'For most of history, man has had to fight nature to survive; in this century he is beginning to realize that, in order to survive, he must protect it.'
(Jacques-Yves Cousteau)

ESG Reporting Guide

for Issuers of the Budapest Stock Exchange

Table of Contents

Foreword 1
Introduction 2
What is the purpose of this Guide? 2
What is ESG? 2
What are the benefits of ESG reporting to issuers? 3
ESG and Corporate Governance reporting 5
Stakeholders and Materiality of Reporting 6
Stakeholders 6
Materiality 8
Content, Quality, Format and Frequency of Reporting 10
Content of Reporting 10
Quality of Reporting 11
Reporting format and disclosure channels 12
Roadmap of reporting 14
Building reporting capacity 14
Advancing reporting capabilities 14
Reporting frequency 15
Regulatory and Policy Landscape 16
Introduction to ESG Reporting Standards 18
Global reporting standards to start with 18
Issue specific global disclosure and target setting schemes 18
Integrated reporting to enhance transparency and address interconnectivity 19
ESG Data from collection to issuers becoming rated 19
Main ESG Rating agencies 19
BSE Minimum standards 21
Annex 23
Disclaimer 25

Foreword

Leaders, governments and organizations around the world are recognising that the time to take action for a sustainable future is now. Setting sustainable development goals is at the core of strategic planning, taking actions to confront global challenges such as climate change, other natural disasters, poverty, biodiversity loss, overpopulation, infectious diseases, to mention only a few, has never been more critical than at this present time.

The financial sector has a key role in the global economic sustainability action plan and so do capital markets and their flagship institutions: the stock exchanges. Together with the financial industry, exchanges around the world promote sustainable finance, the incorporation of environmental, social and governance (ESG) factors into investment decision-making, and the allocation of capital towards sustainable assets.

The Budapest Stock Exchange is no different from its peers in that regard. In 2018, BSE joined the United Nations Sustainable Stock Exchanges initiative declaring its commitment to meet the UN Sustainable Development Goals (SDGs) by 2030. In addition, we work closely with the Federation of European Securities Exchanges (FESE) in its Sustainable Finance Task Force and pay intense attention to the parallel efforts of the World Federation of Exchanges (WFE). BSE defined its most important focus areas as follows:

- improve the sustainability reporting and ESG data sharing of listed companies
- draw investor attention to sustainable and green instruments listed on the exchange
- develop marketplace for the new, ESG compliant and green investment products

The ways stock exchanges can influence these areas can be numerous. First and most, it is imperative to include ESG principles into their own strategies to act as role models for listed companies. Further, exchanges should take part in creating a supporting regulatory environment through lobbying activities to build an adequate European and domestic regulatory framework and supplementary stock exchange rules.

Exchanges also play an important role in education, may become *think tanks*, *information hubs* of ESG-related topics and concentrate as much attention to them as possible. BSE is organising expert events, conferences, educational events to spread the notion of sustainability to as broad a public as possible.

ESG awareness can further be improved by product developments (dedicated market segments, promoting green investment products, etc.) and by guiding listed issuers in their efforts to develop their ESG reporting routines and provide the market with quality information. The latter is the purpose of this present Guide.

Richárd Végh

CEO

Budapest Stock Exchange

Introduction

What is the purpose of this Guide?

Public companies increasingly feel the pressure to disclose more and more non-financial information to satisfy investors' expectations in that regard. The growing demand for socially responsible investments presents both a new opportunity and a great challenge for companies, especially for SME issuers with more modest organizational capacities to deal with ESG-related matters.

This Guide has been issued to help BSE-listed companies to have a basic understanding of

- the ESG approach in general
- the importance of ESG reporting
- the basic terms, actors and processes involved
- the roadmap that leads to the implementation of a stable reporting regime

We are aware of the fact that ESG framework constantly evolves, so this Guide tries to set some minimum standards, recommendations to help BSE-listed issuers along the way, but will be updated as needed, incorporating future regulatory changes, experience and feedback from market participants. We hope it shall pave the road to a more transparent and more sustainable operation for our issuers.

What is ESG?

