Brussels, 30th October 2020

EACB comments to the EFRAG Lab *ad personam* mandate on Non-Financial Reporting Standard Setting

30th October 2020

QUESTIONNAIRE

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 standard setting mechanism, apply if EFRAG were to be the standard setter?

Question 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?

EACB answer: Strong and transparent governance is a key requirement. EFRAG Governance should be adapted to its mission, if it were to evolve potentially into a (quasi) EU NFI reporting standard setter.

For non-financial reporting, in addition with enhancing the role of the stakeholders, currently members of EFRAG, other players are relevant and may be willing to join EFRAG and become fully involved in the standard setting process. Given that the relevant stakeholders for financial and non-financial reporting might not always be the same, changes to the EFRAG's governance appears to be inevitable.

EACB believes that it might be necessary to consider a two-pillar structure to deal with non-financial reporting standards alongside the current pillar dealing with financial reporting. Nevertheless, the aim must be to ensure the interaction and coherence between non-financial and financial reporting to the maximum possible and desirable extent. It has to be underlined that the preparers and users are to a great extent the same for both financial and non-financial accounting standards.

If EFRAG were entrusted with non-financial reporting, attention should be paid in not moving away from international reporting and undermining the coherence of International reporting. Challenges such as climate changes, human rights and social concerns affect companies globally. Ideally the ESG reporting should be developed globally and at all levels of the economy to fulfil the data gap. However, we support EU leadership in NF reporting standard setting as a solution

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is needed in the short term (according to the European sustainable finance legislative framework) although this will represent an interim answer with the aim to stimulate and accelerate the process to create a worldwide recognized NFR standard. Nevertheless, if the EU would decide to set standards it should continue its commitment to global standards and contribute actively to a global solution. We acknowledge that in this respect the IFRS Foundation has launched a consultation[1] on the possible global approach to develop on sustainability reporting.

While the EU Commission recently outlined the idea of a separate governance structure and new players, the interaction with the current structure remains unclear. We believe the governance should be built on the proven credible and successful existing model of EFRAG, resulting into a single highest body overseeing both pillars of EFRAG. The EFRAG governance should be built on two pillars, but it should be one world, integrating or interconnecting between governance over financial and non-financial information reporting activities.

Despite the global efforts, if EFRAG were involved in the development of non-financial reporting standards in a revised NFRD, we believe it should follow the same working arrangements with the EU Commission that are in force for the financial pillar (level II type measures).

Question 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?

EACB answer: EACB believes that it is really difficult to make a selection as the number of agencies working in this sector is currently increasing. To involve them in the development of future standards we suggest the launch of an official application procedure for participation, that will ensure transparency in the selection process.

Finally, we believe that ESAs (ESMA and EBA in particular) should be involved in the process of developing a European non-financial reporting standard. The fact of enhancing their role from observer seat (as it is the case for financial accounting) could be considered in order to enhance EFRAG's public mandate. Of course, this will have implication on funding.

Question 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?

EACB answer: We believe that relevant national public authorities should be included in the governance of the non-financial reporting pillar to permit them to provide input about whether any future standards are responsive to the public interest: among the others, national central banks and public financial markets authorities should be involved in this project. The participation of these institutions is probably necessary for a higher credibility.

Moreover, we believe that national accounting standards setter should be involved in the process of developing European non-financial reporting standards, to a lesser extent national

[1] https://cdn.ifrs.org/-/media/project/sustainability-reporting/consultation-paper-on-sustainability-reporting.pdf

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environmental agency. However, we highlight that a too large number of participants can create difficulties in the decision process. For this reason, we suggest making a distinction between voting Members and technical experts, to ensure the decision-making process will be more efficient and functional without compromising representativeness.

Question 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 stakeholders1 should be involved? Should the standard setting pillar be a **public-private partnership** like in the financial reporting pillar?

EACB answer: For financial reporting, membership of EFRAG Board and General Assembly is already defined. The role and the broad participation of the existing Stakeholders should be ensured, and all voices should be considered. The question arises however whether the membership basis could be extended to some additional relevant members at EU level and at national level both from the private and the public sector. For non-financial reporting, in addition to the stakeholders, currently members of EFRAG, other players are relevant and may be willing to join EFRAG and become fully involved in the standard setting process. The EACB thinks that stakeholder groups that are contributing to the elaboration of financial reporting standards, such as investors, preparers of financial reports (companies) and auditors/accountants shall be involved to a reasonable extent in the process of developing a European non- financial reporting standard. The EACB insisted on the need to involve banking association due to the fact that non-financial reporting could represent a challenge for banks according to the provisions of the NFRD (under revision) integrated with the indications included in the Guidelines on climate-related disclosure. In their role of intermediaries, Financial institutions can only assess their non-financial performance on the basis of their clients' non-financial performance. Without data from their clients', financial institutions will not be able to assess their portfolios with regards to ESG performance. This will allow them to be best placed in providing advices and expertise needed when it comes to set a non-financial reporting standard. We acknowledge that the current EFRAG project task force on the development of recommendations and preparatory work for EU non-financial reporting standards is addressing this issue in the context of the specific workstream for financial institution.

Moreover, preparers should be member of the task force to ensure that the new Standards rules are realistic and feasible. Auditors, accountants, relevant existing standard setter organizations (in particular GRI, SASB but also TCFD, IIRF, CDP and many others) and representative from the Sustainable Finance Platform should also be involved as member of the task force. However, this might lead to an unreasonable number of participants. For this reason, we suggest to consider to take a two-level approach in which representatives from the civil society should be divided in category related to the sector of activity. Each category could nominee a spokesperson that will take part directly to standard setting work (first level) and liaise with the broader group of supporting representatives (second level).

