant to directive 2014/95/EU. The review should enable a strong alignment with the **taxonomy regulation** and its technical standards which include thresholds and metrics. It is also essential to ensure that not only companies' policies are disclosed but also **the impact** of these policies. **Intangibles**[1] should also be included as they represent potential material impact for the company and the society as well. Finally, we advise for the creation of **sector specific KPIs** that allow to capture the metric differences within sectors.
Standardisation	Common standards would facilitate to address reporting issues and would allow the comparability of the information provided by companies. It would be advisable to have a **simplified framework for SMEs** as long as this is mandatory and will be able to assess the double materiality[2] of these companies. Therefore, a derogation from the 500 employees as scope criteria[3] for the SMEs should be considered. We also stress the need to include not only accounting experts but also **investor associations** and **civil society organizations** in the legislative process in order to ensure that the perspective of individual investors/shareholders as users of listed companies' reporting, and society at large is considered in the formulation of standards.
Application of the principle of materiality	The reviewed NFRD needs to clarify the definition and the scope of the" **double materiality[4]"**. At the moment, the directive focusses primarily on the financial risks derived by sustainability issues. The disclosure process should be based on a double materiality criterion defined as: • The potential/actual impact of sustainability risks on the financial performance, reputation and activities of the companies over the short and long-term • AND the potential/actual impact of sustainability risks generated by the company on the environment, society and local communities, over the short and long-term.

[1] Intangible assets for a company are defined as: Goodwill, intellectual property (patents, trademark, copyright), and brand recognition. These are in opposition to tangible assets which include land, equipment, machinery and inventory.

[2] "*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*" https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12129-Revision-of-Non-Financial-Reporting-Directive/public-consultation

[3] "*The disclosure requirements for non-financial information apply to certain large companies with more than 500 employees [..] Companies are required to disclose relevant, useful information that is necessary to understand their development, performance, position and the impact of their activity, rather than an exhaustive, detailed report. Furthermore, disclosures may be provided at group level, rather than by each individual affiliate within a group. EC Guidelines on non-financial reporting:*" https://ec.europa.eu/transparency/regdoc/rep/3/2017/EN/C-2017-4234-F1-EN-MAIN-PART-1.PDF

[4] See footnote n 2

Assurance	The lack of a common framework and standardized reporting requirements does not facilitate the audit assurance engagement. At the moment, there is multitude of standards and framework, and the role of the auditor on non-financial reporting is not clear. Therefore, as there are already different divergent practices, it is necessary **to streamline assurance practitioners' approaches** based on requirements aligned with taxonomy (metrics, standards, thresholds, evidence).
Digitisation	Digitisation could generate benefits, such as **comparability and accessibility**. However, it is crucial to ensure that the digital tagging process does not undermine the whole process and will facilitate the analysis of sustainability risks of the companies. The tagging of non-financial information would only be possible if reporting is compliant with standards. Therefore, coordination and harmonization with the taxonomy is crucial on this aspect. The centralization of information via a single access point would facilitate the accessibility of the information for investors.
Structure and location of non-financial information	BETTER FINANCE believes that the information on non-financial reporting should be **mandatory and easily accessible** in the annual management report of the company. The standardization of the information provided in the annual report is essential in order to ensure comparability, therefore disclosure of information in documents that are outside the legal mandate of national authorities should be presented separately. Otherwise, it would undermine the transparency and the assessment of these information.
Scope of the directive (which companies should disclose)	Considering the **differences between financial institutions and non-financial companies**, the scope's threshold[5] needs to be defined according to these differences. For financial institutions, exposure in terms of investments and financial aspects (balance sheet and turnover) is more relevant than the number of employees. For example, many asset managers and private equity firms have a small number of employees.
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 not very prescriptive and does not require the use of any particular reporting standard. In order to overcome some of the aforementioned issues we would advise to carefully consider and assess changing the choice of legislative instrument from a directive to a regulation (as this on the one hand would guarantee a stronger enforcement of rules including a better harmonization of rules across member states, but on the other hand could result in the minimum harmonization approach). If on the one hand, reporting requirements should not increase burden for companies, on the other hand companies are under pressure to respond to demands of rating agencies, data providers etc. Therefore, clear underlying standards are crucial and necessary to clarify what information companies need to provide.