The global environmental and social challenges the world is facing are now clearly apparent for governments, corporations, and households as well. Investors and analysts on capital markets expand their corporate valuation models currently in use involving environmental, social and governance (ESG) criteria, recognising the fact that in successful long-term investments investor focus must go beyond mere financial profit maximalization. Investors expect companies to adjust their long-term strategies to include ESG principles and to follow up their adherence thereof in a transparent way.

ESG is becoming a catchword in the past few years that listed companies and investors become more and more aware of. The easiest way to introduce the ESG concept is perhaps the explanation of the acronym 'ESG' itself:

- 'E' stands for the environmental criteria, such as climate change, pollution, resource scarcity, energy consumption, waste release, greenhouse gas emission, biodiversity loss, etc.
- 'S' stands for the social facet, demonstrating the connection between business and society, highlighting the ways a company influences the life of its employees and the surrounding local communities. Issues related to public health, education, equality and diversity, health and safety, community support are among the most important aspects.
- Finally, 'G' gives the aspect of corporate governance covering a broad range of corporate activities including board and management structures, corporate culture, information disclosure, auditing and compliance, remuneration, to mention only a few.

ESG is a widely used term used side by side with other similar definitions such as SRI and CSR.

- Sustainable & Responsible Investment (SRI) defines investments in general which take into account sustainability factors (environmental, social, economic, ethical, etc.) in the selection and retention of investments. The investment is considered "socially responsible" due to the nature of the business the company conducts.

- Corporate Social Responsibility (CSR) is a term used by the companies to describe their interactions with society and the environment. It mostly refers to a business model, which enables the company to operate in a way that protects and enriches society and environment.

What are the benefits of ESG reporting to issuers?

To achieve long-term success, companies must incorporate the sustainability principles in their business strategies. Monitoring ESG factors is of great importance to mitigate risks and create a future proof business model as well as competitive positioning. The performance of the transparent companies (like e.g. exchange listed ones) can be further improved by sharing non-financial or extra-financial data with their stakeholders. Greenhouse gas emissions, energy consumption, water usage, waste management or any social issues mean either positive or negative externalities that can and should be measured and monetized in the corporate valuation model. Therefore, the companies need to provide a report on sustainability including strategic plans regarding ESG opportunities. Moreover, companies are required to share non-financial data with investors allowing them to calculate ESG effects. Companies must keep in mind that intermediaries like ESG data-hubs use all public sources running advanced technologies (NLP – Natural Language Processing Machine Learning, Artificial Intelligence) in order to compare the reported data with the information available on the internet. Even social media feeds are monitored closely to indicate ESG controversies.

Financing benefits – better access to capital

Better valuation from investors, enhanced performance in financial markets,

Providing ESG data to the investors improves the company's transparency. Improved transparency lowers portfolio risks, resulting in better valuation for the enterprise, and in the long run, better stock performance in the market. Higher valuation due to ESG factors not only impacts equities but also other asset classes, especially corporate bonds.

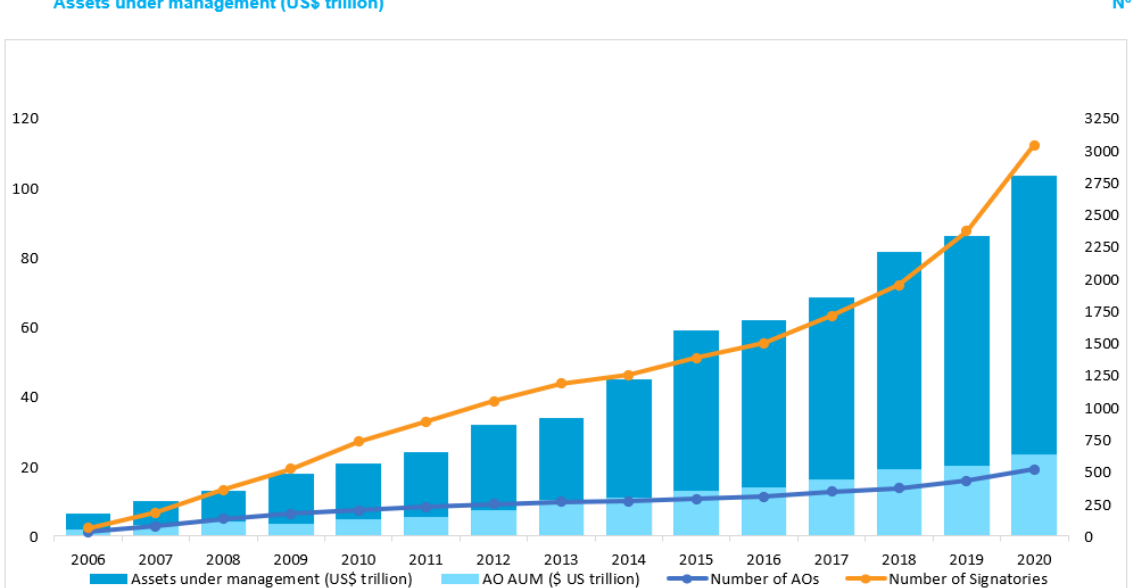
Certain ESG Reporting Standards, *inter alia* SASB and CDP were developed with the information needs of investors in mind. The standards contain the specific ESG issues that potentially impact the financial performance of the companies, enabling the disclosures to support the decision making of investors in particular.

