# IA RESPONSE TO EUROPEAN COMMISSION CONSULTATION DOCUMENT ON THE UPDATE OF THE NON-BINDING GUIDELINES ON NON-FINANCIAL REPORTING

1. **Do you have any comments on Chapter 2 "How to use these guidelines" of the report?**

The Investment Association welcomes the opportunity to comment on this Consultation Document and supports the Commission's efforts to facilitate "sufficient, reliable and comparable sustainability-related information from investee companies" by updating the NFRD Guidelines specifically with regard to climate-related information. Moreover, we support the "flexible approach" taken to the non-binding guidelines given that "methodologies and best practice in the field of climate-related reporting are evolving fast".

In particular, we welcome the distinction made between Type 1 and Type 2 disclosures. Type 1 disclosures refer to those climate-related risks and opportunities that are seen to have a material financial impact on an investee company and which a company "*should* consider if climate-related information is necessary for an understanding of its development, performance, position and impact its activities". By contrast, Type 2 disclosures relate to climate-related risks and opportunities that have environmental and social materiality; companies "*may* consider [these disclosures] in order to provide more enhanced information". We would echo the importance of treating these two forms of disclosures separately.

As the Consultation Document clearly states, there are a number of existing frameworks which have already contributed significantly to the area of non-financial reporting, in particular in relation to Type 1 disclosures. Chief among them are the recommendations from the Taskforce for Climate-Related Financial Disclosure (TCFD). Other initiatives include:

- The Institutional Investors Group on Climate Change (IIGC) has produced a guide to help investors with climate scenario analysis.[1] It sets out a five-step framework to help asset owners and managers use scenario analysis in setting out how climate change can drive financial impact across their portfolios.
- The United Nations Environment Programme Finance Initiative (UNEP FI) is in the process of developing guidelines towards a first set of climate-related investor disclosures in alignment with the TCFD recommendations (including development of scenarios, models and metrics)[2]
- The Bank of England's Prudential Regulation Authority's CP of October 2018 sets out a strategic approach to managing the financial risks from climate change.[3]

Given substantial progress already made in this space, we are very supportive of the European Commission's commitment to make links between the revised guidelines and existing reporting frameworks and standards. Moreover, we echo the importance of drawing on global reporting frameworks to promote harmonisation at a global level.

**2. Do you have any comments on Chapter 3.1 "Business Model" of the report?**

As above, it is imperative that climate-related disclosures made by businesses hinge on the risks and opportunities that are financially material to that particular investment's business model. We would expect such "business model" disclosures to be overwhelmingly Type 1 in nature.

**3. Do you have any comments on Chapter 3.2 "Policies and Due Diligence Processes" of the report? (3000 character(s) maximum)**

It is important for companies to produce disclosures relating to policies and due diligence processes. In particular, it is crucial that all companies undertake a wide-ranging risk assessment (i.e. initial due diligence process) to ascertain the extent to which ESG risks, including climate-related risks, have a material impact on the

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1 http://www.iigcc.org/publications/publication/navigating-climate-scenario-analysis
2 http://www.unepfi.org/investment/tcfd/
3 https://www.bankofengland.co.uk/prudential-regulation/publication/2018/enhancing-banks-and-insurers-approaches-to-managing-the-financial-risks-from-climate-change (p.12)

success of their business, in the short and long term, and that this risk assessment should be the responsibility of the Board.

We have concerns around the expectation that a company's remuneration policy should link to Type 2 disclosures. It is not clear how this would work in practice. We would not advocate the prescription of such an approach. Instead, we believe that remuneration policy should align the incentives to a company's management with the company's overall long term, sustainable performance.

In the Investment Association's Long Term Reporting Guidance, we make recommendations related to companies' disclosure of their material environmental and social risks. We advocate that a company's Board ensure the company has in place "effective systems for managing and mitigating significant [environmental and social] risks, which, where relevant, incorporate performance management systems and appropriate remuneration incentives."[4]

4. **Do you have any comments on Chapter 3.3 "Outcomes" of the report?**

We would welcome further clarification on the example of Type 2 disclosure given in Table 3 on page 15 of the Consultation Document. If the impact of climate change on a company influences its financial performance, we would understand this particular factor to have a financially material impact, i.e. to refer to and require Type 1 disclosure.

