Sustainability disclosures

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Sustainability-related disclosures by financial entities and revision of NFRD

The urgency of the challenges arising from climate change and environmental degradation require strong action and increased efforts from all actors. In order to mobilise end-investors, we need to make it easier to identify whether and how financial entities and financial products are ambitious in terms sustainability. One cornerstone in the EU Sustainable Finance strategy is the Regulation on sustainability-related disclosures in the financial services sector (Reg. 2019/2088).

This Regulation, although *prima facie* a disclosure framework, has considerable behavioural effects: Many financial entities will have disclosed their due diligence policies on the integration of principal adverse impacts on sustainability caused by their investment decisions (i.e. the negative externalities). In order to reduce greenwashing and ensure credibility of financial products that pursue sustainable investments or promote environmental or social characteristics, any sustainability-related claim by a financial product must be well justified.

The Co-legislators agreed on an ambitious timeframe for the Regulation: most of its provisions apply as of March 2021. By then several regulatory technical standards must be jointly developed by EIOPA, ESMA and EBA. The finalisation of the regulatory technical standards faces several challenges. Whilst pioneering sustainability disclosures, the standards should ensure the overall regulatory neutrality and cross-sectoral standardisation so that end-investors can compare relevant information across borders, financial sectors and financial products. In addition, the Commission is adapting provisions on fiduciary duties and suitability test in UCITS, AIFMD, Solvency II, MiFID II and IDD rules.

The Commission also intends to put forward a proposal to revise the Non-Financial Reporting Directive (NFRD) in early 2021, which governs the disclosure of non-financial information from companies towards investors and other stakeholders.

Good disclosure of non-financial information is critical to the Sustainable Finance strategy as financial market participants need comparable and reliable non-financial information to be able to understand the risks and impacts of their investments.

There is considerable evidence that information currently reported under the NFRD is not sufficiently comparable and relevant information is not reported at all, also because of the discretion that companies have in deciding what information to report.

The revision will need to strike the right balance between materiality (information that is relevant to the circumstances of a company, that is necessary for understanding its social or environmental impacts or the risks that it faces) and standardisation (users of information need reporting to be comparable between companies and that companies report all relevant information) and find a way of combining European and global approaches. In the meantime, the European Financial Reporting Advisory Group was mandated to launch preparatory works on potential European non-financial reporting standards, including mapping of existing non-financial reporting standard-setting initiatives. ●

Frank Pierschel

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Data do make the difference

With the adoption of the EU action plan on sustainable finance in March 2018, the issue of data needs has rapidly gained attention amongst legislators, financial regulators, domestically and worldwide. Sustainability disclosures are essential to meet the objective of the Paris Agreement targeting a carbon neutral economy by 2050. Rescuing our human life on earth will mark the biggest structural challenge since the industrial revolution in the 19th century. In order to achieve this goal, it is not just capital to be allocated. It is also information, education and a de-ideologised assessment of the risks ahead to us.

Now, the financial industry is put into a delicate sandwich position. Sandwich between political and social goals on one side and the needed real economy's structural change on the flipside. Financial industry is obliged to disclose information about their approaches on integration of sustainability risks into their business strategies.

It has to report on the integration of sustainability risks, on the consideration of adverse sustainability impacts, on sustainable investment objectives, ▶

▶ as well as on the promotion of environmental or social characteristics, in investment decision-making and in advisory processes. Harmonised requirements for financial companies and their products will ensure a certain standard of investor and consumer protection and will help to mitigate the risk of greenwashing.

Hence, we are faced with three key challenges: First, to fulfil its role in sustainable finance, the financial industry needs information from non-financial industries. Therefore, non-financial reporting must be enhanced. Secondly, as long as we are bound by the obstacle of limited ESG data availability, data must be pooled and publicly available to level the playing field. I plead for a publicly funded data pool of raw data. Thirdly, we need to find the right balance of information. Foremost, data must be comparable and transparent.

Financial and non-financial disclosures are key to bridge the financial industry's data needs to fulfil their elevated tasks in sustainable finance and the key responsibility of the real economy to make this planet great again.

Disclosures should be simple, clear, concise and not misleading. Information overload that would ultimately confuse an investor must not happen. As well as we need to ensure that disclosures are not overly burdensome for the industry. It is of paramount importance that we may not lose track of continuing to apply the principle of "supervision with a sense of proportion" almost good practice in the roll-out of previous comprehensive frameworks.