Attracting new types of investors

In addition to achieving better transparency and thus better valuation, ESG reporting enables the company to attract a new type of long-term investors: the responsible investor. There is a noticeable shift in the focus of institutional investing towards environmental and social issues. The United Nations Principles for Responsible Investment (PRI) were launched in April 2006 at the New York Stock Exchange. It is voluntary for institutional investors to follow the six principles of ESG compliant investments during the investment procedure:

1) Incorporate ESG issues into the investment analysis and decision-making process
2) Incorporate ESG issues in ownership policies and practices
3) Seek appropriate ESG disclosure from companies
4) Promote the principles within the industry
5) Work together to enhance the implementation of the principles
6) Report on the activities and the progress regarding the implementation of the principles

The number of signatories has grown from 100 to over 3000 since the launch of PRI and doubled in the past four years increasing exponentially, indicating serious investor commitment. *source: UN PRI*



Another advantage associated with ESG reporting is the improved communication with investors which leads to deeper engagement and enhanced overall cooperation with the company's main stakeholders.

Operational benefits

ESG disclosure requires data gathering in various areas, often beyond the generally monitored performance indicators. This data gathering, the following data and risk analysis and eventually year-on-year monitoring and competitor comparability enables the company to realise operational benefits.

Better understanding of the current operational risks means more efficient business. Considering ESG issues during the operation reduces risk factors not only for investors, but also for a number of other stakeholders: regulators, employees, local communities, etc.

Possible areas of operational benefits include

- alignment to future markets – better product and service development goals
- improving reputation (customers, employees, suppliers)
- cost savings and increased productivity
- advantages in employee recruitment and retention

With ESG reporting the company applies a set of indicators that that helps to comply with ESG standards and to better understand its own operation. However, finding adequate metrics to measure the adherence to sustainability goals may be difficult at times, but not necessarily. For instance, employee turnover is an easily accessible metric which might give valuable feedback on employee satisfaction and loyalty and signal internal problems or inefficiencies worth paying attention to. Reporting ESG data enables management to gain insight and better understand more complex internal processes and tendencies.

Regulatory benefits

Voluntary ESG reporting may help the companies to adopt to the ever-changing regulatory landscape. As with corporate governance principles, the tendency with ESG reporting is that voluntarism will be superseded by mandatory regulatory standards in a few years.

Compliance with ESG standards also helps issuers to conform to various other relevant industrial standards and increase their overall compliance levels.

ESG and Corporate Governance reporting

Corporate governance is the focus area of ESG which goes back to a longer history having a very definite and direct connection to shareholder (investor) rights and interests. Corporate governance reporting standards have developed in the past decades almost everywhere, most countries have corporate governance codes for listed companies. These codes are not harmonised on EU level, and there are differences across the different jurisdictions regarding the setting, supervision and monitoring of the codes and the issuer reports (there are countries where it is supervised by the ministry of justice, elsewhere the financial supervisory authority or the stock exchange). Most codes use the "comply or explain" principle for compliance: deviation from the recommendations is not penalized but must be transparently presented in the individual reports. It is also stipulated in Commission Recommendation 2014/208/EU, that "efficient monitoring of the compliance with the corporate governance codes is required at a national level within the framework of the existing monitoring system."

