



**ICMA response to EC consultation on the NFRD review**  
**11 June 2020**

The International Capital Market Association welcomes the opportunity to provide feedback on the consultation (the “Consultation”) on the Review of the Non-Financial Reporting Directive (NFRD).

ICMA is a membership association, headquartered in Switzerland, committed to serving the needs of its wide range of members. These include private and public sector issuers, financial intermediaries, asset managers and other investors, capital market infrastructure providers, central banks, law firms and others worldwide. ICMA currently has around 600 members located in over 60 countries. See: [www.icmagroup.org](http://www.icmagroup.org). ICMA’s transparency register number is 0223480577-59.

This feedback is given on behalf of the ICMA Corporate Issuer Forum (CIF) and ICMA Asset Management and Investors Council (AMIC). The feedback provided by the CIF, an ICMA forum which gathers senior representatives of a number of major corporate issuers active in the euro markets, is restricted to two areas set out in the Consultation: standardisation, and structure and location. The feedback provided by AMIC, an ICMA forum composed of asset managers and asset owners, covers all parts of the Consultation.

**Both the CIF and AMIC support the review of NFRD, which they believe is an opportunity to achieve a greater level of standardisation of ESG disclosures.** Adopting KPIs for each sector based on most commonly used standards (GRI, SASB) could not only increase comparability of companies’ performance for investors, but also, from an issuer perspective, facilitate the actual reporting process (e.g. materiality assessment) and dialogue with investors. A comprehensive and coherent, harmonised reporting framework which is agreed between stakeholders would undoubtedly be to the benefit of all market participants.

**Regarding the location of the NFR report, both the CIF and AMIC want to flag the potential practical and liability challenges arising from the EC’s suggestion to combine non-financial information with annual reports.**

**AMIC response highlights in particular the need to enhance NFR (e.g. quality disclosures, assurances) to allow the buy-side to comply with its own new requirements, namely the Sustainable Finance Disclosure Regulation, which requires asset managers to report on (1) the impact they have on their environment in the broad sense of the term (i.e. the “E”, the “S” and the “G”) and (2) the impact of sustainability risks on the performance of portfolios.**

The need to align reporting obligations between issuers and investors also means that the scope needs to be reviewed (bearing in mind potential red tape for smaller issuers) and that disclosures need to be made mandatory.

## Quality and scope of non-financial information to be disclosed

### Comments from AMIC:

- **Currents challenges with non-financial reporting: AMIC agrees that comparability of non-financial information is an important outstanding issue for investors.** The fact that NFRD allow companies a great level discretion on non-financial reporting disclosure (e.g. comply or explain clause) can indeed lead sometimes to the publication of information, which is not necessarily considered to be material by investors. As raw data/non-financial information disclosed by issuers are still limited in quality, asset managers rely increasingly on ESG data providers and credit rating agencies, which have they own methodology and scoring systems. Combining and interpreting these different ESG rating approaches, asset managers have often developed their own methodology and scoring systems used as filters for their different types of sustainable products (screening investments, impact investments, ESG investments). These analyses contribute to enrich data and, partially, to overcome the lack of reporting on material NFR aspects and enhance comparability between issuers. But it would certainly become more cost-effective and comparable if ESG scoring methodologies were supported by a common set of raw data.
- **NFR aspects to be covered by the review: AMIC suggests focusing on existing NFRs aspects rather than expanding NFRD to other non-financial aspects such as intangible assets.**  
**Regarding governance aspects, which are already covered by NFRD,** AMIC tends to agree with the fact that governance metrics are currently limited under NFRD (e.g. board diversity). There could be some merit in incorporating some of the governance KPIs used by existing standards (GRI, SASB) in the reviewed version of NFRD. For instance under GRI 405 the diversity disclosure apply more broadly to governance bodies and to employees in general (not just the Board). Under this standard companies also need to report the ratio of basic salary and remuneration of women to men. SASB also provides relevant KPIs on governance aspects: e.g. competitive behaviour (losses due to anti-trust fines). Adopting relevant metrics will certainly be helpful but a qualitative reporting should still be required.
- **Regulatory alignment between issuers and asset managers: AMIC agrees that the sequence and interaction between different pieces of legislation present serious implementation challenges.** The lack of non-financial reporting will be increasingly challenging for asset managers, as regulators are requiring them to comply with new types of disclosures. **The fact that the Disclosure Regulation enters into application (10 March 2021) before the NFRD review and pre-empts it is problematic.**  
**According to the Disclosure Regulation asset managers will have to disclose how their investment decisions weighs on ESG factors.** The RTS proposed by the ESAs would require asset managers from 10 March 2021 to consider at company and fund levels ESG indicators. The following indicators would systematically need to be

