

On behalf of the Public Affairs Executive (PAE) of the EUROPEAN PRIVATE EQUITY AND VENTURE CAPITAL INDUSTRY

11 June 2020

Response to the European Commission public consultation on the revision of the Non-Financial Reporting Directive

1. Quality and scope of non-financial information to be disclosed

- Question 1 - To what extent do you agree or disagree with the following statements about possible problems with regard to non-financial reporting?

	1	2	3	4	5	Don't know
The lack of comparability of non-financial information reported by companies pursuant to the NFRD is a significant problem.			X			
The limited reliability of non-financial information reported by companies pursuant to the NFRD is a significant problem.			X			
Companies reporting pursuant to the NFRD do not disclose all relevant non-financial information needed by different user groups.			X			

1= mostly disagree, 2= mostly disagree, 3= partially disagree and partially agree, 4= mostly agree, 5= totally agree

- Question 2 - Do you consider that companies reporting pursuant to the NFRD should be required to disclose information about other non-financial matters in addition to those currently set out in Article 19a? Please specify (no more than three matters).

Answer:

No, not necessarily from our perspective.

Members of Invest Europe and the national associations are private equity and venture capital funds and fund managers that are users of non-financial information relating to companies they invest in (which are principally unlisted companies and typically do not currently report under NFRD). PE/VC fund managers are currently able to specify and obtain

the non-financial information they require from investee companies, either for regulatory reasons or to satisfy the needs of fund investors, in greater detail and in areas more suitable to their and their own investors' needs than would likely be provided by standardized disclosures under Article 19a (to the extent those companies are themselves able to obtain that information).

This is a direct consequence of the exchange of information that follows from the negotiations in the acquisition process and the very relationship between PE/VC investors and portfolio companies. The relationship and constant dialogue between PE/VC investors and company owners - a specific and inherent feature of the PE/VC industry - cannot be regulated. It grows organically: if investors want more information, they will ask for more; if they want less information, they will ask less.

Against that background, it is unclear how our member firms would benefit directly as investors from any mandating of further public disclosures from the companies they invest in.

- Question 3 - Are there additional categories of non-financial information related to a company's governance and management procedures, including related metrics where relevant, (for example, scenario analyses, targets, more forward-looking information, or how the company aims to contribute to society through its business activities) that companies should disclose in order to enable users of their reports to understand the development, performance, position and impacts of the company? Please specify (no more than three).

Answer:

No, not from our perspective.

Whilst these types of non-financial information will often be useful to PE/VC funds and fund managers as investors, our members, as controlling or significant investors in those companies, are typically able to obtain such information without recourse to legal requirements. It is unclear to us how further *public* disclosures would be of benefit to them or investee companies/potential investee companies.

In relation to the concrete examples given in the question, we would like to make the following observations:

- If the scope of the NFRD is to be widened, i.e. more companies will be required to disclose pursuant to the NFRD, then one should be careful about adding more categories. Expanding the scope of the reporting to include more companies, as discussed later in this consultation, may be more valuable than expanding the scope of what is required to be disclosed.

- It is important to strike a balance between legitimate business interest in maintaining confidentiality of business plan and wider public policy requirements (if any) to disclose forward-looking information.
  - *If* it is to be disclosed, forward-looking information should only apply to targets set by the company in the ESG domain and should *not* relate to commercial information or any other information that could endanger the competitive situation of the company.
  - Disclosing forward-looking climate change scenarios (as suggested by TCFD) should be voluntary. If considered helpful, the EU could provide relevant guidance that companies could use to produce those.
  - A voluntary requirement to include a statement of how the company aims to contribute to society (and/or local community) does not seem overly onerous and could be of use.
  - Reporting on targets could be helpful *when* specific targets have been set by the reporting company but setting such targets should not be mandatory.
- Question 4 - In light of the importance of intangibles in the economy, do you consider that companies should be required to disclose additional non-financial information regarding intangible assets or related factors (e.g. intellectual property, software, customer retention, human capital, etc.)?  
*Yes, No, Don't know*

Answer:

No, not from our perspective.

While intangible assets/related factors should be specifically in scope when assessing material sustainability risks (e.g. labour issues related to human capital or privacy issues related to software), they should not need to be reported on if not deemed material. In fact, we question the need to provide details on software, customer retention and human capital as we are unclear what benefit this will provide to the users of the accounts.

In light of the above, such additional disclosures should *only* be considered *insofar as*:

- (i) it can be demonstrated to be useful, e.g. in facility investor disclosure requirements; and
- (ii) it does not damage the intellectual property of high-tech young companies in which venture capital and private equity funds have been investing.

On a similar note, it should also be considered to what extent part of this information can be too commercially sensitive to provide. In general, companies should not be required to disclose commercially sensitive information about assets such as intellectual property, customer retention, employees, IT, etc.

Materiality and proportionality are key in this respect.

- Question 5 - To what extent do you think that the current disclosure requirements of the NFRD ensure that investee companies report the information that financial sector companies will need to meet their new disclosure requirements?  
*Not at all, To some extent but not much, To a reasonable extent, To a very great extent, Don't know*

Answer:

To a reasonable extent.

PE/VC firms that will be subject to the sustainability-related disclosure regulation<sup>1</sup> (SFDR) from 2021 will themselves ensure that portfolio companies disclose, to the extent those companies are able to do so, the material information required for firms to report publicly and to their own investors under the new rules for financial services firms. Further disclosure rules for portfolio companies are not required by our members for these purposes.

In addition, it is important to take into account that this may be further impacted by the outcome of the RTS that the European Supervisory Authorities are preparing. It is in the interest of everyone to ensure alignment, as this will facilitate easier adoption and make the process more (cost) efficient.