The Corporate Governance Recommendations of the Budapest Stock Exchange were first published in 2004 and last amended in 2018. In Hungary, the maintenance of the code as well as the monitoring of the issuer reports is performed by the Exchange and the Corporate Governance Committee.
With the issuance of this ESG Guide the parallel system of corporate governance reporting will not cease; however, the two will most probably merge in some form in the years to come.

Stakeholders and Materiality of Reporting

Key steps in developing reporting ability are the identification of stakeholders and material topics. The two tasks are connected and together they inform report content development. For purposes of the present guidance, stakeholder and materiality assessment is described closely linked to the requirements of the Global Reporting Initiative.

Stakeholders

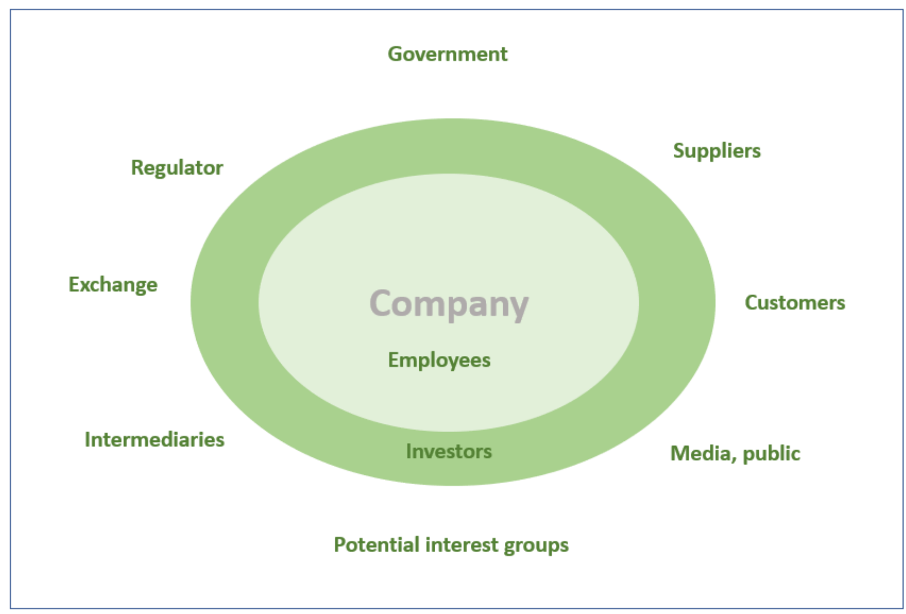
The company's stakeholders are the various constituents (institutions, businesses, interest groups or people) who directly or indirectly influence the operation of the company and vice versa.

To create a proper ESG strategy and reporting regime, the first step for the company is to identify these stakeholders or stakeholder groups. Stakeholder assessment is needed for the development of the report content, as ESG reporting serves to inform stakeholders' reasonable expectations and interests.

Stakeholder assessment requires a company specific, objective approach, and it serves both the identification of said stakeholders and the assessment of their relation towards as well as understanding of ESG reporting. The assessment requires company resources both for conducting the assessment and participation as internal stakeholders.

There are some typical stakeholder categories; however, the list may not be the same for every company, it is affected by many factors (country, industry, comparative advantages, market sentiment, etc.). The relative importance of the specific stakeholder categories also differs in each case.

Typical stakeholder categories that the company should address are shown on the following figure. These categories and groupings are only examples, customised stakeholder mapping must be prepared for each company individually:



Source: BSE

Investors

The investors are the owners of the company, ideally, their interest revolves around the most important issues from profitability through compliant and safe operation to sustainability matters. Investors can be broken down into different types depending on the

- level of influence on the company (majority shareholders versus minority shareholders)
- level of expertise in core business and in investments in general
- purpose of investment
- their ESG involvement, etc.

The company should carefully consider its investor composition to streamline ESG concepts. In recent years, investors have become more conscious about ESG performance and indicators, therefore, this aspect has an increased weight in investment decisions.

Employees

Employees' interests regarding sustainability matters may have multiple aspects:

- they expect their immediate working environment to be safe and pleasing (e.g. green offices, clean air);
- they are also increasingly conscious about the social/labour conditions of their workplace (staff turnover, training and qualifications, gender equality /diversity/, physical working conditions, social dialogue, rights of workers, trade union rights, health and safety, etc.);
- they are getting progressively concerned about their macro environment; therefore, the more employees identify with their company, the more important its social responsibility efforts are becoming for them.