[5] "*The NFRD currently applies to large Public-Interest Entities (PIEs) with more than 500 employees. In practice this means large companies with securities listed in EU regulated markets, large banks (whether listed or not) and large insurance companies (whether listed or not) – all provided that they have more than 500 employees.*
The Accounting Directive defines large undertakings as those that exceed at least two of the three following criteria:

(a) *balance sheet total: EUR 20 000 000;*
(b) *net turnover: EUR 40 000 000;*
(c) *average number of employees during the financial year: 250.*

Some Member States have extended the personal scope of the NFRD by lowering the threshold to 250 employees, in effect capturing all large PIEs." https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12129-Revision-of-Non-Financial-Reporting-Directive/public-consultation

Contents

About BETTER FINANCE

BETTER FINANCE, the European Federation of Investors and Financial Services Users, is the public interest non-governmental organisation advocating and defending the interests of European citizens as financial services users at the European level to lawmakers and the public in order to promote research, information and training on investments, savings and personal finances. It is the one and only European-level organisation solely dedicated to the representation of individual investors, savers and other financial services users.

BETTER FINANCE acts as an independent financial expertise and advocacy centre to the direct benefit of European financial services users. Since the BETTER FINANCE constituency includes individual and small shareholders, fund and retail investors, savers, pension fund participants, life insurance policy holders, borrowers, and other stakeholders who are independent from the financial industry, it has the best interests of all European citizens at heart. As such its activities are supported by the European Union since 2012.

Instructions on how to read this paper: this document contains the response of BETTER FINANCE to the European Commission's online survey (public consultation) concerning the review of the non-financial reporting directive but this is not the actual response form submitted.[6] For each section summaries and explanations (*in italic*) are reported exactly as in the EC consultation document.[7]

Introduction

Background information on the Non-Financial Reporting Directive

The Non-Financial Reporting Directive (Directive 2014/95/EU, the "NFRD") 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. Companies under the scope of the NFRD had to report according its provisions for the first time in 2018 (for financial year 2017).[8]

What the *Directive 2014/95/EU- Non-financial reporting directive* already covers?

[7] https://ec.europa.eu/info/sites/info/files/business_economy_euro/company_reporting_and_auditing/documents/2020-non-financial-reporting-directive-consultation-document_en.pdf
[8] https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12129-Revision-of-Non-Financial-Reporting-Directive

- *Scope:* It applies to large Public Interest Entities with more than 500 employees.
- *Content*: Identifies four sustainability issues (environment, social and employee issues, human rights, and bribery and corruption) and with respect to those issues it requires companies to disclose information about their **business model, policies** (including implemented due diligence processes), **outcomes, risks and risk management, and key performance indicators (KPIs)** relevant to the business.
- *It does not*:
    - Introduce or require the use of a non-financial reporting standard or framework,
    - Impose detailed disclosure requirements such as lists of indicators per sector.

Additional document published by the EU in regard to reporting guidelines:

- Non-binding guidelines for companies on how to report non-financial information.
- Guidelines on reporting climate-related information, which integrate the recommendations of the Task Force on Climate-related Financial Disclosures, as part of the Sustainable Action Plan.

Current context

Non-financial information is extremely important in particular for the investment community, and its demand is increasing very substantially and very quickly. The demand for meaningful information is driven by institutional and individual investors to better understand the sustainability of the companies. This information is necessary to assess the sustainability risk of issuers that compose sustainable financial products that seek to address environmental and social problems.

According to the public consultation on corporate reporting carried out in 2018[9] there are persistent issues preventing an adequate disclosure of non-financial information:

- Reported non-financial information is not sufficiently comparable or reliable.[10]
- Companies do not report all non-financial information that users think is necessary, and many companies report information that users do not think is relevant.[11]
- Some companies from which investors and other users want non-financial information do not report such information.[12]
- It is hard for investors and other users to find non-financial information even when it is reported.[13]

In addition, companies face uncertainty and complexity when deciding what non-financial information, they have to report and where it should be reported. This complexity could also be driven by different disclosure requirements contained in different pieces of EU legislation.

In European Green[14] deal the European Commission has committed to review the non-financial directive in 2020 in order to reinforce its strategy on the sustainable finance. The revision of the non-financial directive should help to improve the transparency of sustainable investments.

---

[9] https://ec.europa.eu/info/consultations/finance-2018-companies-public-reporting_en
[10] *Ibid.*
[11] *Ibid.*
[12] *Ibid.*
[13] *Ibid.*
[14] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=COM%3A2019%3A640%3AFIN

Consultation questions

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 Directive 2014/95/EU ("the Non-Financial Reporting Directive" or NFRD). Likewise, ESMA's 2018 Activity Report gathers evidence that shows there is significant room for improvement in the disclosure practices under the NFRD.