Indeed, moving forward, we believe it is crucial to ensure consistency between (a) the SFDR disclosures concerning the principal adverse impacts of investment decisions on “sustainability factors” and (b) the NFRD reporting requirements on large companies’ “external” impact of their activities. While the four non-financial matters considered by the NFRD correspond to the SFDR “sustainability factors”, the RTS implementing the SFDR disclosures will likely impose the supply of very granular information which is not currently contemplated by the NFRD.

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<sup>1</sup> Regulation of the European Parliament and of the Council on disclosures relating to sustainable investments and sustainability risks and amending Directive (EU) 2016/2341

- Question 6 - How do you find the interaction between different pieces of legislation (You can provide as many answers as you want)?  
*It works well, There is an overlap, There are gaps, There is a need to streamline, It does not work at all, Don't know*

Answer:

It works well. There is an overlap. There are gaps. There is a need to streamline.

Given the diversity of the PE/VC industry and the wide variety of members, experience with the different pieces of legislation will also differ. Some members will find that the interaction works well, the experience of others will indicate that there are gaps or overlaps. Hence, the multiple answers given to this question.

That said, overall we do not think that immediate changes to the framework are needed to help our members meet the requirements that will be imposed under the disclosure regulation, as they can obtain the information from companies already.

However, if there is an appetite or ambition to head towards a unified framework, then we would strongly encourage consistency and advocate for a coherent regulatory approach to sustainability disclosures. A uniform framework would also need to be applied proportionately and should be voluntary at least at the SME end.

On a related note, it is important to ensure that the legislation works on a through the structure basis, i.e. from portfolio company, to GP to large investor with their corresponding obligations, to reduce the time and adviser cost of managing/processing the same data at the GP and investor levels. Concretely, there should be an express and clear interaction between the regulatory requirements at the different levels of the ownership and investment structure. Obligations should apply to the top company of each portfolio company group, not fund-wide.

Ultimately, disclosures by portfolio companies must translate into greater ease for managers and institutional investors to comply with their own sustainability/ESG and reporting obligations.

- Question 7 - In order to ensure better alignment of reporting obligations of investees and investors, should the legal provisions related to non-financial reporting define environmental matters on the basis of the six objectives set out in the Taxonomy Regulation: (1) climate change mitigation; (2) climate change adaptation; (3) sustainable use and protection of water and marine resources; (4) transition to a circular economy; (5) pollution prevention and control; (6) protection and restoration of biodiversity and ecosystems?  
*Yes, No, Don't know*

Answer:

Yes, from our perspective.

Within the current scope of the NFRD, it may make sense to ensure coherence with the Taxonomy Regulation (though it is worth noting that the Taxonomy was set up for a different purpose). Alternatively, companies could be advised to provide information on their *alignment* with the Taxonomy.

*If* NFRD were extended to unlisted companies, then reporting using the definitions in the Taxonomy Regulation could be sensible where relevant and perhaps on a materiality/proportionality/comply-or-explain basis.

Widening the scope of the Taxonomy Regulations would not be appropriate, particularly given the close relationship and organic exchange of information between PE/VC investors and company owners that is already in place. As indicated previously, our members can already obtain the information they need in the form they need in order to meet any regulatory obligations imposed on them (subject to the company itself being able to obtain that information).

***Please provide any comments or explanations to justify your answers to questions 1 to 7.***

Answer:

First and foremost, we believe it is critical to consider and approach any revision to the Non-Financial Reporting Directive in the context of the current Covid-19 pandemic and the recovery from the ongoing crisis. It is crucial that regulators and authorities tap into the new reality and the likely aftermath, and considerably calibrate their proposed regulation accordingly.

The post-Covid world is never ending and a deep recession is looming, if not already upon us. Given the unprecedented impact, every ounce of business energy will be needed to fight their way out of that recession and start the economy growing again. Efforts should focus on aiding businesses to grow, ensuring that businesses adopt appropriate ethical standards and that they adopt a transparent approach to business and the reporting of their financial and non-financial affairs under the overarching concept of proportionality.

Secondly, when considering expanding or introducing changes to the NFRD regime, it is important to take into account the differences between and specificities of various financial services sectors. In the case of PE/VC, the main characteristics of the business model include: (i) the existence of extensive knowledge reporting and the organic exchange of information that grows from the very relationship between PE/VC investors and company owners; and (ii) the core, primary targets of PE/VC investments being SMEs, start-ups and other high-growth companies. While non-financial reporting can have value in some context(s), imposing overly burdensome

reporting obligations on such companies would be counterproductive to the overall goals of sustainability.

Finally, the following concerns should be kept in mind *at all times* when reviewing and considering changes to the NFRD:

- (i) reporting obligations should be aligned and consistent with reporting requirements that will follow from other EU regulation/legislation, e.g. the ESG disclosure standards for financial market participants and the supplementing RTS on which that the European Supervisory Authorities have recently launched a consultation;
- (ii) alignment between reporting obligations and identifying synergies is key to get a real (and positive) effect on the economy, although there also needs to be a balance between the cost of forcing disclosure of additional items and the benefit to recipients;
- (iii) reporting should focus on information that investors find useful and/or need for their own reporting (and investment) obligations, avoiding issues that are of marginal benefit. Information provided by portfolio companies should map appropriately to investors' requirements;
- (iv) reporting should not lead to a disproportionate burden, additional bureaucracy and/or excessive costs, especially for smaller companies; and
- (v) requirements should be the same for similar (private) companies regardless of their ownership structure so as to ensure a level playing field.