These questions may easily become value propositions and make the difference for some people when they select between jobs.

Governments, Regulators

Governments worldwide take serious measures, create economic and other programs to increase environmental consciousness and take immediate steps to stop climate change and improve world ecosystem as a whole. Therefore, regulators everywhere urge companies to provide quality ESG data in structured form. The Nonfinancial Reporting Directive in Europe (2014/95/EU) requires certain companies to include ESG contents in their annual reports. These trends and the regulatory framework are expected to intensify in the years to come (*for more information on this topic please refer to the* Regulatory and Policy Landscape *chapter*).

Exchanges

Exchanges around the world can be catalysts of sustainability efforts and help listed companies to live up to stakeholder expectations. As a result of the work in UN Sustainable Stock Exchanges (SSE), many exchanges issued ESG Guides to orient companies and help improve their nonfinancial reporting routines.

Suppliers, Customers

ESG reporting and transparency is becoming more important in supply-chains as well. Companies seriously engaged in social responsibility matters require their suppliers to comply with the same standards and values (e.g. ethical sourcing). ESG compliance can be an important selection criterion.

Customers, end-users of services and products are also conscious about buying from businesses that focus more on product safety, environmental protection and social problems. ESG attentiveness can be a competitive advantage, especially in certain industries.

Media, public

Sustainability gets superior media and public attention in recent years. Especially for listed companies, who are constantly in the public eye, there is significant pressure to conduct socially responsible operation. Transparency in nonfinancial areas improves positive media attention in general, further, certain news agencies rank businesses based on their ESG strategy which can be an added value for them.

Intermediaries (rating agencies, data providers, rankings, indexes)

In the past decade, many firms got specialised in developing ESG standards and ratings (*for further details on this topic, please refer to the* Main ESG Rating agencies *chapter*). It is also becoming a commonly accepted fact that companies with high ESG rating usually outperform their peers in economics as well, benefiting even strictly *for-profit* investors. ESG ratings therefore play an important role in analysis and company evaluations.

Potential interest groups

Certain Non-Governmental Organizations (NGOs) also highly engage in environmental and social responsibility affairs. These may be international or local organizations, some of them evolved to be quite influential in recent years (UN Environment Programme, UN Women, etc.) and shape the ESG landscape.

Materiality

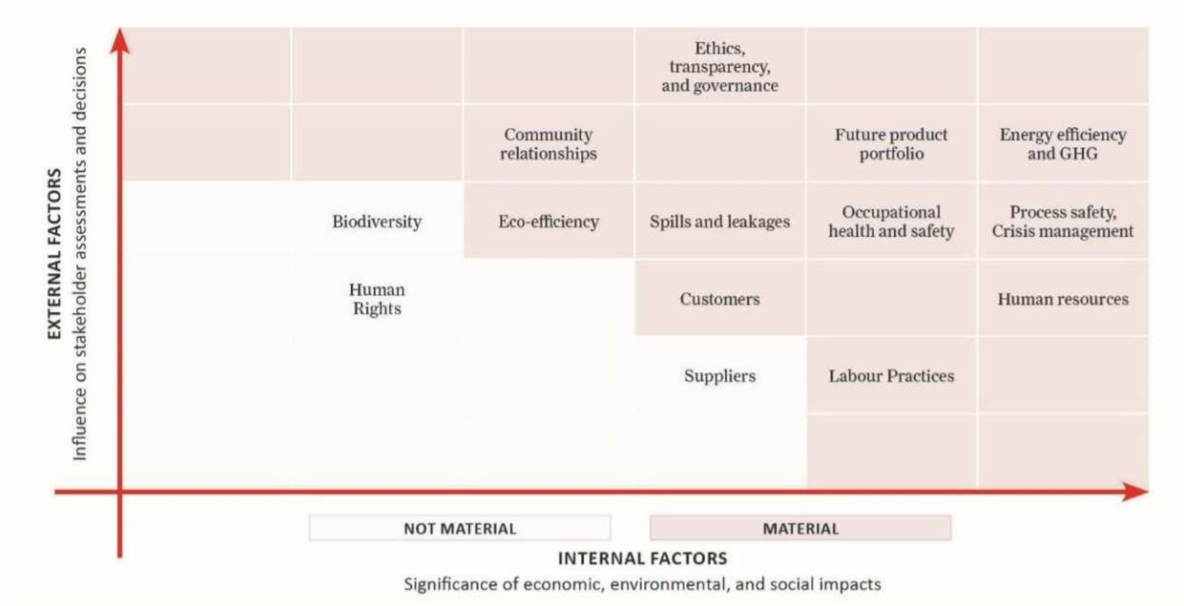
As the content of nonfinancial reporting is less strictly circumscribed in regulations than financial reporting, the burden of determining the subject of the disclosure falls on the reporting organisation itself. The standards of ESG reporting guide and control the process through the materiality principle.