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)

Article 19a of the Accounting Directive (which was introduced into the Accounting Directive by the NFRD) currently requires companies to disclose information about four non-financial matters, if deemed material by the particular company: (i) environment, (ii) social and employee issues, (iii) human rights, (iv) bribery and corruption. These correspond to the "sustainability factors" defined in Article 2(24) of Regulation (UE) 2019/2088 on sustainability-related disclosures in the financial services sector.

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).

Additional Governance criteria, in particular alignment with the shareholder rights directive. For example, there should be a clear link between sustainability objectives (KPIs) and executive remuneration that would ensure behavioural changes.

2.

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).

1. Alignment with the taxonomy: the directive needs to include thresholds and rationales of the criteria in the taxonomy and information that are related to the non-significant harm and adaptation activities.

2. Additional metrics: CO_2 emissions are not the only GHGs which contribute to climate change and global warming. In order to have a more effective reporting, the directive should consider other GHGs emitted by companies such as methane (CH_4), nitrous oxide (N_2O), the hydrofluorocarbons (HFC), perfluorocarbons (PFC), and sulfur hexafluoride (SF_6).

3. Targets: companies should define and disclose specific targets and measures in line with their sustainability strategy and to report their progress accordingly. The set of targets need to be aligned with international conventions as Paris agreement or the Sustainable Development Goals.

Investment in intangible assets currently represents the majority of investment carried out by the private sector in advanced economies.[151] There is a long-standing debate about the need for better reporting of intangible investments in company reports, including in relation to sustainability.[16] Irrespective of the potential future changes to accounting standards, it is likely to remain the case that a significant proportion of intangible assets will fail to meet the definition of an asset or the criteria for recognition as an intangible asset in the financial statements. The Accounting Directive currently makes no explicit reference to intangible assets in the Articles concerning the management report, other than the requirement to report about activities in the field of research and development in Article 19(2)(b).

15 https://voxeu.org/article/productivity-and-secular-stagnation-intangible-economy

16 The European Financial Reporting Advisory Group (EFRAG) is currently carrying out a research project on this topic. See http://www.efrag.org/Activities/1809040410591417/EFRAG-research- project-on-better-information-on-intangibles. The United Kingdom's Financial Reporting Council issued a consultation document about business reporting of intangibles in 2019. See https://www.frc.org.uk/news/february-2019/consultation-into-improvements-to-the-reporting-of.

Question 4.: In light of the importance of intangibles in the economy, do you consider that companies should be required to disclose additional non-financial information regarding intangible assets or related factors (e.g. intellectual property, software, customer retention, human capital, etc.)?

Yes	No	Don't know
X		

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?

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.

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	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.

We believe that KPIs should not be based on one size fit all approach. The directive should provide sector specific KIPs that allow to capture differences among economic sectors.

In order to ensure reality and trustworthiness of the information provided by the companies KPIs need to be based on scientific and factual data. The definition of metrics and the rationale has to be anchored to a common methodology in order to guarantee the comparability of the information provided by the companies.

In this regard, the 6 environmental objectives of the taxonomy are the minimum requirement to align the taxonomy with the directive but it is necessary to take into account also the *do not significant harm assessment* during the review of the non-financial reporting. However, there is a time gap between the taxonomy and the NFRD, which does not allow to completely align the taxonomy with the new non-financial requirements. The Commission needs to ensure this alignment with the level 2 regulation of the Taxonomy.

It is also essential to ensure that not only company's policies are disclosed but also the impact of these polices. Intangibles should also be included as they represent potential material impact for the company but for the society as well.
Also, as mentioned already in answer to Q2 it should be possible to hold decision makers to account for making poor decisions and there should be a mechanism enabling behavioural changes of the boards and senior executives (such as including the sustainability risks in the KPIs used to calculate the senior executives' remuneration).

Standardisation

Note: in this section, the word "standard" is used for simplicity. This should not be read as a suggestion that all relevant reporting requirements must be specified in a single normative document. Rather, "standard" is merely used as a shorthand that could encompass a consistent and comprehensive set of standards. Reporting standards define what information companies should report and how such information should be prepared and presented.

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

<u>Question 8.</u>: 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

<u>Question 9.:</u> 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

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.

<u>Question 10.:</u> 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 <u>comprehensively</u> 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		X			
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

*Please specify other framework or standard (no more than three.)

	1	2	3	4
1.				
2.				
3.				