## 2. Standardisation

- Question 8 - In your opinion, to what extent would a requirement on companies to apply a common standard for non-financial information resolve the problems identified?  
*Not at all, To some extent but not much, To a reasonable extent, To a very great extent, Don't know*

Answer:

To a reasonable extent.

A superior non-financial standard does not completely exist today so within the current scope of the NFRD, encompassing public equity investments and anonymous (retail) investors, a common reporting standard may seem sensible.

However, *if* there is an appetite to expand the NFRD to private investments, then there are some important considerations to be made and a common standard may not be helpful (one size may not fit all).

As alluded to previously, as things stand, requirements at firm level under the Disclosure Regulation should be sufficient to ensure that end user investors obtain the information they require in a comparable, reliable and relevant way. This is particularly the case for PE/VC firms given how the industry works.

In any case, it is crucial that the NFRD does not become too onerous/prescriptive before there is one reporting standard.

- Question 9 - In your opinion, is it necessary that a standard applied by a company under the scope of the Non-Financial Reporting Directive should include sector-specific elements?  
*Yes, No, Don't know*

Answer:

Ideally, no. See also our response to Question 8, touching upon the importance to avoid forcing standardised disclosure on a one-size-fits-all basis to companies of different natures and sizes in diverse sectors and with diverse operations.

The requirements should be expressed in a way which allows for a flexibility of response which is appropriate to different sector-specific issues.

Including sector-specific elements risks creating multiple differing regimes and an associated compliance and cost burden. A diversity of responses by sector has potential additional burdens and suggests that additional information will be required. Anything additional should be voluntary. That said, *if* the standards eventually will require reporting on specific metrics, then it needs to include sector-specific elements to make it useful for investors. This would avoid including metrics that are non-material in certain sectors or vice versa.

- Question 10 - To what extent would the application of one of the following standards or frameworks, *applied on its own*, resolve the problems identified while also enabling companies to comprehensively meet the current disclosure requirements of the Non-Financial Reporting Directive, taking into account the double-materiality perspective?

	1	2	3	4	Don't know
Global Reporting Initiative		X			
Sustainability Accounting Standards Board			X		

International Integrated Reporting Framework		X			
Another framework or standard (Please specify)					
<a href="#">WEF ESG Metrics - Consultation draft: Toward Common Metrics and Consistent Reporting of Sustainable Value Creation.</a> Note: The above draws metrics from e.g. GRI and SASB			X		

1= not at all, 2= to some extent but not much, 3= to a reasonable extent, 4= to a very great extent

Answer:

GRI, SASB and IIRF are all good frameworks but none of them *alone* could comprehensively meet NFRD requirements.

Frameworks like GRI and SASB are complementary and their application makes some sense but these should be guidance rather than prescriptive. Indeed, *if* a standard is recommended, then it should be applied on a voluntary rather than a mandatory basis.

- Question 11 - If there were to be a common European non-financial reporting standard applied by companies under the scope of the NFRD, to what extent do you think it would be important that such a standard should incorporate the principles and content of the following existing standards and frameworks:

	1	2	3	4	Don't know
Global Reporting Initiative			X		
Sustainability Accounting Standards Board			X		
International Integrated Reporting Framework			X		
Task Force on Climate-related Financial Disclosures (TCFD)			X		
UN Guiding Principles Reporting Framework (human rights)			X		
CDP (Carbon Disclosure Project)			X		
Carbon Disclosure Standards Board (CDSB)			X		
Organisation Environmental Footprint (OEF)					X
Eco-Management and Audit Scheme (EMAS)					X
Another framework or standard (please specify)					

1= not at all, 2= to some extent but not much, 3= to a reasonable extent, 4= to a very great extent

Answer:

The first seven of these frameworks all contain valuable elements and are participants in the Corporate Reporting Dialogue, which is a reasonable kite mark.

That said, there are three important observations we would like to make:

- The paramount consideration should be creating a regulatory framework which addresses the requirements of all market participants in a consistent and coherent manner. When thinking about the international nature of various financial services sectors, including the PE/VC industry, a global standard may be preferable. The EU should not create its own standard when others, such as SASB and TCFD, are useful and have already gained significant traction globally - global coherence is important.
- Any framework would need to be proportionate, allow for certain sector specific reporting and be driven by materiality.
- *If* a standard is recommended, then it should be applied on a voluntary rather than mandatory basis.
- Question 12 - If your organisation *fully* applies any non-financial reporting standard or framework when reporting under the provisions of the NFRD, please indicate the recurring annual cost of applying that standard or framework (including costs of retrieving, analysing and reporting the information).

Name of standard or framework (max 3)	Estimated cost of application per year, excluding any one-off start-up costs
N/A	N/A

- Question 13 - In your opinion, would it be useful for there to be a simplified standard and/or reporting format for SMEs?  
*Yes, No, Don't know*

Answer:

No. Not from our perspective.

Many private equity portfolio companies will fall within this bracket and so information relating to them will require to flow back to private equity managers and institutional investors in any event.

We think that (a) in general PE/VC fund managers can obtain the reporting that they require from portfolio companies that are negotiated on investment and over time, though this may be easier for some (larger) investors than for other (smaller) ones, and (b) PE/VC fund managers would conduct extensive due diligence before investment, so *standardized public* reporting would be of limited assistance to desktop / initial filter reviews of target portfolio companies.

We do not think that forcing disclosure on all SMEs to level the playing field up to the level that fund managers will be required to disclose is compelling. In fact, it is important to avoid (too big) an impact on the SMEs and start-up enterprises backed by the venture capital community as that may be an unnecessary distraction from building a business and creating employment and wealth. In addition, imposing overly burdensome reporting obligations on such companies may be counterproductive to the overall goals of sustainability.