reviewed by ESG products in particular when assessing the “Do Not Significant Harm” (DNSH) objective:

- Greenhouse gas emissions: e.g. carbon emissions/footprint/intensity, exposure to solid fuel
- Energy performance: e.g. consumption from non-renewable sources, consumption intensity
- Biodiversity: e.g. ecosystem preservation practices, exposure to companies affecting IUCN Red List species, deforestation policy
- Water: e.g. emissions, exposure to areas of high water stress, untreated discharged waste water
- Waste: e.g. Hazardous waste ratio, Non-recycled waste ratio
- Social and employee matters: e.g. implementation of fundamental ILO Conventions, Gender pay gap, Excessive CEO pay ratio, Board gender diversity, Insufficient whistleblower protection, investment in investee companies without workplace accident prevention policies
- Human rights: e.g. investments in entities without a human rights policy, due diligence, processes and measures for preventing trafficking in human beings
- Anti-corruption and anti-bribery: e.g. investments in entities without policies.

**If the Disclosure Regulation was applied as proposed by the ESAs (i.e asset managers and ESG fund managers to assess all investee companies against these 32/50 indicators), asset managers would mechanically need issuers to disclose against the same indicators** (in order to comply with the disclosure at entity level and the DNSH principle), even though these indicators might not be necessarily material for them and stakeholders.

According to the Disclosure Regulation asset managers will also have to disclose on the potential impact of sustainability risks on the financial “returns” of investment funds. Likewise, this will only be possible if issuers are specifically required to report on quantitative financial materiality. But one should be cognizant of the fact that there is currently no standard methodology when it comes to translating these risks into income guidance (for issuers) or into asset valuation (for fund managers).

## Standardisation

### Comments from AMIC and the CIF:

- **ICMA believes that the NFRD review is an opportunity to achieve a greater level of standardisation of ESG disclosures, which could not only increase comparability of companies’ performance for investors, but also, from an issuer perspective, facilitate the actual reporting process (e.g. materiality assessment) and dialogue with investors.** ICMA appreciates the difficulty facing investors who rely increasingly on ESG data providers and credit rating agencies (CRAs), each of which has their own methodology and scoring systems. The consequential effect of this is that issuers must involve themselves to a very significant degree, not only providing the information based on applicable frameworks (just some of which are highlighted in the Consultation), but also assisting investors to unravel the frameworks, methodologies and scoring systems in a meaningful way and providing additionality

to ensure ease of comparability. This is extremely difficult, time consuming work, especially when faced with having to provide information to a proliferation of different standards, which may only align in some respects. Standardisation will not replace investors' engagement but could facilitate it. A comprehensive and coherent, harmonised reporting framework which is agreed between stakeholders would undoubtedly be to the benefit of all market participants.