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

On 5 December 2019, the Economic and Financial Affairs Council adopted conclusions on deepening the Capital Markets Union, in which it invited the Commission to "consider the development of a European non-financial reporting standard ***taking into account international initiatives****".*

Most existing frameworks and standards focus on individual or a limited set of non- financial issues.

Examples include the recommendations of the Task Force on Climate- related Financial Disclosures (TCFD), the UN Guiding Principles Reporting Framework (human rights), the questionnaires of the CDP (formerly the Carbon Disclosure Project), and the standards of the Carbon Disclosure Standards Board (CDSB). Several approaches have also been developed at EU level in the environmental area, including the Organisation Environmental Footprint and reporting under the Eco-Management and Audit Scheme (EMAS).

<u>Question 11.:</u> 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 (TCFD)			X		
UN Guiding Principles Reporting Framework (human rights)			X		
CDP			X		
Carbon Disclosure Standards Board (CDSB)			X		
Organisation Environmental Footprint (OEF)			X		
Eco-Management and Audit Scheme (EMAS)			X		
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

*Please specify other framework or standard (no more than three).

	1	2	3	4	5
1.					
2.					
3.					

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

<u>Question 12.:</u> 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 or framework (max 3)	Estimated cost of application per year, excluding any one-off start-up costs.

Small and Medium-Sized Enterprises (SMEs) often do not have the technical expertise nor resources necessary to prepare reports in accordance with state-of-the-art, sophisticated standards. This may imply that requiring SMEs to apply the same standards as large companies may be a disproportionate burden for SMEs.

At the same time, many SMEs are under increasing pressure to provide certain non- financial information to other businesses, in particular if they are suppliers of large companies. In addition, financial institutions are increasingly likely to request certain non-financial information from companies to whom they provide capital, including SMEs. In this respect, SMEs that do not provide non-financial information may experience a negative impact on their commercial opportunities as suppliers of larger companies or on their access to capital, and may not be able to benefit from new sustainable investment opportunities.

<u>Question 13.:</u> In your opinion, would it be useful for there to be a simplified standard and/or reporting format for SMEs?

Yes	No	Don’t know

<u>Question 14.:</u> To what extent do you think that a simplified standard for SMEs would be an effective means of limiting the burden on SMEs arising from information demands they may receive from other companies, including financial institutions?

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

<u>Question 15.:</u> If the EU were to develop a simplified standard for SMEs, do you think that the use of such a simplified standard by SMEs should be mandatory or voluntary?

Mandatory	Voluntary	Don’t know

In the responses to the Commission’s public consultation on public corporate reporting carried out in 2018, just over half of the respondents believed that integrated reporting could contribute to a more efficient allocation of capital and agreed that the EU should encourage integrated reporting.

<u>Question 16.:</u> 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

<u>Question 17.:</u> The key stakeholder groups with an interest in and contributing to the elaboration of financial reporting standards have historically been investors, preparers of financial reports (companies) and auditors/accountants. To what extent to do you think that these groups should also be involved in the process of developing a European non- financial reporting standard?

	1	2	3	4	Don't know
Investors				X	
Preparers			X		
Auditors/accountants			X		

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

<u>Question 18.:</u> In addition to the stakeholders referred to in the previous question, to what extent to do you consider that the following stakeholders should be involved in the process of developing a European non-financial reporting standard?

	1	2	3	4	Don't know
Civil society representatives/NGOs				X	
Academics				X	
Other*				X	

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 categories (no more than three).**

	1	2	3	4
1.Consumer organizations			X	
2. Individual investor associations			X	
3.				

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

<u>Question 19.:</u> To what extent should the following European public bodies or authorities be involved in the process of developing a European non-financial reporting standard?

	1	2	3	4	Don't know
European Securities Markets Authority (ESMA)				X	
European Banking Authority (EBA)		X			
European Insurance and Occupational Pensions Authority (EIOPA)			X		

European Central Bank (ECB)		X			
European Environment Agency (EEA)				X	
Platform on Sustainable Finance[3]				X	
Other*					

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 European public bodies or authorities that you consider should be involved in the process of developing a European non-financial reporting standard (no more than three).**

	1	2	3	4
1.				
2.				
3.				

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

National accounting standards-setters of several EU Member States are represented in the European Financial Reporting Advisory Group (EFRAG), which acts as the EU's voice and technical advisor in relation to financial reporting.

<u>Question 20.:</u> To what extent to do you consider that the following national authorities or bodies should be involved in the process of developing European non-financial reporting standards?