Question 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?

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EACB answer: It has to be ensured that the views of SMEs will also be included with representatives in the standard setting process. In this respect, we note that in the current project task force on the development of recommendations and preparatory work for EU non-financial reporting standards, a specific workstream for SMEs has been created.

Question 1.6 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?

EACB answer: If EFRAG were entrusted with the development of possible EU non-financial reporting standards, we believe radical changes in the governance should occur. We appreciate the public/private sector engagement in the financial reporting pillar of the EFRAG and we would like to suggest to take the same approach in developing the governance of the non-financial reporting pillar. We acknowledge that public authorities influence will play a bigger role for non-financial reporting, to legitimate the future mandate. This will also have direct impact on the funding of the EFRAG.

2. Governance – Cooperation with standard setters and other initiatives

Question 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?

EACB answer: We believe that existing disclosure frameworks of NFI, whether at EU level with the NFRD or at global level (TCFD, GRI etc) all predate, by definition, the sustainable finance action plan (SFAP) and the EU Green Deal.
In the meantime, the NFRD Guidelines on reporting climate-related information (June 2019), the sustainable investments disclosure regulation (Regulation (EU) 2019/2088), CRR2 pillar 3 requirements and the so called taxonomy regulation have been adopted. The SFAP and the green deal are game changers in the way financial players will contribute to the sustainable transition of our economies and in the data they will need from corporate clients to meet their disclosure obligations and play their role. Such game changer calls for a fresh start in NFR. Availability of robust and reliable data on a large scale will allow financial institutions and investors to steer their portfolios towards the objectives of Paris Agreement and the European Green Deal much more efficiently and on a much broader scale.
We need a single European standard for all companies for reporting a harmonized set of non-financial information aligned with the TSC of the EU taxonomy. Accordingly, we believe that in line with the approach taken in Art. 3 and 36 of the Accounting directive 2013/34, a very differentiated framework should be developed for micro-companies, small companies, and for medium and larger companies, all based on a common methodology. For smaller companies, especially micro companies, non-financial reporting via a simplified standard could in a first phase remain a voluntary exercise, and a phased approach should be envisaged to ensure that gradually

they are able to produce the relevant data on a permanent basis. Any newly created non-financial reporting framework, which does not include all corporates, will have to provide appropriate solutions for the reporting duties of companies reporting according to a full or more developed framework (for more information please see the EACB answer to the NFRD review consultation)[2]. Harmonized reporting standards are necessary for development of a EU central data register[3].

As already said, we believe that EFRAG could play an important role in the processes regarding global standards, involving stakeholders, like relevant standards setter and professional associations, in the process: inclusiveness and pluralism should be guaranteed together with transparency in selecting the experts that will take part to the project task force.
For those reasons, it is important to obtain rapid clarification and confirmation from the European Commission proposals and EU legislative process on revising the Non-Financial Reporting Directive on the role and competences it intends to confer to EFRAG. Finally believes that an international coordinated approach is necessary to ensure the coherence and the global impact of this effort.

Question 2.2 How to establish an appropriate **coordination between the financial and non-financial 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?

EACB answer: While the aspects of non-financial reporting differ from financial reporting and qualitative aspects will continue to be of prime importance in NFR, synergies between financial and non-financial reporting should be explored to pave the way towards and integrated reporting system over time. Such synergies are essential to ensure that the reporting system is an integrated, holistic and convergent system that preparers can apply and users can rely on to form an integrated view of the financial and sustainability-related risks and impacts on reporting companies.
In this sense, EFRAG is best placed to become the European centre of expertise on corporate reporting (both financial and non-financial reporting). Certainly, a combined role of EFRAG in financial and non-financial reporting could be a major advantage in developing future non-financial reporting standards for use in the EU.
As envisaged by the European Commission, EFRAG could build on the activities of the LAB to develop its activities further, as advisor to the Commission on the best course of action regarding NFR reporting standards (also taking into consideration whether a simplified standard could be needed for certain types of businesses or SMEs, for instance). For this purpose, EACB considers the involvement of national authorities to be very useful. The same role of national authorities in tow pillars can increase the connectivity

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?

[2]http://www.eacb.coop/en/position-papers/green-and-sustainable-finance/the-eacb-answer-to-the-commission-s-consultation-on-the-nfrd-review.html
[3]http://www.eacb.coop/en/news/eacb-news/joint-industry-letter-call-for-eu-action-a-centralized-register-for-environmental-social-and-governance-esg-data-in-the-eu.html

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EACB answer: Given the envisaged changes to the EFRAG's mandate, role and strategy, the funding model of EFRAG should also be further reviewed. EFRAG needs first to develop a renewed vision and a strategy for the years ahead, adapt its governance, consider the activities necessary to deliver on the strategy before building a budget and set the level of funding necessary to achieve the agreed strategy and related activities.

In this respect, it appears very important to assess what is needed, in terms of resources, to achieve the objectives on financial reporting and non-financial reporting. Synergies need to be found and resources reallocated to the agreed priorities. Any funding model should be fair and built on objective criteria.

The mandate to be given to EFRAG on non-financial reporting should also call for an in-depth discussion on the necessary funding to be provided by EU authorities. The funding mechanism of the EC also needs to be changed to avoid rigidity and counterproductive incentives and reflect the envisaged broadened mandate from the Commission and ensure stability to funding rather than the current approach which amplifies volatility as it is based on % of the total contributions instead of a fixed contribution.

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