Materiality in ESG reporting serves as a tool to identify the most relevant topics of importance from the perspective of the given organisation. The materiality approach of the respective reporting schemes vary and so do the resources required by companies. However, materiality is at the core of all disclosure standards.

Materiality may be considered an analogue to the relative importance of the different topics, which can be vastly different for one business or another. Defining the materiality of the different ESG issues helps determine which elements should be included in the report and thus entail an essential task.

One approach in defining materiality is considering its influence on stakeholder assessment and decisions (external factor) as well as the social, environmental and economic significance of their impact (internal factor). Upon evaluating all relevant ESG issues according to the two factors, the materiality assessment needs to define the threshold of materiality, i.e. the level of significance in both the external and the internal aspects, above which the issue is considered material, therefore must be included in the report.

MOL Group, for instance, uses the above-mentioned external-internal analysis for defining material topics. The materiality matrix of MOL Group is included below as an example. Topics highlighted with darker colour are considered material.



Source: MOL Group Integrated Annual Report - 2019

MOL Group's materiality assessment is based on the requirements of the Global Reporting Initiative (GRI), however there are other approaches. The World Federation of Stock Exchanges (WFE) tries to help exchanges and reporting entities with a closer definition of materiality in its *WFE Guidance and Metrics* (revised June 2018) as follows:

- The International Accounting Standards Board[1] defines 'material' information as that which, if omitted, misstated or obscured, could influence the economic decisions of readers relying on the financial statements.
- The International Integrated Reporting Council (IIRC)[2] suggests an issue is material if it is relevant (is likely to have an impact on value creation) and is sufficiently important in terms of its known or potential effect on value creation with reference to magnitude of the matter's effect and, likelihood of occurrence.
- The Sustainability Accounting Standards Board (SASB)[3] uses the US Supreme Court definition of materiality namely, information is material if there is "a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available."

[1] https://www.ifrs.org/-/media/project/definition-of-materiality/exposure-draft/ed-definition-of-material.pdf
[2] https://integratedreporting.org/wp-content/uploads/2015/11/1315_MaterialityinIR_Doc_4a_Interactive.pdf
[3] https://www.sasb.org/standards-overview/materiality-map/

Content, Quality, Format and Frequency of Reporting

Environmental, social and governance principles are a framework of standards by which a company and its investors can measure the wider impact of its operations and long-term strategy. The main intention of reporting on ESG principles is to demonstrate the way in which ESG issues are integrated into decision-making, therefore information presented in ESG reports should correspond to the information actually used by managers and officers of the company to make business decisions.

To start with, reporting companies should determine the internal roles and responsibilities within the company that are relevant to ESG assessment and reporting. Like many other tasks, it is recommended that ESG reporting starts from the bottom up. Different departments such as finance, investor relations, communications, core business, risk, environmental, HR, purchasing, legal need to be involved to ensure their input is integrated into the report. Most of the larger companies now have a separate sustainability division which plays an essential and integrating role in ESG reporting, however, ESG assessment and reporting should not be considered as their own exclusive duty. It is recommended that ESG factors are embedded into the everyday job duties of directors so that they can become an integral part of the business strategy, organisational culture and operational practices of the company.

The management and the board of directors should also have an essential role in the integration and oversight of ESG reporting.

Content of Reporting

Besides identifying the material topics, which significantly affect the content of the ESG report, stakeholders and reporting standards may have additional expectations towards the report content.