	1	2	3	4	Don't know
National accounting standards-setters			X		
Environmental authorities		X			
Other*					

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 type of European public bodies or authorities that you consider should be involved in the process of developing a European non-financial reporting standard (no more than three).**

	1	2	3	4
1.				
2.				
3.				

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

Please provide any comments or explanations to justify your answers to questions 8 to 20.

PROPORTIONALITY: It would be useful to have a simplified framework/proportional standard for SMEs as long as this is mandatory and able to assess sustainability issues at company and societal level (double materiality). In addition, it would be necessary to derogate the scope of the directive for SMEs having an average number of employees lower than 500 but that have a critical impact on the environment, communities etc.

HARMONISATION: due to the broad categories of non-financial information to be disclosed to investors harmonisation is crucial to ensure comparability.

STANDARDISATION: i) would facilitate better understanding of what data is useful and streamline the data collection process within companies, ii) could improve company performance by better integrating NFI risks and opportunities, iii) could boost compliance efficiency by encouraging provision of standardised software interfaces (APIs) compatible with existing accounting systems.

Due to the specific characteristics of this framework, not only accounting experts but also civil society, consumer organizations and retail investor associations should be involved to ensure that the perspective of individual shareholders and society at large is considered in the formulation of standards.

Application of the principle of materiality

The NFRD requires companies to disclose information "to the extent necessary for an understanding of the development, performance, position and impact of [the company's] activities." This materiality principle implies that companies reporting pursuant to the NFRD must disclose (i) how sustainability issues may affect the development, performance and position of the company; and (ii) how the company impacts society and the environment. This is the double-materiality perspective.[17] The two "directions" of materiality are distinct although there can be feedbacks from one to the other. For example, a company that with severe impacts on the environment or society may incur reputational or legal risks that undermine its financial performance.

Material' information is defined in Article 2(16) of the Accounting Directive as "the status of information where its omission or misstatement could reasonably be expected to influence decisions that users make on the basis of the financial statements of the undertaking. The materiality of individual items shall be assessed in the context of other similar items." This definition is geared

[17] See also the Commission's non-binding guidelines on reporting climate-related information, section 2.2, page 4 https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52019XC0620(01)#page=4.

towards financial reporting, which is principally intended to serve the needs of investors and other creditors. By contrast, non-financial information serves the needs of a broader set of stakeholders, as it relates not only to the increasing impact of non-financial matters on the financial performance of the company, but also to its impacts on society and the environment. This may imply the need to provide an alternative definition of materiality for application in the context of non- financial reporting, or at least additional guidance on this issue.

<u>Question 21:</u> 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*?

No, not at all	To some extent but not much	To a reasonable extent	Yes, to a very great extent	Don't know

<u>Question 22.:</u> 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 impacts on society and the environment*?

No, not at all	To some extent but not much	To a reasonable extent	Yes, to a very great extent	Don't know

<u>Question 23.:</u> If you think there is a need to clarify the concept of 'material' non- financial information, how would you suggest to do so?

In the long term, ESG risks and opportunities can become financially material, and therefore should be integrated in financial decision-making. Public reporting of non-financial information enables investors/shareholders to gather public support for the issues at stake and make their case for engagement with corporate boards/ filing an ESG-related shareholder resolution. Public disclosure of potential impacts of sustainability risks/opportunities allows shareholders to make their own assessment as to their financial materiality.

Double materiality should be defined as the potential and/or the actual impact of sustainability risks on the performance, reputation and activities of the companies over the short and long-term (this includes also the financial materiality of the company). The second aspect of materiality should consider the potential and/or actual impact of sustainability risks outside the company (that includes the environment, society, communities etc.,) over the short and long-term. Therefore, the disclosure process should be based on a double materiality assessment based on a clear definition of these 2 aspects.

<u>Question 24.:</u> 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.

The definition of materiality in the NFRD is based primarily on the financial materiality for the company, therefore aspects that concern the impact of sustainability risks outside the company are not enough covered in the current legislation. In addition, it is necessary to specify the methodology for materiality disclosure that is identified and assessed over the short-term and the long-term. Companies should also be required to disclose how they define short-term and long-term.

Assurance

The NFRD requires that the statutory auditor or audit firm checks whether the non- financial statement has been provided if a firm falls within the scope of the Directive.

