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European Commission

INCEPTION IMPACT ASSESSMENT

Inception Impact Assessments aim to inform citizens and stakeholders about the Commission's plans in order to allow them to provide feedback on the intended initiative and to participate effectively in future consultation activities. Citizens and stakeholders are in particular invited to provide views on the Commission's understanding of the problem and possible solutions and to make available any relevant information that they may have, including on possible impacts of the different options.

TITLE OF THE INITIATIVE	Revision of the Non-Financial Reporting Directive
LEAD DG (RESPONSIBLE UNIT)	Directorate-General for Financial Stability, Financial Services and Capital Markets Union (DG FISMA). Responsible Unit: FISMA.C.1 (Corporate reporting, audit and credit rating agencies)
LIKELY TYPE OF INITIATIVE	To be determined
INDICATIVE PLANNING	Q4 2020
ADDITIONAL INFORMATION	https://ec.europa.eu/info/business-economy-euro/company-reporting-and-auditing/company-reporting/non-financial-reporting_en

The Inception Impact Assessment is provided for information purposes only. It does not prejudge the final decision of the Commission on whether this initiative will be pursued or on its final content. All elements of the initiative described by the Inception impact assessment, including its timing, are subject to change.

A. Context, Problem definition and Subsidiarity Check

Context

In 2014 the EU agreed Directive 2014/95/EU (the Non-Financial Reporting Directive or NFRD), an amendment to Directive 2013/34/EU (the Accounting Directive). The NFRD requires certain companies to report information regarding the environment, social and employee issues, human rights, and bribery and corruption, on an annual basis. The NFRD applies to large listed companies, banks and insurance companies with more than 500 employees. Companies under the scope of the NFRD had to meet these reporting requirements for the first time in 2018, for information covering financial year 2017.

In 2017, as required by the NFRD, the Commission published non-binding guidelines to help companies report relevant, useful and comparable information. In June 2019 the Commission published additional guidelines on how to report climate-related information, which integrate the recommendations of the FSB Task Force on Climate-related Financial Disclosures (TCFD).

The non-financial information needs of the investment community are increasing very substantially and very quickly. The demand for better information from investee companies is driven partly by investors needing to better understand financial risks resulting from the sustainability crises we face, and partly by the growth in financial products that actively seek to address environmental and social problems. According to the preliminary conclusions of a Fitness Check that the services of the Commission are finalising (Fitness Check on the overall EU framework for public reporting by companies), the NFRD does not adequately respond to these needs.

As announced in the Commission's Communication on the European Green Deal, it is important that companies and financial institutions improve their disclosure of non-financial information so that investors are better informed about the sustainability of their investments. To this end, the Commission committed to review the Non-Financial Reporting Directive in 2020 as part of the strategy to strengthen the foundations for sustainable investment. This also reflects global trends, with a wide variety of different organisations and stakeholders calling for a consideration of a new regulatory approach to non-financial reporting.

In the European Green Deal the Commission also committed to support businesses and other stakeholders in developing standardised natural capital accounting practices within the EU and internationally.

In its resolution on sustainable finance in May 2018, the European Parliament called for the further development of reporting requirements in the framework of the NFRD. In December 2019, in its conclusions on the Capital Markets Union, the Council stressed the importance of reliable, comparable and relevant information on sustainability risks, opportunities and impacts, and called on the Commission to consider the development of a European non-financial reporting standard.

Finally, some new EU legislation, including the regulation on sustainability disclosures in the financial services sector, the regulation on a classification system (taxonomy) of sustainable economic activities and the amendment to the benchmark regulation regarding climate-related benchmarks, can only fully meet their objectives if more and better non-financial information is available from investee companies. The taxonomy regulation will require companies under the scope of the NFRD to disclose certain indicators of the proportion of their activities that are classified as sustainable according to the taxonomy.

Problem the initiative aims to tackle

This initiative aims to address the following **problems**:

(1) There is inadequate publicly available information about how non-financial issues, and sustainability issues in particular, impact companies, and about how companies themselves impact society and the environment. In particular:
   a. Reported non-financial information is not sufficiently comparable or reliable.
   b. Companies do not report all non-financial information that users think is necessary, and many companies report information that users do not think is relevant.
   c. Some companies from which investors and other users want non-financial information do not report such information.
   d. It is hard for investors and other users to find non-financial information even when it is reported.

(2) Companies incur unnecessary and avoidable costs related to reporting non-financial information. Companies face uncertainty and complexity when deciding what non-financial information to report, and how and where to report such information. In the case of some financial sector companies, this complexity may also arise from different disclosure requirements contained in different pieces of EU legislation. Companies are under pressure to respond to additional demands for non-financial information from sustainability rating agencies, data providers and civil society, irrespective of the information that they publish as a result of the NFRD.

These problems have the following **consequences**:

- Investors cannot take sufficient account of sustainability-related risks and opportunities, or of the social and environmental impacts of their investments. As a result, there are systemic risks to the economy from investments that do not adequately price in sustainability-related risks, and there are inadequate capital flows to companies that contribute to resolving sustainability-related problems.
- Civil society organisations, trade unions and others cannot effectively hold companies to account for their impacts on society and the environment, which in turn creates an accountability deficit and can undermine trust in companies and in the social market economy.
- The EU Single Market does not fully exploit its potential to deliver on the European Green Deal and contribute to the Sustainable Development Goals.