It is recommended that ESG reports:

- Build on reliable data
- Include context
- Reflect on significant economic, environmental, and social impacts
- Be accessible for all stakeholders

Build on reliable data gathering

Gathering reliable and complete ESG data is imperative. The quality of available data significantly affects decision-making capabilities and performance. Data gathering is a demanding task, which should be addressed by the reporting and preparation timeline accordingly. Companies may assess existing internal data gathering capabilities before creating new, complex channels. Internal systems such as audit, risk and data control and verification systems may serve as great sources of ESG information. Should the internal capability assessment deem existing systems insufficient for providing reliable, comparable and coherent ESG data, companies may decide to invest in improving reporting capacity. Data collection gaps should be addressed and explained in the reports.

Include context

Organisations disclosing ESG information represent a wide variety of industries, are different in size and location, therefore, context of ESG information is especially important to enable stakeholders to understand and evaluate the data properly.

Besides industry, region, location or company specific background data, the report should contain information on the broader context of sustainability as well. This requires companies to understand

global, regional and local drivers affecting their ESG performance and affecting the context, thus the mindset of the report's audience.

Reflect on significant economic, environmental, and social impacts

The information contained in the report should provide a balanced view of the environmental, economic and social impacts of the organization, both positive and negative impacts, enabling the stakeholders to evaluate ESG performance.

The topics, as described in the stakeholder and materiality sections should consider the interest of stakeholder groups targeted by the report as well as general public.

Accessible for all stakeholders

The information contained in ESG reports is often times highly technical, thus the accessibility for all stakeholders reading is key. Information may contain information for subject matter experts; however, the report content should enable understanding of all stakeholders.

Quality of Reporting

Investors seek to understand how ESG information is linked to the company's business strategy and financial performance, and they prefer comparisons to historical company and industry trends, corporate goals, relevant ratios, industry averages and financial results/performance in ESG reports. The indicators chosen may be generic, industry-specific or company-specific and reporting companies may want to use widely accepted indicators developed via a credible process (the GRI, for example, which is the most widely used for corporate sustainability reporting). Instead of qualitative narratives, quantitative data is highly demanded as they can provide comparisons over different periods within the particular company as well as with similar data from other companies. Quantitative data also enhance investment valuation and credit rating models.

ESG reports should explain the changes in the applied indicators year-to-year, and it is recommended that the company also include its perception of how this might change in the future. Reports are also to explain methodologies for data collection and reasoning why they were used. The company should point out the correlation between ESG metrics and financial performance and illustrate how ESG initiatives complement to growth, productivity and risk management in monetary terms, where possible. It is recommended that comparable quantitative information should be provided for the previous three financial years.

It is recommended that information included in ESG reports are:

- Accurate
- Balanced
- Comparable and consistent
- Timely
- Reliable

Accurate

Information should be accurate enough to enable the investors and other stakeholders to evaluate the results of the company's activities and operations.

Reporting companies should employ the same principles to ESG data as to financial data. Data used in ESG reports can be collected from internal systems (internal audit and risk and data control

verification systems) and the report should also contain how the data was compiled, and if there are any uncertainties or limitations to the data. The company should also keep evidence how data sources were used. Key assumptions are to be also clearly presented. Raw as well as normalised data can be used in the reports.

Balanced

The report should provide an objective view, including both favourable and unfavourable, the positive and the negative impacts of the company's activities.

Avoiding or obscuring certain aspects might result in discomfort and even mistrust from investors and stakeholders. Subjects that are more difficult should be explained and commented thoroughly. Describing lessons learnt and changes resulting from negative experiences will be useful to represent the company's dedication to maintain an honest and open approach towards investors.

Comparable and consistent

The information in the report should enable readers to evaluate the company's performance over time and to compare it with other organisations.

It is recommended that consistent global standards are used in the ESG reports in order to facilitate comparability between peers. Comparability and consistency are facilitated by indicators and metrics that are widely used within the specific business area and sector, and companies should aim to report in a similar manner to sector peers. The methods used to collect and normalise data should remain consistent year-on-year and if data compilation methodologies or underlying assumptions change, changes need to be explained. In case of significant changes, previous years data should be recalculated with the new methodology or assumptions to enable comparison.

Timely

ESG reports and data used therein are recommended to coincide with the annual reporting cycle and align to the fiscal year of the company. Investors and stakeholders can cross-use the two different data sets, for example normalising certain ESG data by revenues or staff numbers.