Article 34 of the Accounting Directive requires that the financial statements are audited, and that the statutory auditor or audit firm express an opinion whether the management report (i) is consistent with the financial statements for the same financial year; and (ii) has been prepared in accordance with the applicable legal requirements. Article 34 of the Accounting Directive also requires the statutory auditor or audit firm to state whether it has identified material misstatements in the management report and to give an indication of the nature of such material misstatements. However, the non-financial statement published pursuant to the NFRD – whether contained in the management report or a separate report – is explicitly excluded from the scope of Article 34 of the Accounting Directive. Consequently, the NFRD does not require any assurance of the content of the non-financial statement.

<u>Question 25.:</u> 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?

No, not at all	To some extent but not much	To a reasonable extent	Yes, to a very great extent	Don't know
X				

<u>Question 26.:</u> Should EU law impose stronger assurance requirements for non-financial information reported by companies falling within the scope of the NFRD?

Yes	No	Don't know
X		

There are two types of assurance engagement a practitioner can perform:

- *Reasonable assurance reduces the risk of the engagement to an acceptably low level in the given circumstances. The conclusion is usually provided in a positive form of expression and states an opinion on the measurement of the subject matter against previously defined criteria.*
- *Limited assurance engagements provide a lower level of assurance than the reasonable assurance engagements. The conclusion is usually provided in a negative form of expression by stating that no matter has been identified by the practitioner to conclude that the subject matter is materially misstated.*

Question 27.: If EU law were to require assurance of non-financial information published pursuant to the NFRD, do you think that it should require a *reasonable* or *limited* assurance engagement on the non-financial information published?

Reasonable	Limited	Don't know
X		

Question 28.: If EU law were to require assurance of non-financial information published pursuant to the NFRD, should the assurance provider assess the reporting company's materiality assessment process?

Yes	No	Don't know
X		

Question 29.: If assurance of non-financial information was required by EU law, should the assurance provider be required to identify and publish the key engagement risks, their response to these risks and any related key observations (if applicable)?

Yes	No	Don't know
X		

Question 30.: If assurance of non-financial information was required by EU law, do you think that assurance engagements should be performed based on a common assurance standard?

Yes	No	Don't know
X		

If you answered yes in reply to the previous question, please explain whether there is an existing assurance standard that could be used for this purpose or whether a new standard would need to be developed.

The first problem is the lack of a common framework and standardized reporting requirements that prevent the work of an assurance engagement. At the moment, prepares face difficulties with a multitude of standards and framework, and the role of the auditor on non-financial reporting is not clear. Therefore, as there are already different divergent practices, it is necessary to streamline assurance practitioners' approaches based on the new NFR requirement (metrics, standards, thresholds, evidence).

Nevertheless, the auditing requirements of non-financial information should have the same professional standard as the financial auditing.

<u>Question 31.:</u> Do you think that an assurance requirement for non-financial information is dependent on companies reporting against a specific non-financial reporting standard?

Yes	No	Don't know
	X	

<u>Question 32.:</u> If you publish non-financial information and that information is assured, please indicate the annual costs of such assurance.

If you provided an answer to the previous question, please describe the scope of the assurance services provided (issues covered, reasonable/limited, etc.).

Please provide any comments or explanations to justify your answers to questions 25 to 32.

There is an increasing pressure on companies from investors and other users to disclose NFI. As the current framework is unsatisfactory in terms of investor protection against greenwashing and misleading information, an independent auditing of such information is crucial to ensure that the information is correct and reliable. Consequently, auditing of NFI should have the same professional standard as the financial auditing.

Digitisation

The EU has introduced a structured data standard, the European Single Electronic Format (ESEF) under the Transparency Directive. 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. This allows the information to be machine-readable. This is expected to produce a number of benefits, including cost saving for users of annual financial reports, greater speed, reliability and accuracy of data handling, improved analysis, and better quality of information and decision-making.

Additionally, the Commission is exploring opportunities to establish a single access point for public corporate information. In this respect, the Commission expects the High-level Forum on CMU to examine this topic and formulate recommendations from the Capital Markets angle in the coming months.

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

	1	2	3	4	5	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.				X		

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

<u>Question 34.:</u> Do you think that the costs of introducing tagging of non-financial information would be proportionate to the benefits this would produce?

No, not at all	To some extent but not much	To a reasonable extent	Yes, to a very great extent	Don't know

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

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

Digitalization could generate benefits, including cost saving for users of annual financial reports, greater speed, reliability and accuracy of data handling, improved analysis, and better quality of information and decision-making. However, it is crucial to ensure that the tagging process does not undermine the assessment of the company. Coordination and harmonization with the taxonomy is crucial on this aspect. Tagging of non-financial information has to be done against standards and should be available through a single access point (preferably ESMA) in order to facilitate the use of this information by consumers and civil society. Companies' public financial and non-financial information should be accessible free of charge to the non-industry stakeholders. The requirement imposed by the Transparency Directive for companies to prepare their annual reports in a single electronic format (ESEF), with the technical standards already developed by ESMA based on the IFRS (International Financial Reporting Standards) taxonomy, should be extended to non-financial information.

