"NON-FINANCIAL PERFORMANCE MONITORING". PRESENTATION IN THE SUSTAINABILITY CONFERENCE ORGANISED BY THE RED ELÉCTRICA GROUP

MONTSERRAT MARTÍNEZ PARERA, VICE-CHAIR OF THE CNMV
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1. **The Non-financial and Diversity Information Disclosure Act (Spanish Law 11/2018) requires companies to submit a non-financial statement together with the management report and annual accounts. The CNMV has reviewed numerous non-financial statements of listed companies in Spain in recent years. What issues does the CNMV consider key to progress in corporate reporting and non-financial information in Spanish companies?**

Good afternoon. I would like to start by thanking the Red Eléctrica Group and its chairwoman for the invitation and you, Javier, for introducing me. It is an honour to participate in this conference and in this panel, in such distinguished company.

Before I go into detail, let me emphasise the importance of transparency when we talk about promoting the sustainability of the planet. Without data, without information, we cannot move forward. After all, to use an economic term, we are dealing with a market failure, where investors and citizens may not adequately internalise climate and social risks in their decisions[1]. This justifies public intervention, regulation, and supports, among others, the measures being taken to improve transparency. We are, therefore, facing an unstoppable trend, which we must continue to delve deep into.

You rightly mentioned Spanish Law 11/2018 in your question. It must be acknowledged that in Spain we have been well aware of this need and, in addition to complying with European regulations, the legislator extended the scope and content of the reporting obligations.

Thus, for example, next year in Spain, companies with more than 250 employees, which also meet certain requirements, will be obliged to report on sustainability for the financial year 2021. This represents an almost threefold increase in the number of entities that are under the obligation to publish non-financial information for the current year (around 3,000 companies). Of these companies, around 100 are obliged to send this information to us, the CNMV, and are subject to our supervision.

[1] In addition to the lack of information, we have the added difficulty of the challenge of the time dimension, as we are talking about taking into account today the effects of our actions on future generations, and the game of negative externalities, whereby we have to internalise how our actions affect the well-being of others.

This limit of 250 employees is currently under discussion in Europe, with the proposed new directive on corporate sustainability disclosure.
And let us not forget the transparency requirements deriving from Article 8 of the European Taxonomy Regulation, whereby, inter alia, entities must disclose what proportion of their business and investments is accounted for by environmentally sustainable activities. As well as the future report on how they incorporate the risk of climate change established in the recent Spanish Law 7/2021 on climate change and energy transition into their business.

I would therefore like to acknowledge the remarkable effort companies are making to report information in areas where we do not yet have a complete regulatory framework. At the CNMV we have seen **steady improvement over the years and progress is commendable**. Having said that, and coming back to your question, **what elements do we see as most relevant in non-financial reporting today?**

The main challenge we face in this area is to avoid **greenwashing** or the **dissemination of biased or unreliable information**. In the end, companies compete to be the destination of large amounts of investment that are guided by sustainability criteria and the incentives to "gloss over" the data and appear greener than what they really are. These incentives are high (remember that the European Commission has estimated an additional 350 billion euros of investment each year to meet sustainable goals). This may be intentional, but it may also be the result of the current framework's lack of robustness.

That is why it is so important that we work together to avoid such situations. We cannot allow actions or abuses that cause the market to lose confidence in the information published by companies on their sustainability. In markets and investments, confidence is everything, and there is a lot at stake here.

So, what can we do to improve reporting? In simple terms, I would point to five areas in which progress must be made: information must be more quantitative, easier to compare, more complete, reliable and understandable. Let me explain.

1. **More quantitative information, not only qualitative:** we cannot continue with generalities, nor fall into ambiguities. Companies sometimes use references that are too qualitative, such as "*we are committed to respecting human rights*", and these should be more quantitative, more concrete, in their risks and policies. They also need to better explain the key indicators they use. For example: explain the methodology used to calculate the pay gap (25% of the companies we analysed did not do so) or, when calculating the carbon footprint, be clearer about the objectives and take into account the different types of emissions (direct and indirect), following the EU guidelines (Climate Supplement).

2. **Comparable:** this is one of the main challenges. In order to be able to compare companies, information must be homogeneous and based on common standards. But we do not yet have these globally accepted standards. Here the work being done in Europe, by EFRAG, and globally, led by the IFRS Foundation and supported by IOSCO, is very important. I hope to be able to comment on this issue in a little more detail. And I want to be able to compare not only between companies, but also within the same company between

periods. We therefore urge companies to provide comparative data from previous years to identify how they are evolving over time.