So, the biggest challenge is creating proportionality in a field that could not be wider by now. That is why the taxonomy will extraordinary support streamlining all efforts towards well informed but not too punishing ESG disclosures.

The better all players are informed, the clearer business strategies, risk management practices and ESG cultural behaviours can be drawn, either, in the financial and in the non-financial industries. BaFin requires, for instance, a strategic assessment of sustainability risks and has issued a "Guidance Notice on Dealing with Sustainability Risks" which serves as a compendium of proportional good practice principles to be applied. However, such risk management practices just get into life when necessary data is available. ●

Jacek Jastrzębski

Chair of the Board, Polish Financial Supervision Authority

Moving towards a greater understanding of sustainability

The EU plans for the green transition envisage a major role of ESG disclosures by financial and non-financial institutions, which are the core of the Regulation on sustainability-related disclosures, Taxonomy Regulation and NFRD revision.

The urge for the enhanced disclosures regime and for the green activities taxonomy is understandable. It is true also from the Polish market's perspective that the lack of standardised disclosures is a significant obstacle to ESG consideration in business activity. A comprehensive framework is very much needed to serve as a means of harmonisation for the benefit of the single sustainable market. In particular, the essential feature of Taxonomy is that – considering the company's capex as well as turnover and opex, if relevant – it could give investors a flavour of where the company is going and how and when it would become Taxonomy-aligned. This is important especially for those EU markets where, like in Poland, many activities will not become subject to Taxonomy right away.

A dialogue between all stakeholders should be endorsed to the extent possible.

Disclosures should be directed in such a way to support the market's transformation towards sustainability, but idea for a 'brown' taxonomy should not be a subject of legislative attention at current early stage of ESG standards introduction. We do not want to achieve stranded assets by legislation and this is the greatest danger

that the 'brown' taxonomy carries along. Moreover, there is the fact that industries which are the least green now give employment to thousands of people. This directly relates to the 'S' part of ESG and cannot be ignored.

Entry into force of dedicated laws and revisions will not mark a finish line ▶

for the work on ESG disclosures nor other sustainability-related issues. Disclosures alone are only one element of ESG information flow as a whole. We expect that Polish financial institutions will be keen to use the services of professional data providers – rather than to build their internal capacity in this regard. This means that such providers will play a crucial role in ESG landscape and no doubt they cannot operate unsupervised.

This supervision has to be designed in such a way to allow for the development of local ESG data providers which in practice should mean sharing competence between the EU and MS. This entails in turn great efforts to be made to achieve supervisory convergence as ESG and Taxonomy supervision would be placed on EU and local levels at the same time.

Nevertheless, localisation of ESG issues is indispensable to the extent possible as we wish to achieve a transformation on every level of existing value chains. To that end, we might need to think about the structure of the market in advance – localisation of supervision and data provision are good things to start with.

The right path to take then is to encourage openness to different perspectives and dialogue between all stakeholders. This will bring a common understanding and will contribute to safeguarding the effectiveness of our efforts towards sustainability transformation. Moreover, a constant dialogue is crucial to understand local perspectives and to streamline supervisory convergence.

The above issues were highlighted in the response of the KNF to the EC consultation regarding SF Strategy in July 2020.

Sebastien Raspiller

Director, Treasury, Ministry of Economy and Finance and the Recovery Plan, France

Transparency on ESG risks is now a democratic requirement

In 2020, sustainability disclosures are still the main tool to change investors' behaviors and corporate's strategies towards a more sustainable model. This is why French legislation has moved very early on towards increased transparency regarding ESG risks and the integration of ESG factors into investors' strategies. However, one must remain lucid about the current quality of this information and its real impact on economic behaviors. Transparency is useful in a precise framework where the relevance, quality and comparability of information are guaranteed. Confidence in and access to this information is another key factor of success. We should not seek transparency for the sake of transparency, the information must be substantial.

The wide dissemination of data on sustainability risks and strategies is useful for all actors in the economy. It enables companies to know more about themselves and to deepen their understanding of the issues at stake in their sectors. It enables investors to better manage their risks and to meet the rising expectations of savers in this area. Lastly, it enables public decision-makers to adapt regulation to collective issues as effectively as possible. Transparency is a form of collective cooperation. Transparency on ESG risks must therefore be considered as a democratic requirement.