Structure and location of non-financial information

The default requirement of the NFRD is that companies under scope shall include their non-financial statement in their annual management report. However, the NFRD also allows Member States to allow companies to disclose the required non-financial information in a separate report under certain conditions, and most Member States took up that option when transposing the Directive. Companies can be allowed by national legislation to publish such a report up to six months after the balance sheet date.

The publication of non-financial information in a separate report has a number of consequences, including:

- *Separate reports that include non-financial information are out of the legal mandate of the national competent authorities, whose mandate over periodic reports is limited to the annual and semi-annual financial reports (which include the management report).*
- *Separate reports that include non-financial information are not required to be filed in the Officially Appointed Mechanisms (OAMs) designated by Member States pursuant to Article 21(2) of the Transparency Directive.*

<u>Question 36.:</u> 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]

<u>Question 37.:</u> 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		

<u>Question 38.:</u> 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).					X	
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.

BETTER FINANCE believes that the information on non-financial reporting should be mandatory and easily accessible in the annual management report of the company. The standardization of the information provided in the annual report is essential in order to ensure comparability, therefore disclosure of information in documents that are outside the legal mandate of national authorities would undermine the transparency and the assessment of these information.

The management report, including the non-financial statement, aims to provide a company's stakeholders with the information necessary to understand the company's development, performance, position and impact. Some non-financial information is also reported in the corporate governance statement, which is also part of the management report.

Question 39.: Do you consider that the current segregation of non-financial information in separate non-financial and corporate governance statements within the management report provides for effective communication with users of company reports?

No, not at all	To some extent but not much	To a reasonable extent	Yes, to a very great extent	Don't know

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

Undoubtedly, whether in the form of integrated reporting or not, the non-financial information needs to be easily accessible and understandable for shareholders. On the one hand, providing a separate report for NFI could increase confusion and difficulties to gather all the information, undermining the all process of verification of the information provided by the companies. On the other hand, with integrated reporting the annual reports would become even longer and even less readable for the average investor/user. Therefore, two separate documents (one focusing on financial information but including the material NFI and the other on NFI and referring to the material financial impact) could be more attractive for the readers of the respective documents. BETTER FINANCE doesn't necessarily seee the risk of a separate document considered as being of secondary importance.

Scope of the directive: Personal scope (which companies should disclose)

The NFRD currently applies to large Public-Interest Entities (PIEs) with more than 500 employees. In practice this means large companies with securities listed in EU regulated markets, large banks (whether listed or not) and large insurance companies (whether listed or not) – all provided that they have more than 500 employees.

The Accounting Directive defines large undertakings as those that exceed at least two of the three following criteria:

(a) balance sheet total: EUR 20 000 000;

(b) net turnover: EUR 40 000 000;

(c) average number of employees during the financial year: 250.

Some Member States have extended the personal scope of the NFRD by lowering the threshold to 250 employees, in effect capturing all large PIEs.

Companies that are a subsidiary of another company are exempt from the reporting requirements of the NFRD if their parent company publishes the necessary non-financial information at consolidated level in accordance with the NFRD.

There are a number of potential arguments to support the extension of the personal scope of the NFRD:

- *Changes in the legislative framework: following the adoption of the Regulation on sustainability-related disclosure in the financial services sector and of the Taxonomy Regulation, investors may require non-financial information from a broader range of investees in order to comply with their own sustainability-related reporting requirements.*

- *Large unlisted companies can have significant impacts on society and the environment. There may therefore be no a priori reason to differentiate between listed and non-listed companies in this respect. In addition, the difference in treatment between listed and non-listed companies in this regard may serve as a disincentive for companies to become listed, and therefore undermine the attractiveness of capital markets.*

- *Exempting PIEs that are subsidiaries limits the information about impacts on society and the environment, thus undermining the ability of stakeholders of such exempted subsidiaries to hold them accountable for their impacts on society and the environment, especially at local and national level.*

<u>Question 40.:</u> If the scope of the NFRD were to be broadened to other categories of PIEs, to what extent would you agree with the following approaches?