It is difficult to quantify costs precisely because:

- They will vary significantly between companies, depending on: (a) the amount of non-financial information that is material to that company and therefore needs to be reported (which will depend on the size of the company and its particular business activity); and (b) the amount of non-financial information that any given company already reports (the greater the gap between a company's current reporting practices and those required under NFRD, the greater the cost).
- The level of materiality and assurance that will be required under the recast Directive for different sizes of company (assuming there will be a strong element of proportionality) remains unclear.
- It would be difficult to disentangle the proportion of reporting costs that could result directly from NFRD from those attributable to existing non-financial reporting practices, where these exist.

However, in general, auditor feedback relating to companies already subject to the NFRD suggests that the costs associated with such reporting could be significant. Companies newly in scope would be required to establish a range of new processes to support the new requirements. For a minority, this may amount to tweaks to existing processes, while for most, new systems will need to be introduced. These systems will need to cover: understanding the new requirements (and preparing instructions and guidance for local teams); local data extraction; internal reporting of information to management; and consolidation of information into final reports. On top of this will come external costs (e.g. legal advice and potentially significant audit costs if any level of assurance is required), training costs and senior management review time.

From experience, costs are always much more than expected, particularly in the first few years of reporting where systems and processes may need changing to accommodate / capture the required data in the correct format. It is also worth the Commission noting that companies just over the reporting threshold will be disproportionately affected by this legislation and the associated compliance cost.

Any further work on ascertaining costs should include internal costs of employees working, external advice/consultants as well as the cost of changing systems and processes in

preparation to comply, IT etc. and should cover a broad range from those businesses just over the threshold to the top end of SME definition.

Against this background, any extension of the recast NFRD should be limited to larger unlisted companies/PIEs (a) that can cover these costs more easily and (b) for whom public disclosure of non-financial information is arguably more easily justified by a larger and more diverse range of stakeholders, akin to those of a larger public listed company/PIE.

In other words, scope should be limited. If it is not, then it is critical that any market-led reporting framework for SMEs is simplified, proportionate, flexible and voluntary (comply-or-explain) to prevent smaller companies being overwhelmed by the production of reporting that is not then used by sufficient stakeholders to justify the cost.

Also consistency is important in this regard. When creating a simplified framework / standard, it is important to ensure a level playing field and not to discriminate on the basis of ownership or shareholder structure. Private equity owned companies should not have higher reporting requirements than any other companies. In addition, lower requirements should not only apply to SMEs but also to mid-caps.

- **Question 14** - To what extent do you think that a simplified standard for SMEs would be an effective means of limiting the burden on SMEs arising from information demands they may receive from other companies, including financial institutions?  
*Not at all, To some extent but not much, To a reasonable extent, To a very great extent, Don't know*

Answer:

To some extent but not much.

In the PE/VC context, GPs are often subject to bespoke reporting requirements to particular investors that require particular data reporting items from portfolio companies, which would not be (and should not be) captured by a simplified standard for SMEs.

It is important to consider that providing non-financial information to large companies or to financial firms pursuant to contractual obligations is different from including that information in annual management reports subject to publicity requirements, considering also the criminal and civil liabilities surrounding the information contained in such reports.

While the activities of large companies have an impact on society and the environment which grounds the imposition of a generalized duty to include non-financial information in their annual management reports (or in separate reports) so as to meet the information requirements of a broad set of stakeholders, extending such a duty to SMEs may be a disproportionate measure considering:

- (a) the associated administrative and cost burdens for SMEs (see also our response to Question 13);
  - (b) the fact that non-financial information requested by business counterparties and capital providers may be supplied to them by SMEs based on specific agreements (i.e. without including such information in their annual management report); and
  - (c) the possibility for SMEs to include such information in their annual management report on a voluntary basis (by way of example, this option is specifically contemplated by the Italian legislation transposing the NFRD).
- Question 15 - If the EU were to develop a simplified standard for SMEs, do you think that the use of such a simplified standard by SMEs should be mandatory or voluntary?  
*Mandatory, Voluntary, Don't know*

Answer:

Voluntary.

We consider that any reporting standard for SMEs, *if introduced* (which we are not in favour of), should be voluntary and proportionate. In fact, disclosures for SMEs should be limited at least until a positive cost-benefit outcome has been proven with the larger, listed companies that are providing this information.

- Question 16 - To what extent do you agree that the body responsible for developing a European non-financial reporting standard should also have expertise in the field of financial reporting in order to ensure “connectivity” or integration between financial and non-financial information? *Not at all, To some extent but not much, To a reasonable extent, To a very great extent, Don't know*

Answer:

To a reasonable extent.

In the spirit of integration, there should be one body. The trend is towards financial and non-financial reporting being integrated to some extent, to facilitate explanations of the impact non-financial issues have on financial reporting.

- Question 17 - The key stakeholder groups with an interest in and contributing to the elaboration of financial reporting standards have historically been investors, preparers of financial reports (companies) and auditors/accountants. To what extent do you think that these groups should also be involved in the process of developing a European nonfinancial reporting standard?

	1	2	3	4	Don't know
Investors				X	
Preparers				X	
Auditors/accountants			X		

1= not at all, 2= to some extent but not much, 3= to a reasonable extent, 4= to a very great extent

Answer:

All of these should be involved:

- to ensure a coherent regulatory framework which will work effectively and efficiently in practice; and
- because they all may identify problems unforeseen by others that need resolution.

Investors should include fund managers, ESG consultants and administrators (who are likely to produce fund managers' disclosures and investor reports).

- Question 18 - In addition to the stakeholders referred to in the previous question, to what extent do you consider that the following stakeholders should be involved in the process of developing a European non-financial reporting standard?

