FESE Position on Corporate Sustainability Reporting Directive

Brussels, 2nd July 2021

1. Introduction

FESE supports the Commission's review of the Non-Financial Reporting Directive (NFRD) via the proposal for a Corporate Sustainability Reporting Directive (CSRD). There is a need for a European Union (EU) wide harmonised standard of environmental, social and governance (ESG) information to enhance transparency, promote investments in ESG activities and ensure that potential systemic risks to the financial system can be addressed.

The objective of the European Green Deal is to ensure that the EU is carbon neutral by 2050. Key to delivery is the need to reorient public and private capital into sustainable activities and the disclosure of robust environmental data by corporates will speed up the rate of investment into sustainable activities. Based on this, we support the extension of reporting requirements to include non-listed large companies. Increasing disclosure obligations on listed issuers alone would have risked disincentivising companies from listing on Exchanges, which would not increase transparency. ESG disclosures should apply to all firms with comparable economic, social, and environmental footprints.

The NFRD review should focus on strengthening and harmonising provisions, striving to achieve both horizontal and vertical consistency with other EU sustainability reporting regulations (such as the EU Taxonomy, the Sustainable Corporate Governance Initiative and the Sustainable Finance Disclosure Regulation). Generally speaking, investors' assessment is that the quality and comparability of sustainability reporting under the NFRD is not sufficient to understand companies' impacts, risks or plans. Gaps in data, particularly for smaller and unlisted companies, as well as inconsistencies in methods and a lack of validation (e.g. by auditors) impede comprehensive integration of relevant and material sustainability factors into investment and/or credit processes. Defining clear ESG standards for companies is necessary to ensure that reliable, comparable and relevant information is disclosed.

In 2020, FESE published the 'FESE Introduction and guiding principles to ESG reporting' available here. It presents guiding principles on ESG reporting, is designed to enhance corporate communication and disclosure, and addresses topics related to ESG issues in capital market communication, highlighting the important role that regulation plays in ESG reporting and supporting the principle of double materiality. In doing so, it seeks to inform companies and promote ESG reporting by consolidating and incorporating a methodology on how to approach sustainability, moving ahead of implementation timeframes, and anticipating upcoming initiatives.

2. Scope and proportionality

FESE very much welcomes the Commission extending the scope beyond today's requirements to include all large undertakings (including non-listed ones). This is a sensible approach as comparable disclosures should apply to companies with comparable footprints. We welcome that the Commission has excluded micro-companies and SMEs listed on SME Growth Markets and Multilateral Trading Facilities to the ESG reporting requirement. In addition, it is also welcomed that proportional reporting requirements are to be developed for SMEs listed on

Regulated Markets. However, we are concerned that non-listed SMEs would meanwhile only be subject to voluntary reporting. This approach risks disincentivising companies from going public and could increase de-listings, as requirements on listed SMEs are already high, making any additional costs an important factor. SME Growth Markets have the potential to develop an ecosystem across the EU that benefits smaller issuers, enabling them to raise money, grow, create employment and generate value for investors and the wider society.

SME issuers wishing to list on public markets currently experience many challenges, including high compliance costs to be listed on a market, a lack of institutional and retail investments and often a visibility and liquidity deficit. These obstacles often make other financing options a more preferable alternative. More needs to be done to address these issues to make listing on an SME Growth Market an attractive option for SME issuers.

The current proposal could also discourage the move of SMEs listed on non-regulated growth markets to regulated market, as part of their natural journey along the funding ladder. The scope of CSRD should be set to include companies based on their size and not based on how they are financed. In that respect we also call to review the definition of an SME by enlarging the scope from 250 employees to 500 employees (as an only condition). The scope as currently proposed does not reflect current market participants views of what constitutes an SME. Widening the scope to 500 employees and removing the financial numbers will create a clear yet relatively feasible scope. This definition should apply to all SMEs regardless of where they are admitted to listing.

FESE would support the introduction of an EU ESG disclosure framework for both listed and non-listed SMEs. This would cater to the need for transparency for investors but place a more proportionate burden on SMEs. SMEs should be included in the EU sustainability reporting landscape in an inclusive but proportionate manner. SMEs are limited by their resources to gather, analyse and report ESG information and should not face the same requirements as large companies. A voluntary sustainability reporting framework for all SMEs (whether they are listed or not) would allow them to respond to financial market participants' demands. Since SMEs are often part of a wider value chain, such disclosure information would also cater to the needs of other undertakings obligated to report ESG information.

We believe that the implementation of this voluntary EU ESG SME disclosures framework could be further supported – at the later stage of the implementation process for SMEs - by the adoption of a 'comply or explain' mechanism at Member State level. The purpose of this mechanism, should Member States choose to introduce it in their jurisdiction, would be to obtain an explanation from SMEs opting not to disclose ESG information in the context of the voluntary standards. Such a mechanism would maintain the principle of proportionality, allowing companies to disclose ESG information without requiring high levels of compliance costs due to the limited size and nature of their entity. It would also ensure a level playing field as it would equally apply to both non-listed and listed SMEs.

As SMEs play an important role in European economies, it is necessary to encourage them to disclose sustainability data. Financial market participants should stimulate SMEs to disclose more ESG data and improve their performance. ESG matters present material risks and opportunities to all businesses. Better sustainability-related performance could lead to fewer and less significant business interruptions, stronger consumer loyalty and better relations with stakeholders.