Looking now at the concrete implications of these principles and objectives for financial regulation. France has been very active in promoting TCFD and we continue to support these recommendations. We are also still committed to the success of the One Planet Summit and the works led by the NGFS. Work at the G20 level has nevertheless come to a halt due to the international context.

We can of course only regret this, but we must now assume that the immediate future of this regulation is European. The most immediate challenge comes with the revision of the non-financial reporting directive, hopefully in 2021. We believe the revision of the NFRD should make a certain number of indicators and computing methods mandatory and contain sectoral requirements while taking into account the size of the company. It should also lead to more "connectivity" between financial and non-financial information.

Finally, a high level of standardization of indicators should not prevent companies from making individualized comments. ESG information should therefore be structured according to three levels: a universal level that makes it possible to find out how a company stands in relation to the economy as a whole and to determine an absolute level of performance and risks, a sectoral level that makes it possible to compare companies with the same level of constraint, and an individual level that allows each company to develop and value its own approach.

> *ESG information should be structured according to three levels - universal, sectoral, individual.*

We are also very keen that the work on the dematerialization of non-financial data should start simultaneously. Our wish is to see the rapid emergence of a European open data base (preferably operated by a private player). We are confident that access to the data will enable the development of risk management and non-financial performance analyses that we so desperately need to transform our system. In this regard, the involvement of financial actors will be crucial to drive these improvements.

Tobias Bücheler

Head of Regulatory Affairs, Allianz SE

Alignment and relevance of sustainability disclosures is key for its success

The EU's ambition to become the first climate neutral bloc in the world by 2050 calls for massive capital flows into sustainable investments. The financial sector has an important role to support the aspiring EU sustainability agenda in financing a broad transformation towards a low-carbon future. However, to channel investments towards sustainable assets effectively and assess sustainability risks correctly, reliable information by investee companies is needed.

In addition, upcoming EU legislation like the Taxonomy Regulation and the Sustainable Finance Disclosure Regulation can only be fulfilled if more and better non-financial information is available. At this stage, there is a strong need to align the different pieces of disclosure regulations and corresponding implementation timelines to avoid compliance challenges and liability risks for financial service providers, as well as confusion for customers and investors. The revision of the Non-Financial Reporting Directive (NFRD) provides a great opportunity to align EU legislation and improve the availability, quality and comparability of sustainability data.

In the context of the NFRD review, companies should be mandated to disclose straightforward climate-related KPIs - based on greenhouse gas emissions - which inform on core business transformation and allow for global scaling and application in global portfolios. This should include forward-looking statements and targets as well as sector-specific KPIs for key sectors, starting with high-exposure sectors. The disclosure of such climate pathways would greatly support the mainstreaming of sustainable finance towards a low-carbon economy while facilitating engagement activities between investors and companies.

The fact that climate risks are particularly acute calls for immediate and effective action with respect to transparency and comparability of environmental data. Nonetheless, other sustainability factors apart from climate aspects are equally important and hence the opportunity to improve and align non-financial disclosure in their regard as well should not be missed.

Moreover, amendments to the NFRD should focus on a high degree of integration and connectivity between non-financial and financial reporting as both types of information are required to evaluate a company's development, performance and position.

While the ongoing EU initiatives on non-financial disclosure are an important step to address the increasing need for sustainability data, a high degree of data comparability can only be achieved via international standardization. The EU should hence avoid further fragmentation and push for a maximum degree of international alignment regarding non-financial reporting.

We strongly support the EU Commission's ambition regarding climate neutrality and believe that the EU is well-positioned to take a global leading role in this regard. Reporting requirements are a critical enabler for this and the chance to develop a consistent and well aligned framework must therefore not be missed. ●

Takanori Sazaki

Regional Executive for Europe, Middle East and Africa, Mitsubishi UFJ Financial Group

Strengthening the road to decarbonisation

An increasing number of governments and individual companies globally are announcing their ambitions to commit to a net zero world. And while it is very important for all stakeholders to state their ambition, it is even more important to understand how governments, corporations and other significant stakeholders are going to achieve these ambitions. These individual roads to decarbonisation are commonly referred to as the transitional pathways.

We will need a whole economy transition in which each stakeholder is playing an important part. Net zero will not be achieved in a niece. In order to understand what the overall transitional pathway will look like, we need to rely on consistent and comprehensive data. Not only will this data help to understand whether we are on track, it will also help financial institutions and central banks assess the risks related to this pathway, while at the same time seize opportunities to enhance and potentially even accelerate the transition.

