Invitation to contribute to the ad-personam mandate of EFRAG Board President Jean Paul Gauzes on non-financial reporting standard setting

In your opinion, if EFRAG were entrusted with the development of possible EU non-financial reporting standards in a revised NFRD, how would the following general and specific considerations, identified as relevant to the standard setting mechanism, apply if EFRAG were to be the standard setter? (NB: this does not affect EFRAG' present mission)

1. Governance – Structure and due process

1.1 Standards need to be developed in the public interest and no individual category of stakeholder may exercise undue influence: How can it be best ensured that standards are developed based on an inclusive and transparent due process? What should be the characteristics of such a due process?

It is impossible to ensure a balanced public interest representation in the standard setter body. The non-financial reporting agenda includes a multitude of important social and environmental issues, each of which requires unique expertise. Furthermore, expertise in setting reporting standards is concentrated in the accounting profession and among reporting initiatives.

Therefore, the EU Non-Financial Reporting Directive should define thematic reporting obligations for companies (for example reporting on climate targets and alignment with the Paris Agreement goals, reporting on human rights due diligence) that specify public interests based on EU and multi-stakeholder needs and objectives; the standard-setter should then be mandated by the European Commission to clarify the reporting requirements and methodologies that would allow companies to fulfil their disclosure obligations.

Assigning the standard-setter with a technical mandate to clarify reporting obligations previously approved by EU co-legislators would prevent individual stakeholder groups from defining what it is that companies should report on, shielding the process from vested interests while ensuring an inclusive outcome.

To ensure a qualitative process, relevant outcomes, due representation of the public interest and sound supervision of the work of the standard-setter, different bodies should interact in the development of standards. For this, we would suggest the following arrangement:

- European Commission: The EC should have the authority to mandate the standard setter to develop particular standards (based on the directions provided by the reformed EU Non-Financial Reporting Directive) and define criteria that would need to be respected by the standard-setting technical body itself in defining standards and indicators;
- Multi-stakeholder supervisory body: There should then be a publicly funded, independent, conflict resolution and supervisory body that oversees the governance, due process and quality of the standard-setting. As part of its competence, such a body should ensure that the criteria defined by the European Commission are respected by the standard-setter in defining standards and indicators. This body could also sign off the proposals of the standard-setter;
- Standard-setter and technical expert groups: As part of the standard-setter, there should be technical expert groups/committees, based on the themes for which the standards need to be developed, and mandated to develop standards; there should also be a group with expertise in process design to facilitate the work of the technical experts (this group and the technical committees should be separate). The final recommendations of the technical groups should

be open for feedback by means of a public consultation, and finalised once the supervisory body expresses satisfaction that a due process has been followed.

Such an arrangement would ensure that the standard-setting process is protected from the undue influence of vested interests. This should be further supported by a transparent selection process of the members of the technical expert groups. Members should be appointed via open public calls with due balance of stakeholders by a dedicated selection committee composed of representatives of different and relevant DGs from the European Commission; information on the selection process and applicants should be publicly available.

1.2 Relevant European institutions and agencies shall be invited to be fully involved in the development of future standards, including the European Securities and Markets Authority (ESMA): How can these European Institutions and agencies be involved in the development of future standards and in the standard setter? Should there a particular role for ESMA?

ESMA - and other public entities that have been mandated to develop technical standards relevant for reporting or having other relevant mandates - should be involved in a separate/external body tasked with ensuring their coordination, with the ultimate objective to ensure policy coherence.

1.3 To permit relevant national public authorities to provide input about whether any future standards are responsive to the public interest, how can these authorities be included in the governance of the non-financial reporting pillar? Which authorities would be the most relevant and how should they be involved?

Given the broad scope of non-financial reporting and the multitude of public interests concerned, the relevant authorities may include public authorities in the area of labour and social affairs, human rights, justice, environment and climate, in addition to financial regulators. Altogether, there might exist several hundreds of such authorities.

Therefore, instead of a formal structure of the standard setter, the standard-setter should have a procedure to inform and consult national governments on strategic developments and decisions. It should also be able to consult topical issues with relevant types of national authorities. National governments should be responsible for ensuring coordination among their own national authorities.

1.4 Should private sector and civil society representatives be involved in the standard setting work? If so, what would be suitable options for doing so in a balanced way? Which stakeholders should be involved? Should the standard setting pillar be a public-private partnership like in the financial reporting pillar?