The **underlying drivers** of these problems arise from regulatory and market failures. The reporting requirements in the NFRD are not detailed, are difficult to enforce, leave a lot of discretion to reporting companies, and do not apply to some companies from which users say they need information. Market pressures on their own have not proven to be sufficient to ensure that companies report the non-financial information that users say they need. The market is characterised by a number of overlapping and sometimes inconsistent private non-financial reporting frameworks and standards, and companies face significant challenges in deciding whether and to what extent they should use these different frameworks and standards.

Basis for EU intervention (legal basis and subsidiarity check)

The legislative initiative will be based on Article 50 TFEU or Article 114 TFEU. The choice of the legal basis of the measure will depend of the aim and content of the act.

Member States acting alone are not able to ensure the consistency of non-financial reporting requirements across the EU. The consistency of non-financial reporting requirements could affect the ability of companies to establish themselves and to operate freely across the single market.

Member States acting alone are also not able to ensure the comparability of the reported non-financial information across the single market. The comparability of reported information enables potential investors to better compare companies across national borders. It is therefore important for the free movement of capital and to the achievement of the Capital Markets Union, especially in light of the growing relevance of non-financial information for investment decisions.

Compared to individual action by Member States, EU intervention can have a larger influence on the development of policy and regulatory approaches to non-financial information in other jurisdictions around the world.

B. Objectives and Policy options

The **objectives** of the initiative are:

(1) To ensure investors have access to adequate non-financial information from companies to be able to take account of sustainability-related risks, opportunities and impacts in their investment decisions.
(2) To ensure that civil society organisations, trade unions and others have access to adequate non-financial information from companies to be able to hold them accountable for their impacts on society and the

environment.

(3) To reduce unnecessary burden on business related to non-financial reporting.

Policy options

The Commission has initially identified the following policy options to analyse in the impact assessment:

1. Continue the current approach of non-binding guidelines to assist companies when reporting according to the NFRD. The Commission could revise the general non-binding guidelines on non-financial reporting published in 2017, and/or issue additional guidelines on particular themes, similar to the 2019 non-binding guidelines on reporting climate-related information.

2. Explore the use of standards. The EU could, for example, endorse an existing or possible future standard on non-financial reporting, which would remain voluntary for companies to use if they wish to. This option should also take account of the non-binding guidelines published by the Commission in 2017 and 2019

3. Revise and strengthen the provisions of the NFRD. Such a revision could modify non-financial reporting requirements in some or all of the following ways:
   - Specifying in more detail what non-financial information companies should report.
   - Requiring some or all companies under the scope of the legislation to use a non-financial reporting standard.
   - Modifying the scope, either to add certain categories of company not currently covered by the NFRD and/or by excluding certain categories of company that are currently covered.
   - Strengthening the provisions regarding the assurance of non-financial information.
   - Clarifying and further harmonising provisions regarding where non-financial information should be reported, in particular with regard to publishing such information in the management report and/or in a separate report.
   - Ensuring that non-financial information is available in a digital format.
   - Strengthening the enforcement regime and promoting greater supervisory convergence.

C. Preliminary Assessment of Expected Impacts

Likely economic impacts

This initiative could create additional administrative burden on companies, due to more detailed reporting requirements, but at the same time it also creates opportunities for simplification and some reduction of administrative burden.

The main determinants of costs for business are likely to be: which companies are subject to any possible reporting requirements; the extent and detail of any new reporting requirements; whether and to what extent non-financial information has to be assured; and the extent to which any information that companies are required to report is information that companies themselves need and use for their own internal management purposes.

Additional reporting requirements could lead to additional demands for information from SMEs, especially SMEs that are in the supply-chains of larger companies, even if SMEs themselves are not subject to the reporting requirements. While this could mean additional burden on some SMEs, failure to provide non-financial information may impact their economic viability and their commercial opportunities as suppliers of larger companies. It might also limit their ability to benefit from green investments.

This initiative should contribute to the achievement of the Capital Markets Union, by ensuring that non-financial information available to investors is more standardised and comparable across the EU.

If this initiative leads to more standardised non-financial disclosure requirements across the EU, and provided that it strikes the right balance between costs and benefits, it should have a positive impact on investment and the single market. It would simplify the operation of companies across the single market and avoid diverging non-financial reporting requirements at national level. It would support investments in particular in green assets in line with the needs of the European Green Deal.

In addition it should help to reduce the potential for financial instability, and contribute to the long-term resilience of the economy, by enabling investors to take greater account of sustainability-related risks and opportunities in their investment decisions.

This initiative could have positive impacts on the resilience and competitiveness of EU companies if it further supports the identification and management of non-financial issues that are relevant to their business. On the other hand, it could undermine the competitiveness of EU companies if it results in unnecessary costs to which non-EU companies are not currently subject.