	1	2	3	4	Don't know
Civil society representatives/NGOs		X			
Academics		X			
Other (please specify)			X		
(National) Statistical offices					
Sustainability reporting bodies (GRI, SASB, WEF)					
Other reporting framework organisations (such as CDP and similar)					
Industry bodies such as Invest Europe and the EBF					

1= not at all, 2= to some extent but not much, 3= to a reasonable extent, 4= to a very great extent

Answer:

Consultation with groups like NGOs and academics is important as it provides valuable input and stakeholder trust to the process but it should be somewhat limited in order to keep the process efficient. In addition, given their often theoretical approach, their involvement introduces a risk of unnecessary disclosures and the creation of an inefficient patchwork of requirements.

Rather, involvement should be focused on users of the information, i.e. the investors, who take a more realistic and practical approach.

- Question 19 - To what extent should the following European public bodies or authorities be involved in the process of developing a European non-financial reporting standard?

	1	2	3	4	Don't know
European Securities Markets Authority (ESMA)			X		
European Banking Authority (EBA)			X		
European Insurance and Occupational Pensions Authority (EIOPA)			X		
European Central Bank (ECB)			X		
European Environment Agency (EEA)			X		
Platform on Sustainable Finance			X		
Other (please specify)					
EU Fundamental Rights Agency			X		

1= not at all, 2= to some extent but not much, 3= to a reasonable extent, 4= to a very great extent

Answer:

All should be involved to ensure (i) a coherent framework, and (ii) that there is consistency between the various frameworks/requirements to avoid inefficiencies, inconsistencies and disproportionate resource burden on companies.

However, there should be some caution that the range of input of these bodies and authorities is limited to common issues rather than broadening into more esoteric areas of interest for specific bodies.

- Question 20 - To what extent do you consider that the following national authorities or bodies should be involved in the process of developing European non-financial reporting standards?

	1	2	3	4	Don't know
National accounting standards-setters		X			
Environmental authorities		X			
Other (please specify)					

1= not at all, 2= to some extent but not much, 3= to a reasonable extent, 4= to a very great extent

Answer:

All should be involved to ensure a coherent framework. However, their involvement should be limited and focused on the alignment of frameworks to avoid a plethora of additional asks.

**Please provide any comments or explanations to justify your answers to questions 8 to 20.**

Answer:

We would like to use this opportunity to emphasise two key messages:

- When considering changes to the NFRD, the potential burden (financial and time) for the companies, especially the smaller ones, should be taken into account. This is why **proportionality** and **materiality** are fundamental.
- There is potential for duplication with other reporting standards so we would want as much **alignment** as possible to **reduce duplication of effort**.

### 3. Application of the principle of materiality

- Question 21 - Do you think that the definition of materiality set out in Article 2(16) of the Accounting Directive is relevant for the purposes of determining which information is necessary to understand a company's development, performance and position?  
No, not at all; To some extent but not much; To a reasonable extent; Yes, to a very great extent; Don't know

Answer:

To some extent but not much.

The Article 2(16) definition has a specific financial reporting purpose and should not be applied here without significant modification. Material effects may be longer term and not directly transpire in financial statements and/or company valuations.

An updated definition more clearly setting out the double-materiality perspective and their interdependence may be beneficial to accelerate the market's internalization of today's externalities. That said, there should be a consistent 'read across' to other associated Regulations.

In addition, one should be wary of asking companies (and possibly their auditors) to make subjective determinations of the materiality of pure externalities. If pure externalities are to be reported, it should be on the basis of objective criteria set by the standard-setters and not left to the judgement of individual companies.

- Question 22 - Do you think that the definition of materiality set out in Article 2(16) of the Accounting Directive is relevant for the purposes of determining which information is necessary to understand *a company's impacts on society and the environment*?  
*No, not at all; To some extent but not much; To a reasonable extent; Yes, to a very great extent; Don't know*

Answer:

To some extent but not much.

As implied by the questions, it is worth drawing a distinction between internal and external impacts of sustainability issues. While the current definition of materiality looks quite appropriate when considering how sustainability issues can affect the development, performance and position of a company (Question 21), the definition seems less adequate to capture the needs of a large set of stakeholders to gain a proper understanding of how the business of a company impacts society and the environment (Question 22). These needs are not necessarily linked to specific decisions to be based on non-financial reporting in the same manner as investors' and creditors' decisions are generally affected by financial reporting (including reporting of the financial and other expected impacts of sustainability issues at company level).

- Question 23 - If you think there is a need to clarify the concept of 'material' non-financial information, how would you suggest to do so?

Answer:

Definitions should be consistent across EU policy and related Regulations and should be useful, in this case material to decisions made by investors/counterparties.

- Question 24 - Should companies reporting under the NFRD be required to disclose their materiality assessment process?  
*Yes, No, Don't know*

Answer:

No. What is meant by 'materiality' should be sufficiently clear without this.

That said, while a detailed assessment process is not necessary, especially not as a requirement, underlying assumptions and/or reference to standard used could be of interest.

***Please provide any comments or explanations to justify your answers to questions 21 to 24.***

Answer:

Even though there is merit in providing some tailoring, it may not always be helpful to users of the accounts to have different materiality thresholds for financial and non-financial information. However, it could be helpful to disclose the materiality level agreed with the auditors.

#### **4. Assurance**

- Question 25 - Given that non-financial information is increasingly important to investors and other users, are the current differences in the assurance requirements between financial and non-financial information justifiable and appropriate?  
*No, not at all; To some extent but not much; To a reasonable extent; Yes, to a very great extent; Don't know*

Answer:

To a reasonable extent.