Both the oversight body and technical expert committees established to develop thematic standards should include subject-matter, expert representatives from multiple stakeholder groups, to ensure (a) the right level of knowledge - given the technical nature of the work - and (b) a balanced representation of different stakeholder groups, as is the case with the Platform on Sustainable Finance. To ensure proper focus of the standards, the body should include a strong representation of NGOs (ensuring representation for each sustainability theme for which standards will have to be developed, e.g. environmental matters, human rights and social issues, anti-corruption), trade unions and workers representatives, responsible investors (with long-standing experience in gathering and assessing corporate sustainability-related data) and academics. This should be alongside a balanced group of representatives from the corporate and financial world, and as mentioned above, from the public sector.

If the new body will be hosted by EFRAG, EFRAG's current governance arrangements should not apply to this new body/institution.

1.5 If there were to be SME standards derived from the future EU non-financial reporting standards, how should the SME angle be addressed in the governance and in the standard setting process?

It is unlikely that SMEs will have resources to participate in the governance directly. Instead, the standard setter should seek to engage them by means of targeted consultations as part of the standard-developing process; and - where relevant - through research and engagement projects similar to the ones currently being implemented by the European Corporate Reporting Lab.

Which governance structure would you foresee for the EFRAG EU non-financial reporting standard setting pillar? How would this fit in the overall EFRAG governance structure? What relation would there be with the financial reporting pillar, if any?

Ideally, there should be an independent body. However, given the urgency to develop standards, we recognise the reasons for the new body to be developed under EFRAG; however, this requires a separate governance structure, as well as a dedicated executive team. To ensure an effective and timely outcome, the EU NFR standard-setting pillar should remain independent from the financial reporting pillar. This is critical to ensure a balanced oversight over the EU NFR standard setter and focus on both sides of materiality (risk and impact perspectives). The work of both pillars needs to be coordinated in order to explore and facilitate integration of financial and non-financial reporting; EFRAG as an institution should provide such coordination. As described above, to ensure a sound non-financial reporting pillar, current governance arrangements should be supplemented by:

- A multi-stakeholder supervisory organ overseeing due process and adherence to the set criteria;
- Multi-stakeholder expert technical committees to be engaged in the development of thematic standards;
- Coordination facility to (a) coordinate the work of the technical committees and (b) ensure policy coherence with other EU institutions;
- Consultative facility to ensure engagement of full spectrum of relevant national authorities;
- Transparency of the process of the development of the standards;
- Public consultation on standards before they are released;
- Capacity to organise research and engagement projects (as is currently the case of the Corporate Reporting Lab);
- Clear strategic priorities provided by Level 1 legislation;
- Public financing of the body.

2. Governance – Cooperation with standard setters and other initiatives

2.1 Any future possible EU non-financial reporting standards must be built on existing reporting standards and frameworks to the greatest possible extent:

- *How can the relevant existing standard-setting organisations be closely associated in future standardisation work? How would you see cooperation and involvement?*
- *More broadly, how should cooperation with existing public and/or private initiatives producing international standards and framework be established, to ensure that any future non-financial reporting standards applying in the EU build to the greatest extent possible on existing standards and frameworks?*
- *How can the EU non-financial reporting standard setting have a global impact?*

If adopted, no one existing standard, nor the blind combination of all standards together, would be suitable to ensure relevant and meaningful reporting from companies on their social and environmental risks and impacts.

Due to their discrepancies, reporting standards and frameworks should not be engaged in the governance of the standard-setter directly. Similarly, the role of the EU standard-setter should not be to align voluntary reporting standards and frameworks, but go beyond that and address gaps.

The EU standard setter, however, should consult its work with these initiatives to understand how to best utilise them.

Existing standard-setters have announced their commitment to collaborate towards the development of international standards. This process will have to take into account gaps and overlaps between all standards involved, and ensure these are properly addressed to prevent any international standard from lacking relevance. These organisations should inform the EU on relevant updates and outcomes of such work, to ensure EU standards can be developed in alignment with such findings. The future EU standard setter should moreover consult existing initiatives when it deems relevant to do so.

The above-mentioned initiative (commitment of existing initiatives to align and coordinate for the development of international standards) should be complementary to the development of EU standards. The needs and ambition behind the development of EU standards clearly differ from those of international standards; nonetheless, these developments should feed into and inform one another. This would ensure both complementarity between European and international processes, as well as the global impact of EU standards.

2.2 How to establish an appropriate coordination between the financial and nonfinancial reporting so as to ensure that financial and non-financial reporting provide an integrated view of the performance, position, development and impacts of reporting companies?

EFRAG should facilitate such coordination. However, no matter how this is done, it’s important to ensure that the impact side of the double-materiality notion is as critical for the development of standards as financial risk.

3. Possible changes to finance of EFRAG

3.1 What ideas do you have for financing of the non-financial reporting pillar? Should the financing reflect the public-private partnership?

No.

4. Do you have any other comments you want to share?

N/A.