5. **Do you have any comments on Chapter 3.4 "Principal Risks and Their Management" of the report?**

Climate change risks are wide in scope, covering physical, transition and liability risk and they also interact with other ESG risks that companies face. In any framework, we believe it is vital to focus on ensuring issuers provide the information that investors need to assess and manage climate risks, rather than asking companies to estimate the risks they face under different scenarios. For instance, it would be more valuable to provide investors with data to calculate the impacts of alternative climate scenarios on individual companies, rather than requiring companies to provide their own estimates of that risk. Companies' estimates may be calculated inconsistently as

[4] Investment Association *Long Term Reporting Guidance,* paragraph 43.4 (p.11) <https://www.ivis.co.uk/media/12519/Long-Term-Reporting-Guidance.pdf>

a result of using different assumptions, and may be coloured by a logical incentive to appear less exposed than peers.

We take issue with some of the disclosures labelled as Type 2 in Table 4. Namely, we think items 5 and 7 in the Type 2 list on page 16 should be moved to Type 1. These relate to the categorization of the risks of climate change on financial performance of a company and on definitions of risk terminology, respectively. They would by their nature be deemed to have a financial impact on the Company and would therefore be better place under Type 1 disclosures.

**6. Do you have any comments on Chapter 3.5 "KPIs" of the report?**

We are generally supportive of the KPIs for Type 1 disclosures. In particular, we note the decision to include a KPI on CapEx and/or OpEx for "assets or processes associated with activities that substantially contribute to mitigation of or adaptation to climate change activities".

Whilst KPIs like revenue or turnover generated from environmentally sustainable activities present a static picture of a company's activities, information on a company's Capex would provide a forward-looking assessment of the kinds of activities which a company is seeking to grow. This would help demonstrate whether a company is transitioning to greener activities. This kind of KPI could be used to evidence substantial movements of capital from large cap companies into green activities.

In addition to KPIs around climate-related solutions, investors would benefit from more information on sustainable products and services more broadly, for example those making a contribution to the SDGs (which extends beyond environmental concerns). We would therefore welcome a specific disclosure requirement on the percentage of revenue from sustainable products and services.

It is important to note that Scope 3 disclosures on greenhouse gas emissions will be more or less relevant and measurable dependent on the sector and materiality.

Finally, we do not think the proposed disclosure of the Green Bond Ratio would be helpful. Asset managers are primarily concerned with companies' exposure to risk, and not simply their exposure to green projects through green bond funding. Moreover, green bonds are not yet consistently defined.

7. **Do you have any comments on Annex I "Proposed disclosures for Banks and Insurance companies to the report?**

We are supportive of sector-specific requirements. The materiality of different ESG considerations will differ between companies and also between sectors.

8. **Do you have any comments on Annex II "Mapping of NFRD requirements and TCFD recommended disclosures" to the report?**

We are very supportive of efforts to link the NFRD Guidelines to existing frameworks, in particular, global initiatives such as the TCFD. This is in large part due to the TCFD framework being a global initiative.

As this Consultation clarifies, whilst the NFRD covers both financial materiality and environmental and social materiality, the TCFD has a financial materiality perspective only. We would reiterate our support for the distinction between Type 1 disclosures – those that companies "should consider" – and Type 2 – those "additional disclosure that companies may consider". It will be important for financial market participants and companies to work together closely to develop good practice around Type 2 disclosures as these are relatively new considerations in the marketplace. This close coordination will be necessary to ensure that any developing practice does not just lead to a "tick box" approach. Any disclosures made by companies – whether fundamental or additional – need to provide decision-useful information related to the sustainability of an investee company and the continuation of its license to operate in society.

9. **Do you have any additional comments on the report as a whole?**

We are supportive of efforts to improve the consistency, comparability and clarity of corporate reporting methods.

As asset managers, we form a central component of the investment chain, along with issuers and asset owners and are supportive of efforts that seek to improve consistency and comparability across the investment chain. A joined up approach is needed to ensure that climate change-related, and other ESG considerations, are meaningfully factored into investing:

- Issuers need to be incorporating ESG considerations into their business strategy and reporting on how they do so in a meaningful way. This should reflect a company's specific business model and demonstrate consistency with its long-term strategy;

- Asset managers, too, need to engage with investee companies to enhance disclosure, improve outcomes from those investee companies, and make capital allocation decisions based on the material risks and opportunities they pose.
- Finally, it is also important that asset owners are engaged and driving demand for long term sustainable approaches to investment.

All these elements should be considered to ensure a joined up approach and to provide the right incentives to drive long-term sustainable growth in financial markets.