Likely social impacts

This initiative is expected to have indirect but significant positive impacts on social issues, for example on labour standards, non-discrimination and social inclusion. These impacts will arise to the extent that the provision of non-financial information by companies:

- Leads to greater capital flows to companies that address social issues and have a good social performance;
- Enables civil society and others to hold companies to account for their social impacts;
- Drives greater awareness of social issues in companies and positively influences the way in which companies address such issues and manage related risks, including in their supply chains.

This initiative could have a negative impact on employment levels in the EU if the chosen option is excessively burdensome and therefore has a substantial negative impact on the competitiveness of EU companies.

Likely environmental impacts

This initiative is expected to have indirect but significant positive impacts on the environment, including climate, air, water, land, biodiversity, and resource use. These impacts will arise to the extent that the provision of non-financial information by companies:

- Leads to greater capital flows to companies that address environmental issues and/or have a good environmental performance;
- Enables civil society and others to hold companies to account for their environmental impacts;
- Drives greater awareness in companies of natural capital impacts and dependencies and positively influences the way in which companies address such issues and manage related risks, including in their supply chains.

This initiative should not lead to any significant negative environmental impacts.

Likely impacts on fundamental rights

This initiative is expected to have indirect but significant positive impacts on fundamental rights, including for example the right to life, freedom of expression, non-discrimination, fair and just working conditions, and the prohibition of child labour. These impacts will arise to the extent that the provision of non-financial information by companies:

- Leads to greater capital flows to companies that respect fundamental rights and seek to contribute to the fulfilment of those rights;
- Enables civil society and others to hold companies to account for their impacts on fundamental rights;
- Drives greater awareness of fundamental rights in companies and positively influences the way in which companies address such issues and manage related risks, including in their supply chains.

This initiative should not lead to any significant negative impacts on fundamental rights.

Likely impacts on simplification and/or administrative burden

This initiative risks creating additional administrative burden on companies, due to more detailed reporting requirements. It could also create additional enforcement and supervision costs for public administrations if the chosen option includes more detailed reporting requirements and if reporting requirements are applied to a larger number of companies than is currently the case.

At the same time, this initiative also creates opportunities for simplification and reduction of administrative burden:

- It could address the current difficulty that companies face in trying to report using a variety of different non-financial reporting frameworks and standards.
- It could reduce the complexity for certain financial sector companies that have to meet non-financial disclosure requirements contained in different pieces of EU legislation.
- It could reduce the burden for companies of having to respond to individual requests for information from sustainability rating agencies and data providers.

D. Evidence Base, Data collection and Better Regulation Instruments

Impact assessment

An impact assessment is being prepared to support the preparation of this initiative and to inform the Commission's decision.

Evidence base and data collection

The services of the Commission have recently contracted two studies that will provide additional data and evidence for the impact assessment:

- "Study on the non-financial reporting Directive". This study will;
  - collect data on the number, turnover and market capitalisation of different categories of EU companies to enable a calculation of the overall impacts of possible changes to the scope of the Directive;
  - provide data and analysis on: the cost of compliance with the NFRD; the assurance of non-financial information; how companies decide what information to report; the extent to which the requirements of the NFRD have led companies to make additional requests for information to their own suppliers; and

whether and how disclosure requirements have affected companies' behaviour. To gather this information, the consultants responsible for this study will, amongst other things, send a targeted survey to companies under the scope of the NFRD.

- "Sustainability Ratings and Research". This study will provide an overview of the market and practices with regard to sustainability ratings agencies and providers of sustainability information. It will, amongst other things: analyse the sources and kinds of information used by such organisations, including the extent to which they use publicly available information from companies; and analyse the costs for companies of responding to requests for information from such organisations.

In addition, the services of the services of the Commission will continue to gather and analyse the evidence contained in studies and reports regarding non-financial reporting and the NFRD in particular.

Consultation of citizens and stakeholders

The aim of the consultation will be to seek stakeholders' views on the problems with regard to non-financial reporting and the possible solutions.

The services of the Commission have already undertaken a number of general and targeted consultation activities that will provide information relevant for this impact assessment, including:

- An open online public consultation carried in the framework of the Fitness Check on the EU framework for public corporate reporting (March-July 2018).
- An open stakeholder meeting (October 2018), also carried out in the context of the Fitness Check.
- A targeted online consultation on a draft version of the guidelines on climate-related reporting (March 2019).
- Expert workshops on the application of the materiality principle in the context of non-financial reporting (November 2019) and on the audit and assurance of non-financial information (December 2019).

In addition, in January 2019 the Technical Expert Group on Sustainable Finance organised an online call for feedback on its report on climate-related reporting, which served as a basis for the reporting guidelines.

Additional consultation activities

The Commission will organise a further open online public consultation, specifically on the possible revision of the NFRD, in the first quarter of 2020. In addition, it will convene meetings with experts and stakeholders to gather views and evidence as necessary.

The services of the Commission will consult Member States and national competent authorities through existing committees.

Will an Implementation plan be established?

The need for an implementation plan will be assessed in light of the outcome of the impact assessment and the decision about which policy option to retain.