

Key points of Finance Watch's response to the NFRD consultation

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Finance Watch

Making finance serve society

Quality and scope of non-financial information to be disclosed

- Non-financial reporting of companies must be:
 - **Compulsory** (optional under the current NFRD)
 - **Exhaustive enough** to satisfy the different information needs of all categories of stakeholders
 - **Comparable** between reporting companies so as to make the work of stakeholders possible
 - **Flexible enough** to allow for a minimum level of standardisation and the possibility to report on the idiosyncrasies of each company
- Information about the **environment** should cover nature and **biodiversity as well as climate**
- Information about **social issues and human rights** should cover the **supply chain of companies**
- Information about the relationship of the reporting company with third parties should include including **tax issues, management of supply chain, bribery and corruption** information
- **Governance** (in particular of sustainability matters) should be disclosed



Standardization

- **Standardization across jurisdictions** (member states): **need for a regulation** (NFRR) to replace the directive (NFRD) to ensure consistency throughout EU
- **Standardization across the spectrum of economic activities**, whilst recognizing the existence of significant structural differences between sectors
- Amount of standardization between companies of different sizes, whilst **recognizing that companies of different sizes can report at a different level of granularity**

Standardization: existing reporting standards

- Inspiration from existing reporting standards **useful but not neutral**
- Double vs. single materiality debate, e.g. :
 - SASB: outside-in short term financial impact
 - GRI: inside-out impact
 - TCFD: outside-in financial impact and only climate-related
- **Need for defining European non-financial reporting standards** founded on double materiality

Application of the principle of materiality

- Materiality is **cornerstone** of non-financial reporting
- Essential to address the issue of the non-financial impact of businesses on their socio-environment = > **carve double materiality in stone**
- **Double materiality** to be defined as the **combination of the inside-out non-financial impact of businesses on their socio-environment, and of the outside-in financial impact of the socio-environment on the accounts and financial performance of businesses**

Assurance

- **Credibility** of non-financial information a direct function of the assurance provided
- **External control and certification** of non-financial information by third-party verification providers should be **mandatory** throughout the EU
- **Third-party verification providers** should be **accredited** on a common set of quality standards and should be subject to well defined minimum criteria of qualification, experience and professional obligations in a consistent manner throughout Europe
- Reasonable assurance of the non-financial information provided necessary

Digitisation

- Non-financial information collecting and processing **challenges** :
 - ✓ Large and growing amount of data
 - ✓ Not standardized
 - ✓ Qualitative and quantitative
- Digitisation essential to **making non-financial reporting possible**
- **Prerequisites** to digitisation:
 - Comparability of data
 - Elaboration of a common standard of reporting
- **Tagging indispensable** to making non-financial information reporting possible
- **Cost** of introducing tagging must be put **in perspective with its benefits**: given the ambition of the sustainable finance effort and its duration, cost of introducing tagging can be seen as being **amortized on an indefinite time horizon**, which makes it by construction **economically cheap**

Structure and location of non-financial information

- Non-financial information should be published with financial information in the management report for two reasons:
 - ✓ Financial information and non-financial information must be coherent and comparable with one another ;
 - ✓ In a double materiality logic, the long term inside-out non-financial impact of companies will feed the outside-in financial impact on companies of their socio-environment, and reporting the two categories of information in different locations would defy the purpose of reporting non-financial information in the first place

Which companies should disclose: scope and thresholds

- **Scope cannot be considered independently of the question of double materiality and of target stakeholders**
- **No reason to distinguish between listed and non-listed companies** (inside-out impact of businesses is unrelated to the fact that legal entities are listed or not)
- Our **recommended criteria** for determining scope and thresholds, in order of preference:
 1. **Materiality**: does the business concern considered have a material inside-out or outside-in impact? (some small companies can have a big impact)
 2. If materiality approach is considered as too difficult to assess, use thresholds linked to turnover and balance sheet and make them consistent with the levels of the Accounting Directive (respectively EUR 20 M and EUR 40 M)
 3. If the number of employees is to be considered, use the threshold of 250 employees (in coherence with the Accounting Directive), possibly with somewhat lighter reporting requirements for companies between 250 and 500 employees



Which companies should disclose: territoriality

- **All companies** should incur the **same non-financial reporting obligations** as long as they are established or listed in the EU, or if they generate a turnover in the EU
- This should apply **regardless of the nationality** of the companies **and of their possible listing in or outside of the EU** (an establishment in the EU with a listing outside of the EU should not exempt the company as its inside-out impact is unrelated to its place of listing and as the target stakeholders are the same)
- **Perimeter of reporting should be global**, including for non-European companies, for businesses that are established, listed or sell their products or services in the EU
- **Global perimeter indispensable both for ESG investors and for non-financial stakeholders** (civil society...) to derive meaningful information and understand the outside impact of companies

Simplification and reduction of administrative burden of companies

- Finance Watch considers that **materiality** is the **key criteria** to determine **what non-financial information to report**
- In the **current NFRD context, companies face uncertainty and complexity** as materiality was not defined in the Directive 2014/95/EU, only partially defined in the guidelines of June 2017, and defined more clearly but in a non-binding text and only for climate-related reporting in the guidelines for reporting climate-related information in June 2019
- **One of the objectives of the precise definition of materiality is to remove uncertainty and therefore complexity for companies**



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