3. **Complete**: this point is very important, because the reality is that many companies still provide partial information. As we do not have a complete standard, it is possible for companies to select on a tailor-made basis. This "cherry picking" for the sake of a better picture may raise doubts about the reliability or impartiality of the information and reduce trust in the company, which in the long run can only work against the issuer itself.

4. **Reliable:** information must be accurate and reliably represent reality; to this end, companies must have their own internal control mechanisms in place. In addition, all data must be verified by an independent third party, similar to the role auditors play with financial information. In Spain it is compulsory for information to be verified by a third party and the new European Directive will also impose this obligation. But there is a need to regulate the verifiers and the nature of the review. The regulation does not now establish what requirements these verifiers must meet, how independent they must be, the degree of review they must carry out, or what technical standards or procedures must be followed. Neither are ESG rating agencies and other providers of ESG data regulated. ESMA has already taken a position calling on the European Commission to act and it is expected that ESMA will take on this role in the future.

5. **Finally, it must be understandable**, i.e., investors, especially retail investors, must be able to understand and assimilate it. For me, this is one of the most difficult challenges ahead.

Here we are faced with **a dilemma**: on the one hand, the information must be comprehensive and reflect the particularities of each company. The realities of each one are very different. And we need to recognise, for example, companies that are investing heavily in transforming their business model, even if they do not yet have much revenue from sustainable activities. It is a matter of facilitating the necessary transition. But to capture business diversity we cannot inundate the investor with multiple indicators and explanations. We need some simplification. This balance between comprehensive information, to aid transition and reflect current realities, and simplicity of information, to facilitate understanding, is a very complex balance that is at the heart of the debate in Europe.

As I said at the beginning, we must continue to move forward, and we can only do so by working together, with **dialogue and collaboration between institutions and the public and private sectors**. We are aware that **businesses face difficulties in accessing the information they need**. And in particular smaller companies with fewer resources. But also, large ones, which need to collect data from suppliers or third parties in order to produce their own data. We must be flexible, and proportionate, and offer guidelines and criteria to facilitate progress.

2. **Measurement is essential for true transparency. It is also a prerequisite for information and comparison. However, the current landscape of non-financial reporting standards does not allow for an objective comparison of alternatives between investments, nor between consumption, economic activity or financing**

options. Work is in progress at European level to build a common standard of indicators that can be defined and comparable. The IFRS Foundation, following its consultation last year, has also confirmed the creation of a global working group to standardise reporting. What can we expect from this work, what standards will they be based on and when can we expect them to be available in Europe and globally?

The work being done by the international standards regulators, which you mention, is **crucial**. Most of the problems I mentioned earlier would be solved by **common standards** that homogenise the **content** of reports and **detail** quality requirements.

It is true that in recent years, in the absence of regulated standards, **multiple standards and criteria have been developed by private initiative**. As a result, we have come to have a **hotchpotch** of standards, with different approaches and priorities. And although it is gradually becoming more homogenised, the information is still not complete. **In Spain**, 99% of the entities that send us information follow the "**Global Reporting Initiative**" (GRI), one of the most widely followed international standards, with details on diversity, working conditions, etc.; but **only 16%** do so **in full**. It is also worth noting here the Task Force on Climate-related Financial Disclosures (TCFD) as a reference on aspects more closely related to the incorporation of financial risks resulting from climate change.

However, discrepancies remain with regard to content and level of detail, and the problems discussed previously are favoured. Hence the importance of having a commonly accepted global standard.

Here, I think there are **two variables that define the game**. On the one hand, the **work schedule**: time is pressing, and progress must be made as soon as possible. And on the other hand, the **territorial dimension**: we have to avoid ending up with different approaches between jurisdictions. In this race, if you will excuse my use of the simile, we have to reach the finish line early and we have to do it together.

In Europe**,** the European Financial Reporting Advisory Group (EFRAG) is already working to develop these standards. If all goes well, we will have a first draft by the middle of next year, with the aim of adoption by the European Commission by the end of 2022. In any case, this means that, in the best-case scenario, companies will publish their reports based on the new standards in 2024, on the 2023 financial year. So, there is still time and work ahead of us.

