FESE Position on Sustainable Finance – Disclosure Proposal

Brussels, 5th March 2019

Introductory remarks

The Federation of European Securities Exchanges (FESE) represents 35 exchanges in equities, bonds, derivatives and commodities through 19 Full Members from 30 countries, as well as 1 Affiliate Member and 1 Observer Member.

FESE is a keen defender of the Internal Market and many of its members have become multi-jurisdictional exchanges, providing market access across multiple investor communities. FESE represents public Regulated Markets. Regulated Markets provide both institutional and retail investors with transparent and neutral price-formation. Securities admitted to trading on our markets have to comply with stringent initial and ongoing disclosure requirements and accounting and auditing standards imposed by EU laws.

FESE members organise markets dedicated to sustainable finance and offer products that contribute to sustainable development, facilitate management of climate risk and incorporate carbon reduction in investment strategies, as well as allow the tracking of sustainable companies' performance. Moreover, FESE members actively engage in the UN Sustainable Stock Exchanges initiative to promote sustainable capital markets, through which companies are encouraged to perform greater disclosures of relevant ESG issues.

FESE fully supports the **Commission's Sustainable Finance proposals** aimed at reorienting capital flows to sustainable investments and managing financial risk related to climate change, as well as fostering transparency and long-termism in financial and economic activity. These initiatives include:

- A proposal for a regulation on the establishment of a framework to facilitate sustainable investment, also defined as the taxonomy regulation proposal (the **Taxonomy Proposal**);
- A proposal for a regulation on disclosures relating to sustainable investments and sustainability risks and amending Directive EU 2016/2341 (the **Disclosure Proposal**);
- A proposal for a regulation amending regulation EU 2016/1011 on low carbon benchmarks and positive carbon impact benchmarks (the **Benchmarks Proposal**).

This paper covers FESE's position on the second of these initiatives, that is to say the **Commission's Disclosure Proposal**.

Disclosure Requirements in the Scope of the Commission's Action Plan

FESE welcomes the fact that the Action Plan indicates that the Commission will revise the guidelines on non-financial information by Q2 2019 (in the context of the NFRD[1]) based on metrics developed by the Technical Expert Group and implementing the FSB Task Force on Climate-related Financial Disclosures recommendations (TCFD).

FESE supports the FSB TCFD recommendations as we consider these will contribute positively to achieving greater certainty about the type of climate related information that preparers of financial information should disclose. However, FESE considers additional disclosure obligations

[1] Non-Financial Reporting Directive

should be proportionate to the scale of the economic activity of companies and should cover both listed and non-listed enterprises.

More generally, we fully support the creation of the European Corporate Reporting Lab and its project to assess the current state of play for climate-related reporting by European companies, and the current and potential use of climate-related information by investors and other users.

European Parliament amendments to include investee companies in the scope of the Disclosure Proposal

FESE welcomes the Commission's intention to introduce harmonised rules on asset managers and insurance funds in respect of sustainability-related disclosures to end-investors as part of their investment advice processes. This framework would help transform Europe's economy into a greener, more resilient and circular system. However, we are concerned by amendments proposed in the European Parliament's Final Report which could bring **investee companies** within the scope of this obligation, by amending Article 1.

While FESE supports high-quality, comparable, consistent, investor-relevant disclosures by investee companies, we do not see how obligations designed for investment firms can be extended to the companies themselves, as they do not have this role. For example, potentially requiring companies to incorporate sustainability risks in pre-contractual disclosures information which include providing the "procedures and conditions applied for integrating sustainability risks in investment decisions" (Article 4) appears problematic.

Companies should provide the information required for financial intermediaries to make assessments and decisions but should not be required themselves to assess the risk.

Equal Disclosure Requirements for both Listed and Non-Listed Companies

Regarding the proposed review of corporate reporting of non-financial information, FESE considers that disclosure obligations on listed issuers should be well-calibrated and proportionate. We would caution against increasing non-market-related disclosure obligations on listed issuers alone as this would risk disincentivising companies from listing on public markets, which would not increase transparency.

We believe that the relative attractiveness of public markets should be preserved and that it should not be possible to avoid complying with further disclosure requirements by remaining private as this would disincentivise listing and result in decreased overall corporate transparency.

Should additional disclosure requirements become legally binding, it is important that these **disclosures also apply to private firms** with comparable economic, social, and environmental footprints. Moreover, if a legally binding approach is selected, this should be implemented on a phased-in basis to allow sufficient time for market participants to adapt.

Finally, the scope and targets of policy measures related to sustainability need to remain detached from the type of financing a company has opted for. The same rules should apply to companies, whether they have opted for debt or equity financing.

Avoid Indirect and Un-harmonised Transparency Requirements

As such, the Disclosure Proposal does not apply to FMIs or Benchmark Administrators, which are not in scope. However, the European Parliament Report on the Commission proposal introduces a requirement for institutional investors offering financial instruments based on an index to disclose how – very broadly defined – “sustainability risks” are “considered in the methodology of the index”.

Given that the proposal on low carbon and positive carbon impact benchmarks and the benchmark regulation itself explicitly specify transparency requirements regarding the benchmark methodology, the wording proposed by the European Parliament risks creating parallel but slightly different disclosure requirements, introducing legal uncertainty and disproportionate regulatory burden for Benchmark Administrators.

Fostering long-termism in financial and economic activity

The Action Plan indicates that the Commission will analyse further if undue short-term market pressure hinders sustainable development by favouring short-term over long-term action. FESE believes several measures could be taken to incentivise market agents towards longer-term orientation, including:

- Ensuring that accounting standards do not overly incentivise short-term behaviour and accommodate longer-term perspectives, which are important in respect of sustainable financing.
- Reassessing the range of factors needed to incentivise market participants in assessing longer-term risks.

FESE considers that the emergence of specialised credit rating agencies should be made possible. In parallel, all credit rating agencies should be required to share their current practices on TCFD-related information in their credit ratings.

Financial regulation can facilitate sustainable investments by introducing further transparency, standards and requirements on products; ultimately investment decisions will however be based upon an assessment of profitability, which is determined based on market developments and regulation of the economic activity.

Therefore, to increase investments made in sustainable products, unsustainable activities have to become more expensive to carry out. This is not to say that other initiatives cannot facilitate sustainable investments. However, as markets respond to incentives, the first objective of the Commission’s Action Plan “to reorient capital flows towards sustainable investments” could be achieved by appropriately tackling unsustainable economic activity.

Ultimately, a shift in all economic agents’ mind-set is likely the most crucial component of a successful transition to a low-carbon and resource-efficient economy that is geared towards inclusive growth and awareness of long-term risks.

The Federation of European Securities Exchanges (FESE) represents 35 exchanges in equities, bonds, derivatives and commodities through 19 Full Members from 30 countries, as well as 1 Affiliate Member and 1 Observer Member.

At the end of January 2019, FESE members had 8,648 companies listed on their markets, of which 13% are foreign companies contributing towards the European integration and providing broad and liquid access to Europe’s capital markets. Many of our members also organise specialised markets that allow small and medium sized companies across Europe to access the capital markets; 1,341 companies were listed in these specialised markets/segments in equity, increasing choice for investors and issuers. Through their RM and MTF operations, FESE members are keen to support the European Commission’s objective of creating a Capital Markets Union.