Whilst a common standard could be useful in future, we would urge the European Commission to move slowly and with extreme caution in relation to SMEs and mid-caps. This is particularly the case in the current environment where a mandatory common (reasonable) assurance standard and extension of the scope to SMEs could lead to a very large number of companies suffering significant and disproportionate costs whilst fighting for survival.

That said, while extending the assurance requirement to non-financial reporting risks introducing significant additional and disproportionate (regulatory) costs to SMEs and mid-caps in particular, it will also increase the quality and uniformity of the disclosures.

We would therefore propose to draw a proportionality distinction between large enterprises and SMEs/mid-caps.

More generally, we would like to express our concerns about the possible inclusion of non-financial information within the scope of a company audit requirements without a clear understanding of the possible cost. Audited financial information is clearly necessary for lenders/other counterparties, e.g. suppliers who place reliance on it before taking financial decisions and engaging in commercial activity with the company - this is not to the same extent for non-financial information. Practicalities of auditing non-financial data - this requires other expertise in many areas (not just financial/accounting). We believe that this would be outside of auditors' standard work and would potentially cause a bottleneck in the audit process which expands in scope every year. It should be covered separately and not within company audit.

- Question 26 - Should EU law impose stronger assurance requirements for non-financial information reported by companies falling within the scope of the NFRD?  
*Yes, No, Don't know*

Answer:

No. This would be particularly disproportionate for smaller companies.

As mentioned above, extending the assurance requirement to non-financial reporting risks introducing disproportionate cost to SMEs and mid-caps in particular. That said, while assurance will introduce additional regulatory costs, it will also increase the quality and uniformity of the disclosures. We would therefore propose to draw a proportionality distinction between large enterprises and SMEs.

- Question 27 - If EU law were to require assurance of non-financial information published pursuant to the NFRD, do you think that it should require a *reasonable* or *limited* assurance engagement on the non-financial information published?  
*Reasonable, Limited, Don't know*

Answer:

Limited. Moving to reasonable (as opposed to limited) assurance at this stage in particular would be a significant change for the many companies that are not set up to do this.

The type of assurance engagement will basically depend on the reporting criteria applied by each company when drafting the non-financial information documentation. That is, the service provider will be able to apply a “reasonable assurance” or a “limited assurance” based on the information available for its verification.

In this sense, the verification assessment will be focused on how reliable the information provided is according to the criteria previously applied by each company and, for this purpose, different regulations could be used by the service provider for carrying out the verification process (e.g. the ISAE 3000). As a result, it is difficult to figure out which type of assurance could be applied for each company.

Therefore, in the event of imposing an assurance requirement, we consider it advisable to impose, at least, a minimum limited assurance by default (in any case, allowing SMEs to adopt this on a voluntary basis and to extend such assurance at their sole discretion) - as indicated above, a reasonable assurance may increase disproportionate costs to SMEs, which should also be considered as a key point for assessing all interests involved.

Building on the above, while reasonable assurance, which is akin to financial audit standard, may be preferred to increase quality and ultimately get to a similar standard as financial disclosures, it should be a stepwise process to get there, for example (i) with an initial focus on only certain standardized, quantitative KPIs for the reasonable assurance, keeping remaining parts at a limited assurance level, and/or (ii) it may be worth considering a higher standard for large enterprises, and a lower standard for SMEs.

- Question 28 - If EU law were to require assurance of non-financial information published pursuant to the NFRD, should the assurance provider assess the reporting company’s materiality assessment process?

*Yes, No, Don’t know*

Answer:

No.

- Question 29 - If assurance of non-financial information was required by EU law, should the assurance provider be required to identify and publish the key engagement risks, their response to these risks and any related key observations (if applicable)?

*Yes, No, Don’t know*

Answer:

No.

- Question 30 - If assurance of non-financial information was required by EU law, do you think that assurance engagements should be performed based on a common assurance standard?  
*Yes, No, Don't know*

If you answered yes in reply to the previous question, please explain whether there is an existing assurance standard that could be used for this purpose or whether a new standard would need to be developed.

Answer:

Yes.

We answered No to the previous questions, but *if* this route were taken, then that would seem sensible and an adequate standard would need to be developed. This will also help to create a level playing field.

- Question 31 - Do you think that an assurance requirement for non-financial information is dependent on companies reporting against a specific non-financial reporting standard?  
*Yes, No, Don't know*

Answer:

No, although it may make the process easier, more efficient and hence cost effective.

- Question 32 - If you publish non-financial information and that information is assured, please indicate the annual costs of such assurance.

Please describe the scope of the assurance services provided (issues covered, reasonable/limited, etc.).

Answer:

N/A

This question is difficult to answer from an association perspective. Giving a meaningful number that is representative of the full industry is not possible.

***Please provide any comments or explanations to justify your answers to questions 25 to 32.***

Answer:

No further comments.

## 5. Digitisation

- Question 33 - To what extent do you agree or disagree with the following statements regarding digitalisation of non-financial information?

	1	2	3	4	5	Don't know
It would be useful to require the tagging of reports containing non-financial information to make them machine-readable.			X			
The tagging of non-financial information would only be possible if reporting is done against standards.			X			
All reports containing non-financial information should be available through a single access point.			X			

1= totally disagree, 2= mostly disagree, 3= partially disagree and partially agree, 4= mostly agree, 5= totally agree

Answer:

Although there will be various benefits of having information easily and digitally available, it is difficult to answer this question without having an indication of the cost involved.

- Question 34 - Do you think that the costs of introducing tagging of non-financial information would be proportionate to the benefits this would produce?  
*No, not at all; To some extent but not much; To a reasonable extent; Yes, to a very great extent; Don't know*

Answer:

Don't know. It depends on whether the collected information is actually being used and what the costs are likely to be.