Climate risk and resilience should become a core part of financial decision making and comprehensive disclosure will enable

financial institutions to appropriately adjust their strategies and build risk management capabilities. ▶

The first voluntary climate related disclosure standards suitable for a broad range of companies were published in by the Task Force for Climate Related Disclosures (TCFD) back in 2017. TCFD membership support has increased exponentially to approximately 1100 organisations representing USD 140 trillion in balance sheet. 285 of the total number of TCFD supporters are public and private Japanese organisations, bringing Japan to the top of the TCFD league table.

The TCFD standards have matured over time and companies have steadily increased their disclosures in each of the four key climate risk areas covering Governance, Strategy, Risk Management and Metrics. In the EU, we are expecting the TCFD standards to become mandatory standards through the revised non-financial disclosure regulation and other jurisdictions may follow.

The Japanese financial system, including our institution as the current chair of the Japanese Bankers Association, welcomes and has continuously supported a number of globally coordinated initiatives which have developed since the first voluntary guidelines were published in 2017 to further enhance sustainability related disclosures, such as the work of the Network for Greening the Financial System (NGFS), whose mandate is to enhance the role of the financial system to manage risks and to mobilize capital for green and low-carbon investments, the work of UNEP-FI to develop methodologies for assessing physical and transition risks related to climate change, specifically focussing on carbon intensive sectors, and the recently established BCBS high level Task Force on Climate-related Financial Risks (TFCR), which is tasked with the impact of climate change on global financial stability.

It is essential to ensure that the voluntary TCFD standards are indeed appropriate and complete, before adopting them into regional legal frameworks and using them to design policy, supervisory and regulatory standards. These climate related disclosures will only strengthen the role of the financial system in the world's path to net zero, if they are used in a consistent manner by both public and private organisations and that they remain globally aligned.

Ingrid Holmes

Head of Policy and Advocacy, Federated Hermes International

EU sustainability disclosures: Non-Financial Reporting Directive reform is key

Investors incorporating sustainability or ESG data into investment decisions will be looking for (ideally) consistent and comparable sustainability-related information. This is difficult to come by. This is partly because the disclosure landscape today is crowded with a range of different voluntary regimes aiming to tackle a range of environmental and social challenges, and to an extent governance challenges (although these are increasingly addressed through corporate governance codes), through greater transparency. Their focus lies along a spectrum from the more obviously and immediately financially material (e.g. SASB) to the more medium term financially material and, largely, more currently public policy-focused disclosures (e.g. SDGs). While this happened for the best of intentions it creates a confusing reporting landscape for companies, which must identify the most relevant frameworks for them. It also creates a lack of comparability in the information reported to users. As such there is a clear value case to be made for streamlining disclosure regimes to bring efficiency to the system overall through cutting costs of disclosure – and, as part of that process, to ensure that disclosures are made in a decision-useful way for their intended audience, which includes investors.

'Audiences' or 'users' of sustainability disclosures will, in the main, be interested in the specifics of how companies are identifying, assessing and managing sustainability-related financial risks and over what timescale in order to better understand the risk versus reward profile of the firm and better inform their own decision-making. For this reason, preparers should keep front of mind the need to ensure disclosures are decision-useful to the different users of those disclosures. This means they should focus on what is material for the respective audiences of disclosure, which sometimes may not align with what the preparer themselves might consider material.

Consolidating the currently patchwork approach to voluntary versus legal reporting requirements will help with the standardisation of corporate reporting and so is, overall, welcome. However, for a sustainable/responsible investor this can never be a substitute for looking in detail at the information provided and the inputs and assumptions that underpin it. There is already a lot of data available (especially from large caps); the challenge now is for investment managers to contextualise it, for it to be reported in a more coherent fashion and for it to be essentially integrated into financial reporting - both narrative and numbers. Being or becoming a sustainable company is always a work in progress that static reporting cannot capture - and so it is important to look at trends as well as numbers.

Attempts at streamlining the current plethora of sustainability disclosures regime it is not without risks, however. In simplifying the complexity inherent in the sustainability agenda, straightforward but misleading reporting may result. In addition, while EU leadership on standardising reporting is to be commended, setting new EU standards does potentially risk a significant divergence between EU and non-EU markets, which is a concern given US companies, for example, account for around 50% of the investable universe.