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Associazione fra le società italiane per azioni

POSITION PAPER ON THE FUTURE REVISION OF THE NON-FINANCIAL INFORMATION REPORTING DIRECTIVE (NFRD)

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SUMMARY

- **A harmonised non-financial reporting framework developed under EU leadership** is needed to stop the proliferation of various public or private reporting initiatives which are not aligned and make reporting extremely time-consuming and confusing for corporates who are confronted with numerous questionnaires and ratings, based on different methodologies and definitions.
- **Companies should be put at the heart of the standardisation process.** The non-financial reporting framework needs to be elaborated in close collaboration with companies to make sure it is operational and reflects the sustainability policies implemented by companies.
- **Non-financial reporting obligations should be extended to non-EU companies operating in the EU** if they exceed a certain threshold of global turnover. This is essential to avoid unfair competition. **Small and medium sized companies should not be included in the scope** because it would create too high compliance costs for them.
- **Flexibility should be maintained regarding the location of non-financial information**, be it in the management report or a separate report dedicated to sustainability, if the quality of and public access to the information is guaranteed in the same way.
- Companies do accept to **disclose in non-financial reports how they define materiality** and which processes they have put in place to identify their material environmental, social and governance (ESG) issues.
- However, **companies need to remain master of defining what is material information** according to their specific activity and sector. They are totally **opposed to the introduction of an obligation to produce a negative statement**, explaining why certain issues are considered as not material, which would indeed lead to illegible reports and a bureaucratic box-ticking approach of materiality.

BACKGROUND

Non-financial information published by companies on the social and environmental impacts of their activities is today in the centre of attention for multiple reasons.

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On the one hand, EU legislation and guidelines request or commend that **companies publish more and more detailed information on sustainability related issues such as social or environmental risks, particularly in relation to climate change**. The newly adopted "**Taxonomy Regulation**" adds a new layer to these obligations, requiring companies to disclose to which extent their turnover, investments and/or expenditures are linked to activities defined in the EU taxonomy.

On the other hand, **investors will have to inform the public about the environmental and social impacts of their investments**, in accordance with the new "**Disclosure Regulation**" relating to sustainable investments and sustainability risks. Investors will inevitably turn to companies to obtain the information they will need to provide to the market.

Addressing the question of a **harmonised reporting framework for non-financial information is therefore urgent** to prevent stakeholders from working with different methodologies and definitions, which make comparison difficult and force companies to answer numerous questionnaires.

It is hard to properly assess responsible business conduct when **non-financial ratings vary so widely**. A research team from MIT Sloan found that the correlation among ESG ratings is on average 0.61 whereas financial ratings are correlated at 0.99.[1] **50 % of overall divergence is explained by measurement divergences**. The comparability of data underlying ESG ratings is therefore key to improve the quality of ratings, as well as increased transparency of ESG rating agencies about their methodologies.

Assonime believes that **Europe should play a central role in building a more coherent system of non-financial reporting**, because multiple private initiatives co-exist today without actually converging. Business involvement is essential in this context to ensure that information is meaningful to both businesses and their stakeholders.

In a speech given on 28 January 2020, Commissioner Dombrovskis said that the European Commission will support a process to develop **European non-financial reporting standards** and announced that he will invite the European Financial Reporting Advisory Group (EFRAG) to begin preparatory work for these standards.

[1] **Aggregate Confusion: The Divergence of ESG Ratings,** F.Berg, J. Koelbel, R. Ribogon, MIT Sloan School of Management, August 2019

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Assonime welcomes this announcement and believes that there are two key requirements for Europe to take back the lead on this matter:

- **Have a pragmatic (not theoretical) approach** involving companies and respecting the principle of materiality;
- **Act fast**, as other actors are several steps ahead.

SPECIFIC COMMENTS

- **NFRD should be extended to non-EU companies operating in the EU** if they exceed certain thresholds of global turnover. All companies offering products or services in the EU should be subject to the same reporting obligations on sustainability policies and risks. Otherwise EU companies are likely to be exposed to unfair competition and social or environmental dumping. From a legal point of view, there are numerous EU regulations that already apply to non-EU companies, such as Regulation 679/2016/UE on data protection, or Directive 828/2017/ET on the encouragement of long-term shareholder engagement.[2]

- The **verification of non-financial information by independent third parties** should provide for a **plurality of competent organisations** (not only auditors), which have been **explicitly accredited** for verifying social and/or environmental information published by companies. A rigorous process of accreditation of these independent third parties by one of the signatories of the European Accreditation Multilateral Agreement (EA MLA), should be put in place in order to guarantee the quality, legitimacy and credibility of such verifications. It should be made clear that non-financial verification is very different in nature from financial audit, as the information to be verified is different in nature, and often qualitative. Financial auditors are therefore not automatically competent in the field of non-financial verification. In the case of Member States where mandatory verification does not yet exist, appropriate transition periods should be provided for in order to allow competent independent parties to emerge.

[2] **Numerous other pieces of EU legislation with an extended territorial scope of application can be mentioned**, such as Directive 2012/19/EU on waste electrical and electronic equipment; Directive 2011/61/EU on Alternative Investment Fund Managers; Timber Regulation 995/2010/EU; Directive 2008/101/EC including aviation activities in ETS; Directive 2005/35/EC on ship-source pollution and on the introduction of penalties for infringements; Regulation (EC) No 391/2009 on common rules and standards for ship inspection and survey organisations; …

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- The **principle of both financial and non-financial materiality** should be clearly referred to as the guiding principle for corporate disclosure on non-financial issues in order to avoid box-ticking and information overkill. The necessary flexibility allowing each company to define its own material issues may be counterbalanced by increased **transparency on the methodologies** applied by companies to define which environmental or social issuers are considered material. However, the obligation to produce a negative statement explaining why certain issues are considered as not material, is unacceptable for Assonime because it would lead to a huge additional burden and box-ticking exercise without added value.

- The non-financial statement should be able to be published either within the management report or in a dedicated report. Indeed, companies need **flexibility regarding the location of non-financial information**, provided that the quality of and public access to the information is guaranteed in the same way. For example, in Germany, where the non-financial statement can be published in a separate report, the Supervisory Board must examine the content of the non-financial report prior to its publication according to the implementation act of NFRD. The publication in a separate report has no impact on the verification by independent third parties. [3]

[3] Although an external audit is not mandatory, more than half of German non-financial reports are audited externally. A report on the implementation of the German law mentions on page 14/15 that the percentage of companies that have their non-financial report audited on a voluntary basis by independent third parties has increased from 56% in 2017 up to 63% in 2018.

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