- **Some KPIs should be applicable across all sectors, while clearly some should be specific to some only and may align with, and be based on best practices from, existing standards. In this respect, ICMA considers that GRI/SASB/TCFD are a good starting point.** GRI's disclosures recommendations apply to all sectors (with sectoral recommendations under development) and is addressed to various groups of stakeholders, whereas SASB makes specific recommendations for each sector and sub-sectors and is addressed to investors/shareholders. Both frameworks contain similar reporting fields and KPIs which could be included in the NFRD review.
- **Standardisation efforts should involve experts such as specialist accountants and auditors, environmental authorities, issuers and investors who can contribute at both a general and sectoral level.** This work could be for instance prepared by EFRAG before being endorsed by EU institutions : the European Federation of Financial Analysts, which is an industry member of EFRAG, has already done significant work on both general and sectoral KPIs.

### Application of the principle of materiality

#### Comments from AMIC:

- **Materiality is indeed a key concept that probably needs to be reviewed under the new version of NFRD. The climate-reporting guidelines of NFRD have introduced a new definition of materiality – called “double materiality”.** The first perspective concerns the potential or actual impacts of climate-related risk and opportunities on the “performance, development and position” of the company (indicated as “financial materiality”, with an investor type of audience). The latter refers to the “external impacts of the company’s activities” (labelled as “environmental and social materiality”, whose audience consists of consumers, civil society, employees, and investors too). **This concept is now also included in the Disclosure Regulation** in which asset managers will have to disclose how their investment decisions weighs of ESG factors but also the potential impact of ESG factors on the financial “returns” of investment funds. **There is therefore a need to include the double materiality concept in the level 1 text of NFRD.**
- **Currently, it's difficult for investors to understand the way the materiality assessments are built.** Further transparency on this would be welcome as issuers may/should report on firm-specific NFR aspects, which won't necessarily be covered by general and sectoral KPIs.

### Assurance

#### Comments from AMIC:

- **An EU standard/definition regarding assurance requirements for non-financial information reported by companies falling within the scope of NFRD would be welcome by the AMIC members**, in particular regarding financially material disclosure. ISAE 3000 (Assurance engagements other than audits or reviews of historical financial information) could be a good starting point.
- **A “reasonable approach” by opposition to a “limited approach” is critical to bring a high degree of certainty to investors and to allow asset managers to comply with SFRD.** Well calibrated KPIs will be instrumental to implement an EU standard based on a “reasonable approach”.
- The need for the assurance provider to identify and publish the key engagement risks and response would also be greatly valuable to investors.

## Digitisation

### Comments from AMIC:

- **The tagging of non-financial information would indeed be useful to make them machine-readable.** This will be possible once the new EU standard comes into application.
- **In the medium/long term, we would be in favour of single data access point.** However we consider that the immediate priority should be to deliver on key areas of improvements identified by this consultation (e.g. standardisation, assurances).

## Structure and location

### Comments from the CIF and AMIC:

#### *AMIC*

**The location of non-financial information as well as the integration of it into the financial and other (governance) reporting is of less importance than the fact that it exists and it is credible, transparent and holds high quality.** There is hope that including non-financial information in annual reports would improve the connectivity between financial and non-financial information and inform the stakeholders to the fullest extent about a company's performance, risks, future development and impact on the environment and society. Enhancing of financial materiality disclosures would certainly be helpful for asset managers given that they will soon need to disclose potential impact of sustainability risks on the future performance of portfolios. But **one should be cognizant of the fact that there is currently no standard methodology when it comes to translating these risks into income guidance.** AMIC is also sympathetic to the arguments presented by the CIF regarding liability challenges arising from the EC's suggestion to combine non-financial information with annual reports.