	1	2	3	4	5	Don't know
Expand scope to include all EU companies with securities listed in regulated markets, regardless of their size.					X	
Expand scope to include all *large* public interest entities (aligning the size criteria with the definition of *large undertakings* set out in the Accounting Directive: 250 instead of 500 employee threshold).					X	
Expand scope to include *all* public interest entities, regardless of their size.					X	

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

<u>Question 41.:</u> If the scope of the NFRD were to be broadened to non-PIEs, to what extent would you agree with the following approaches?

	1	2	3	4	5	Don't know

Expand the scope to include *large non-listed* companies.					X	
Remove the exemption for companies that are subsidiaries of a parent company that reports non-financial information at group level in accordance with the NFRD.					X	
Expand the scope to include large companies established in the EU but listed outside the EU.					X	
Expand the scope to include large companies not established in the EU that are listed in EU regulated markets.					X	
Expand scope to include *all* limited liability companies regardless of their size.					X	

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

Question 42.: If *non-listed* companies were required to disclose non-financial information, do you consider that there should be a specific competent authority in charge of supervising their compliance with that obligation?

Yes	No	Don't know
X		

If yes, please specify who in your opinion should carry out this task (National Competent Authorities, European Supervisory Authorities, other...) and how.

The competent authority in this regard could be ESAs or the National Competent Authorities based on the administrative establishment of the company in the EU.

Due to the nature of their activities, credit institutions and insurance undertakings have larger balance sheets than non-financial corporations. Hence, the vast majority of such institutions will exceed the balance sheet threshold in the definition of large undertakings set-out in the Accounting Directive. Moreover, the application of some public disclosure requirement of EU prudential regulation for credit institutions and insurance undertakings is defined based on various size thresholds.

For example:

- *the Regulation on prudential requirements for credit institutions and investment firms includes in its definition of large credit institutions those with a total value of assets equal to or greater than EUR 30 billion;*
- *the same Regulation defines small and non-complex institutions as those that have EUR 5 billion or less total assets;*
- *the consultation paper published by EIOPA in October 2019 proposes to revise article 4 thresholds of Solvency II (below which entities are excluded from the scope of Solvency II), doubling the thresholds related to the technical provisions (from EUR 25M provisions to EUR 50M) and allowing Member States to set the threshold referring to premium income*

between the current EUR 5M and until a maximum of EUR 25M.

<u>Question 43.:</u> To what extent do you agree with the following statements relating to possible changes of the personal scope of the NFRD for financial institutions?

	1	2	3	4	5	Don't know
The threshold criteria for determining which banks have to comply with the NFRD provisions should be different from those used by Non-Financial Corporates.					X	
The threshold criteria for determining which insurance undertakings have to comply with the NFRD provisions should be different from those used by Non-Financial Corporates.					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 40 to 43.

The scope of the EU Directive should therefore be enlarged beyond the threshold of 250 staff as it currently covers only 6000 companies in the EU out of the total 42000 large companies. The many SMEs exempt from non-financial reporting legislation can actually have a major negative impact on e.g. human rights and the environment. Considering the differences between financial institutions and non-financial companies, the scope threshold needs to be different. For financial institutions, exposure in terms of investments and financial aspects (balance sheet and turnover) is more relevant than the number of employees. For example, many asset managers and private equity firms have a small number of employees.

Simplification and reduction of administrative burdens for companies

<u>Question 44.:</u> If your company publishes non-financial information pursuant to the NFRD, please state how much time the employees of your carrying out this task, including time of retrieving, analysing and reporting the information? Please provide your answer in terms of full-time-equivalents (FTEs, 1 FTE= 1 employee working 40h a week during 250 working days per year). Please provide your answer for reports published in 2019, covering financial year 2018.

Please state the total cost per year of any external services, *excluding the cost of any*

***assurance or audit services*, that you contracted to assist your company to comply with the requirements of the Non-Financial Reporting Directive. Please provide your answer for reports published in 2019, covering financial year 2018.**

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.

<u>Question 45.:</u> 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.						
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.						
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.						

(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.

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 not very prescriptive and does not require the use of any particular reporting standard. In order to overcome some of the aforementioned issues we would advise to carefully consider and assess changing the choice of legislative instrument from a directive to a regulation(as this on the one hand would guarantee a stronger enforcement of rules including a better harmonization of rules across member states, but on the other hand could result in the minimum harmonization approach). If on the one hand, reporting requirements should not increase burden for companies, on the other hand companies are under pressure to respond to demands of rating agencies, data providers etc. Therefore, clear underlying standards are crucial and necessary to clarify what information companies need to provide.