In addition, further reflections could be made to encourage the flow of capital in sustainable activities by SMEs, or projects specific to them. We believe that one way to achieve this is by incentivising Member States to provide tax subsidies and/or lower the capital requirements to institutional investors who invest in SMEs that contribute substantively to at least one of the six environmental objectives, or that do not significantly harm any of the environmental objectives.

Lastly, we would suggest that non-EU corporates operating within the EU should also be subject to EU corporate disclosure requirements. We agree with the findings of the

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Commission’s impact assessment that unequal treatment of EU and non-EU companies would be detrimental to the level playing field in the EU Single Market. EU companies, in fact, risk incurring higher reporting costs than non-EU companies if other jurisdictions do not take an approach similar to that outlined in the CSRD proposal.

3. Standardisation, assurance and supervision

Many new ESG reporting requirements have recently been agreed (Benchmarks, Disclosure, Taxonomy) and are now discussed within the CSRD proposal and upcoming files as use-cases for ESG information reported by issuers. It is therefore important to consider streamlining the disclosure requirements under those frameworks, as there is a risk of introducing legal uncertainty and a disproportionate regulatory burden if companies would need to comply with diverging or overlapping disclosure requirements towards different authorities. The CSRD should also recognise other disclosure efforts, for instance the Sustainable Corporate Governance Initiative. Overlap of requirements should be avoided and a holistic approach with respect to all sustainable requirements is essential in order to meet the anticipated benefits for the investor community.

FESE considers that CSRD should provide companies with one set of sustainability-related reporting requirements. These should be tailored to the specific objectives of CSRD. It is therefore welcome that the Commission indicates that CSRD standards should be developed ensuring coherence with other pieces of regulation on sustainable finance.

FESE welcomes the recommendations of EFRAG on EU sustainability reporting standard-setting[1]. We would support guidance that is driven by science, forward-looking, sector specific and provides clear KPIs that help steer undertakings and measure their impact to have better (risk) management and alignment with public policy goals. We agree that sustainability reporting standards should reflect a reporting entity’s decision-making and reporting cycle and associated processes in a structured manner. This will help in advancing towards more integrated reporting (including both financial and sustainability information) with decision-useful information being disclosed. If sustainability reporting and financial reporting are to be placed on an equal footing under an identical timing requirement, connectivity becomes essential. We would however uphold the double-materiality principle, which should not be sacrificed to the mandatory nature of the standards to be developed by EFRAG. Even in the presence of mandatory standards, companies should be warranted the ability to conduct their own materiality analysis as the concept of materiality is specific to each company.

To upgrade sustainability information, FESE welcomes the proposal to make reporting in the management report mandatory by removing the exemption that Members States currently have to allow the non-financial statement to be reported outside the management report. Greater standardisation of the time and place of disclosures of sustainability data enhances comparability. The option of fully integrating reporting, paired with the option of presenting it as a separate section in the management report, should both remain and be explicitly mentioned. Furthermore, we believe that limited assurance of the reported sustainability information is a right step towards improving the quality of sustainability reporting.

FESE recommends that National Competent Authorities should be in charge of supervising companies’ compliance. Once implemented, ensuring equal supervisory outcomes on the CSRD requirements will be important. The current regime on non-listed companies’ disclosure obligations of financial information remains adequate and should not be changed under CSRD. The scope of any potential due diligence requirements should be aligned with the scope of the new disclosure requirements after the CSRD review.

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[1] The report is available here.

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4. Digitalisation

The Commission proposes that sustainability reporting should be disclosed in a digital, machine-readable format. FESE believes that digitisation is key to enable a broad and efficient use of ESG data. Potential users of such information would not be able to gather such data from classic, non-digital sources like annual reports – at least not in an efficient and reliable way.

From a report users' perspective there are (in part considerable) obstacles to obtaining sustainability data, which should be addressed to make it easier to sort through and process relevant sustainability data. At the same time, there should be no disproportionate burden on report preparers. Companies should not be forced to publish in costly digital formats in European Single Access Point (ESAP) where such an obligation is not required by the relevant reporting legislation. If this is the case, companies should be given sufficient time to adapt to new reporting standards.

We recommend the incremental introduction of a standardised, digitised and machine-readable reporting formats for fulfilling investors' needs in respect to finding and comparing ESG data available across the EU. This would serve to match sustainability and financial reporting, in respect of the formats used and improve the flow of information between companies and financial market players/databases. In the long term, this would make sustainability data a standard component of companies' (financial) reporting.

5. Global outlook

The Commission outlines that they aim to build on and contribute to international sustainability reporting initiatives and align as far as possible with those while taking into account European specificities. In parallel, the IFRS Foundation have announced that they aim to establish an International Sustainability Reporting Standards Board within their governance structure. This would build upon the work of the Financial Stability Board's Task Force on Climate related Financial Disclosures (TCFD) and work with leading standard-setters in sustainability reporting. The G7 Finance Ministers' communiqué issued on 5th June also supported making TCFD mandatory in the G7 jurisdictions.

FESE welcomes these developments. We should increase dialogue at the global level on ESG reporting standards to ensure consistency, allow legal frameworks and best practices to align better and avoid overlapping regulatory obligations. The EU has played a leading role in driving the development within Sustainable Finance. One key aspect, which should also be reflected in international discussions, is double materiality. Moreover, sustainability issues beyond climate aspects should also be considered. Ideally, the IFRS workstream and regulatory dialogue will help in achieving a global level playing field in ESG reporting for companies consisting of high-quality standards.