- Question 35 - Please provide any other comments you may have regarding the digitalisation of sustainability information.

Answer:

No further comments.

**Please provide any comments or explanations to justify your answers to questions 33 to 35.**

Answer:

Digitisation is always welcomed, but any rules should not be too prescriptive, particularly given the pace of change of the relevant technology.

In addition, it is important to build a better understanding of: (i) likely time and cost of providing standardised digital information, (ii) how much this is/will be used, and (iii) whether the up-front cost is balanced by limiting data input/manipulation.

**6. Structure and location of non-financial information**

- Question 36 - Other consequences may arise from the publication of the non-financial statement as part of a separate report. To what extent do you agree with the following statements:

	1	2	3	4	5	Don't know
The option to publish the non-financial statement as part of a separate report creates a significant problem because the non-financial information reported by companies is hard to find (e.g. it may increase search costs for investors, analysts, ratings agencies and data aggregators).				X		
The publication of financial and non-financial information in different reports creates the perception that the information reported in the separate report is of secondary importance and does not necessarily have implications in the performance of the company.				X		

1= not at all, 5= to a very great extent

- Question 37 - Do you believe that companies should be *required* to disclose all necessary non-financial information in the management report?  
Yes, No, Don't know

Answer:

No, there would not be a need for such requirement from our perspective. While it is preferable that the non-financial statement is included in the regular company reporting, this should be on a **voluntary** basis (i.e. it should be an option, not mandated). This can be reconsidered once market practices emerge.

- Question 38 - If companies are allowed to publish the required non-financial information in a report that is separate from the management report, to what extent do you agree with the following approaches?

	1	2	3	4	5	Don't know
Legislation should be amended to ensure proper supervision of information published in separate reports.				X		
Legislation should be amended to require companies to file the separate report with Officially Appointed Mechanisms (OAMs).			X			
Legislation should be amended to ensure the same publication date for management report and the separate report.			X			

1= totally disagree, 2= mostly disagree, 3= partially disagree and partially agree, 4= mostly agree, 5= totally agree

Please provide any comments regarding the location of reported non-financial information.

Answer:

Recognising that the trend is towards demonstrating the link between non-financial factors and financial information, it may make sense for these two types of information to be together.

However, ultimately any non-financial information should appear where it makes most sense and provides most insight. This may be in the management accounts, the corporate governance section or within the financial disclosures sections (e.g. intangibles). It doesn't necessarily need to all be in one place.

There should be caution about aligning the publication dates (row three in the table above). This would add to the burden of portfolio companies at what is a busy time of year so staggering timing would probably be helpful.

- Question 39 - Do you consider that the current segregation of non-financial information in separate non-financial and corporate governance statements within the management report provides for effective communication with users of company reports?  
*No, not at all; To some extent but not much; To a reasonable extent; Yes, to a very great extent; Don't know*

Answer:

To some extent but not much. There seem to be conflicting views in the market.

**Please provide any comments or explanations to justify your answers to questions 36 to 39.**

Answer:

No further comments.

### 7. Personal scope (which companies should disclose)

- Question 40 - If the scope of the NFRD were to be broadened to other categories of PIEs, to what extent would you agree with the following approaches?

	1	2	3	4	5	Don't know
Expand scope to include all EU companies with securities listed in regulated markets, regardless of their size.			X			
Expand scope to include all <i>large</i> public interest entities (aligning the size criteria with the definition of <i>large undertakings</i> set out in the Accounting Directive: 250 instead of 500 employee threshold).			X			
Expand scope to include <i>all</i> public interest entities, regardless of their size.		X				

1= totally disagree, 2= mostly disagree, 3= partially disagree and partially agree, 4= mostly agree, 5= totally agree

Answer:

As a starting point, we would like to note that we do not see a critical need to extend the scope of the NFRD at this point in time.

That said, in the event of an extension (Questions 40-41), we would propose to adopt a **gradual approach**, giving priority to the creation of a common framework for the non-financial reporting requirements of large companies and the sustainability disclosures of the financial sector.

The NFRD non-financial reporting duties should preferably be extended, initially, to limited categories of additional large companies. After testing this common framework for some years, when experience accumulates, proper methodologies for gathering, analyzing, assessing and presenting new standardized sustainability information are developed and all

associated costs are clearly determinable and reduced to an affordable level, these non-financial reporting duties could be extended to a broader range of companies. It seems to us that this approach would involve a more orderly and sensible process, allowing for a progressive assessment of the results and impact prior to further extending non-financial reporting duties.

In addition, any extension of scope:

- should include a proper and reasonable transition period (perhaps at least two reporting periods); and
  - should be on a proportionate and/or comply-or-explain basis. As mentioned above, we also consider that *if* reporting is extended to SMEs (which we do not think it should be) it should be voluntary and disclosures limited, at least until the benefit has been proven with the larger, listed companies that are providing this information.
- Question 41 - If the scope of the NFRD were to be broadened to non-PIEs, to what extent would you agree with the following approaches?

	1	2	3	4	5	Don't know
Expand the scope to include <i>large non-listed</i> companies.			X			
Remove the exemption for companies that are subsidiaries of a parent company that reports non-financial information at group level in accordance with the NFRD.		X				
Expand the scope to include large companies established in the EU but listed outside the EU.			X			
Expand the scope to include large companies not established in the EU that are listed in EU regulated markets.			X			
Expand scope to include <i>all</i> limited liability companies regardless of their size.	X					

1= *totally disagree*, 2= *mostly disagree*, 3= *partially disagree and partially agree*, 4= *mostly agree*, 5= *totally agree*

Answer:

There are a few considerations we would like to make when answering this question:

- The NFRD rightly recognises that investors are not the only users of non-financial information relating to investee companies. The larger the company, the broader the range of stakeholders with an interest in public non-financial disclosures, and for larger unlisted companies there seems to be some justification for imposing requirements similar to those applicable to listed companies with similarly large and diverse

populations of stakeholders. This is not the case with SMEs. As indicate above, Invest Europe is not at the current stage in favour of extending the scope to SMEs, even though it is difficult to quantify costs/cost implications with certainty as these will likely vary greatly between company, sector, size etc. See earlier comments made on costs.