#### *CIF*

**It is also important to consider carefully the legal consequences of where the non-financial information is located:** firstly to ensure that the disclosure does not become inappropriately

subject to any liability regime that applies to the document within which the disclosure is made; secondly to ensure that disclosure is made in a way which is meaningful to investors, and will encourage dialogue between issuers and investors; and thirdly to ensure that unnecessary consequences are avoided, such as increased costs of capital, or a possible move by issuers away from regulated markets (if applicable) due to overly onerous disclosure requirements or increases in liability. There is a clear divide between what certain existing disclosure documents are for. For instance:

- **Annual Report:** The Annual Report's purpose is to allow shareholders and/or investors to assess the company's financial performance or prospects. It must contain: (i) information on ESG matters necessary for an understanding of the company's development, performance and position and the impact of its activity; and (ii) a directors' report containing a range of other data on employees, stakeholder engagement, greenhouse gas emissions, energy consumption and energy efficiency. This is a broad scope, and goes beyond the information required for an assessment of the company's financial performance or prospects, which is the more limited purpose of a Prospectus.
- **Prospectus:** Article 6 of the Prospectus Regulation (EU) 2017/1129 provides that ". . . a prospectus shall contain the necessary information which is material to an investor for making an informed assessment of . . . the assets and liabilities, profits and losses, financial position, and prospects of the issuer and of any guarantor. . ."

The focus of the detailed disclosure requirements that apply to debt is to a large extent on the creditworthiness of the issuer, and ESG disclosure will be relevant to that extent only. However, despite the very different disclosure functions and liability regimes that apply to them, Annual Reports can become part of Prospectuses; for example if incorporated by reference by default in a US Prospectus, or in an EU context, if the Annual Report is used as a universal registration document. As a result, **disclosure included in the Annual Report for one purpose and subject to one liability regime can become part of the Prospectus and perform a different purpose attracting different liability.**

**Relevance of ESG disclosure:** The relevance of ESG disclosure needs to be considered from a range of different perspectives: some ESG disclosure will be relevant to investment decisions in primary markets, or for an assessment of a company's financial performance or prospects. Some will be of little relevance to either. And then some will be designed to encourage a change in corporate behaviour for the benefit of society as a whole, which is context-neutral. So not all ESG disclosure will be relevant in each context.

**Reliability of ESG disclosure:** Some ESG disclosure may also be less reliable, on the basis that it may involve a degree of assumption about future scenarios; IOSCO notes that "ESG disclosures are often forward-looking and are often founded on "what if" scenarios and related assumptions that are inherently uncertain. ". In addition, EFRAG notes that "climate-related disclosures are in an early implementation stage and there is room for improvement" and that companies should avoid "disclosing information that is too general

or does not provide sufficient detail, and disclosures that lack necessary supporting information”.

**Disclosure of less relevant and less reliable information:** Disclosure of less relevant and less reliable information in Annual Reports or Prospectuses could mislead investors as to the significance of the disclosure, or the relevance to their context. This could in turn lead to lengthy and costly litigation, possibly in multiple jurisdictions. At the same time, efforts to ensure the information is entirely relevant and reliable will be costly to issuers. So it is important that the provision of such information is commensurate with its importance and the potential liability that attaches to it.

Less relevant or reliable information could be disclosed in ways that reduce or eliminate liability – for example, on segregated sections of websites with suitable caveats and explanations and/or with statutory protection from litigation; this in turn enables issuers to make disclosure and enter into dialogue with investors in a more meaningful way, without the threat of incurring liability under the Annual Report or the Prospectus.

**Mindful of the above, ICMA recommends that careful consideration be given to the location of ESG disclosure, taking proper account of the relationship between the relevance and reliability of the information and the liability attaching to the relevant disclosure document and its location.**

## Scope

### Comments from AMIC:

- **A broader scope of application will contribute to widen potential universe of ESG investments, which would be beneficial from a risk management perspective.**
- We agree that, generally speaking, all listed companies should be in the scope.
- **However, for SMEs, we would suggest a simplified and proportionate reporting.**
- We are not in favour of including large private companies unless they issue debt instruments publicly.
- For entities (such as listed investment funds) that have to already comply with similar EU legislation (SFDR), applying NFRD appears unnecessary.
- We believe that there should be no distinct threshold criteria between banks/insurers and non-financial corporates, to allow investors to apply the same assessment processes.