In addition, there is the international aspect, where the work done by the IFRS Foundation[2], supported by IOSCO, to put in place standards that are globally accepted by all jurisdictions, is of the utmost importance. The timetable is similar to the European Commission's working agenda. By the end of next year, it will be possible to have draft IFRS standards on sustainability, which would be applicable for the 2023 non-financial statements and information to be issued in 2024.

The challenge here is that we are able to develop a common global baseline to integrate the different level of ambition of jurisdictions, following the so-called building block approach.

[2] Last April, the IFRS Foundation published its findings on its sustainability reporting project. Subsequently, in June, it issued a call for nominations for members of the new International Sustainability Standards Board.

For example, in Europe, we follow the principle or **perspective of dual materiality**. That is, companies must explain:

i) not only how environmental and social aspects impact on the entity's business and results: "outside-in perspective" (financial materiality),
ii) but also, how the company's activity impacts on the environment, in a broad sense: "inside-out perspective".

This is a more ambitious approach than that advocated in other jurisdictions. We must therefore avoid ending up with different approaches across jurisdictions (e.g., between the US and Europe), and to this end, standards regulators must prioritise international dialogue and collaboration, as is already being done.

3. **In Spain, more than 130 sustainability funds are expected in the short term. The Regulation on Sustainability Disclosures in the financial services sector entered into force in March this year and work is ongoing on regulatory technical standards to implement the regulation. The latest to join the trend are Hong Kong fund managers, who will be required to report climate-related information from August 2022. What is your assessment of the implementation so far of Regulation (EU) 2019/2088 on sustainability disclosures in the financial services sector and what would be your recommendations?**

Taking into account the existing difficulties, I think we should say that the assessment is generally positive, and I would like to acknowledge the effort made by the investment industry to adapt in complex circumstances. Let me explain:

The Regulation you mention, on sustainability disclosure, regulates the information to be provided in the investment services sector. That is, the information that investment managers and funds have to provide to end-investors, such as retail investors who want to invest their savings.

Thus, the Regulation states:

i) At the level of the entity, or management company, the information they have to provide on their sustainability risks and how they integrate them, as well as whether they take into account the main adverse events.
ii) For investment products and funds, detailed information should be provided on investment funds promoting environmental or social features (Art. 8 or light green) or investment funds aiming at sustainable investment (Art. 9 or dark green).

The problem is that the investment industry has had to implement this European Regulation, which came into force in March this year, without the regulatory developments having been approved, i.e., without having the details of how to do so.

This lack of definitions has led to the implementation of the regulation not being straightforward, either for firms or for us, the supervisors.

In order to help the sector with this task, and while awaiting European regulatory developments, we at the CNMV wanted to assist the sector and facilitate, as far as possible, adaptation. To this end, we have published criteria, in the form of questions and answers. We also announced that we would follow a flexible and proportionate approach to enforcement. Furthermore, we have established a simplified procedure to facilitate the updating of investment fund prospectuses. Our ultimate goal was, and is, to get the sector to adapt in a timely manner.

Currently, we already have 141 registered funds that promote sustainability and six that declare that they comply with the highest sustainability requirements of the Regulation, i.e., that they directly target sustainable investments. In total, we have 147 investment funds that declare or have sustainability as an objective. We are talking about 15.6% of investment fund assets.

This is a figure that is certain to grow in the future.

We will continue to work to make this possible. In fact, we plan to update the Q&A document in the very near future.

And we are also working to ensure that there is no investor confusion. For example, an investment fund that allocates less than 50% of its investments to promoting sustainability should not use ESG terms in its name. Moreover, we also need to make sure that we are applying the same criteria across countries. In this area, we are being very active in ESMA, where the CNMV chairs the Sustainability Committee.

In short, I maintain the **positive view I expressed at the beginning, considering the environment**. For there is still much to be done and there are new regulations that will soon be applicable. Therefore, all of us market participants must maintain our attention and the necessary means in this area.

Investment funds have a key role to play as a tool for channelling retail investors' savings to help direct more funds towards sustainable transformation. Funds are, in fact, the main way for retail investors to access the securities market. It is important that we maintain confidence in their professionalism and that, together, we help investors understand what sustainable investments are and what risks they are taking. After all, good understanding and transparency are the basis for building trust in the new environment.