- Removing the exemption (detailed in row 2 of the table above) might result in certain misunderstandings and/or inconsistencies between the information reported in each subsidiary and the parent company.

Also, each subsidiary might incur a time-consuming task by having to coordinate its internal work with the work carried out by the parent company in order to provide the non-financial information (subsidiaries do not always have sufficient resources in order to properly take care of these matters) - especially if subsidiaries and/or the parent company are located in different jurisdictions.

Another obstacle could be the requirements set forth by each Commercial Registry which could vary significantly when submitting the annual accounts in each country (even more if subsidiaries are not located in the EU).

This could also have a negative impact on the costs incurred by the group of companies.

- We do not currently consider it advisable to include all limited liability companies by default.
- Private equity funds should not be caught at the fund level through consolidation. The scope should exclude that fund managers/fund level entities, if in scope, report on their underlying portfolio (also, a fund/fund manager should not be able to meet a size threshold based on adding up its underlying investments).

Indeed, portfolio companies of private equity funds should be expected to report themselves if within scope on a stand-alone basis and not as part of a fund. Fund level reporting would be excessively onerous on the fund and could pull in small companies that would otherwise be sub-threshold and not be required to report.

- Question 42 - If *non-listed* companies were required to disclose non-financial information, do you consider that there should be a specific competent authority in charge of supervising their compliance with that obligation?  
*Yes, No, Don't know*  
 If yes, please specify who in your opinion should carry out this task (National Competent Authorities, European Supervisory Authorities, other...) and how.

Answer:

Don't know.

As a starting point, we do not think that the scope should be enlarged to cover non-listed companies.

That said, *if* non-listed companies were to be brought in scope, then it may make sense for national competent authorities, i.e. the same authorities as those that supervise compliance with financial reporting currently, to be involved provided that they are ready to monitor non-financial disclosures by a potentially wide universe of non-listed companies.

- Question 43 - To what extent do you agree with the following statements relating to possible changes of the personal scope of the NFRD for financial institutions?

	1	2	3	4	5	Don't know
The threshold criteria for determining which banks have to comply with the NFRD provisions should be different from those used by Non-Financial Corporates.						X
The threshold criteria for determining which insurance undertakings have to comply with the NFRD provisions should be different from those used by Non-Financial Corporates.						X

1= totally disagree, 2= mostly disagree, 3= partially disagree and partially agree, 4= mostly agree, 5= totally agree

*Please provide any comments or explanations to justify your answers to questions 40 to 43.*

Answer:

It is unclear what the benefit has been to date, if any, to the users of the accounts from having this information. This analysis should be undertaken and provided before expanding the scope and reach.

## 8. Simplification and reduction of administrative burdens for companies

- Question 44 - If your company publishes non-financial information pursuant to the NFRD, please state how much time the employees of your company spend per year carrying out this task, including time of retrieving, analysing and reporting the information? Please provide your answer in terms of full-time-equivalents (FTEs, 1 FTE = 1 employee working

40h a week during 250 working days per year). Please provide your answer for reports published in 2019, covering financial year 2018.

Please state the total cost per year of any external services, *excluding the cost of any assurance or audit services*, that you contracted to assist your company to comply with the requirements of the Non-Financial Reporting Directive. Please provide your answer for reports published in 2019, covering financial year 2018.

Answer:

N/A. This question is difficult to answer from an association perspective.

- Question 45 - To what extent do you agree with the following statements?

	1	2	3	4	5	Don't know
Companies reporting pursuant to the NFRD face uncertainty and complexity when deciding what non-financial information to report, and how and where to report such information.			X			
Companies are under pressure to respond to individual 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.				X		
Companies reporting pursuant to the NFRD have difficulty in getting the information they need from business partners, including suppliers, in order to meet their disclosure requirements.				X		

1= totally disagree, 2= mostly disagree, 3= partially disagree and partially agree, 4= mostly agree, 5= totally agree

**Please provide any comments or explanations to justify your answers to questions 44 to 45.**

Answer:

Consistency is important but flexibility is also required so that companies only report what is important, not what is irrelevant in the circumstances.



## Contact

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## About the PAE

The Public Affairs Executive (PAE) consists of representatives from the venture capital, mid-market and large buyout parts of the private equity industry, as well as institutional investors and representatives of national private equity associations (NVCAs). The PAE represents the views of this industry in EU-level public affairs and aims to improve the understanding of its activities and its importance for the European economy.

## About Invest Europe

Invest Europe is the association representing Europe's private equity, venture capital and infrastructure sectors, as well as their investors.

Our members take a long-term approach to investing in privately held companies, from start-ups to established firms. They inject not only capital but dynamism, innovation and expertise. This commitment helps deliver strong and sustainable growth, resulting in healthy returns for Europe's leading pension funds and insurers, to the benefit of the millions of European citizens who depend on them.

Invest Europe aims to make a constructive contribution to policy affecting private capital investment in Europe. We provide information to the public on our members' role in the economy. Our research provides the most authoritative source of data on trends and developments in our industry.

Invest Europe is the guardian of the industry's professional standards, demanding accountability, good governance and transparency from our members.

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