Reliable

Reporting companies should apply strong internal assurance processes, information included in the report should be overseen by the board of directors, the supervisory board and the audit committee and this fact also should be mentioned in the report.

External assurance by qualified and independent auditors is also vital to strengthen the credibility of the ESG data. The scope and process used for external assurance should be described in the report.

In order to decide the type and level of assurance desired, companies should consider recommended standards for assurance within their sector, as well as stakeholder expectations.

Reporting format and disclosure channels

Reporting formats

The ESG report can be included in the board of directors' annual report, elsewhere in the company's annual report, in an integrated report, but it can also be presented in a separate, stand-alone report

or even through other channels. Regardless of the reporting channel chosen, the format of the report must satisfy all relevant legal requirements and be easily available via the company's website.

ESG reports come in four typical categories:

- Basic reports: these are considered to be non-financial reports disclosing information on environmental, social and governance issues relevant for the company, but they are not in accordance with the ESG reporting standards contained in this Guide.

  An example for basic report can be the 2019 Sustainability Report of Borsodi Sörgyár Kft.
- Standardised reports: reports developed in accordance with a reporting standard.

  An example for standardised reports can be the 2019 Sustainability Report of Szerencsejáték Zrt.
- Assured reports: standardised reports, developed according to a standard that can be and are externally assured by an independent third party.

  An example for assured reports can be the 2019 Sustainability Report of OTP Nyrt.
- Integrated reports: reports developed according to an integrated reporting standard, representing the company's performance from both financial and ESG aspects.

  An example for integrated reports can be the 2019 Integrated Report of ALTEO Nyrt.

Different reporting formats may include different levels of breadth and depth; they can facilitate to focus on certain individual material issues or a wider horizon. Reporting companies may choose to disclose ESG information in dedicated reports, rather than publishing it as part of their wider-scope reporting. This approach most probably provides a greater degree of flexibility and clarity and the specific information is easier to retrieve on its own. Companies that are just starting non-financial reporting might find it easier to prepare a standalone report.

If the report is separated from financial disclosure, then both types of disclosures should cover the same period so that financial information can be considered and analysed within the context of ESG information. Cross-references within these reports are encouraged. It is also important to ensure consistency among the different communication channels. The information has to be easily accessible.

Most probably the future standard for the format of ESG reporting will be the integrated report, where financial and non-financial information is integrated into one single report. Larger listed companies might want to choose this format and direction.

The Hungarian Accounting Act requires large companies to integrate non-financial information into their annual financial statements and the company may decide to include certain ESG information in the company's financial disclosure even if it is not mandatory by rules of law.

Disclosure channels

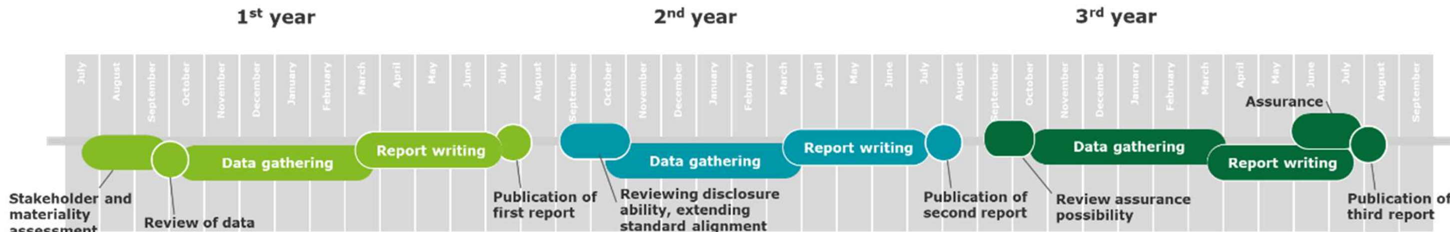
The proper disclosure channels should be chosen so that stakeholders can access the reports easily and in a timely manner. Companies should be familiar with their target audiences' preferred ESG information sources and update them regularly. These information needs might be different so companies might want to use different communication channels to ensure that the entirety of a company's target audience receives the information. Choosing a language widely spoken by international investors is recommended in addition to a national language.

Roadmap of reporting

Achieving the different levels of reporting maturity requires varying resources. Report development requires significant amount of time. The following two examples outline the reporting roadmap for developing and for advancing reporting capabilities.

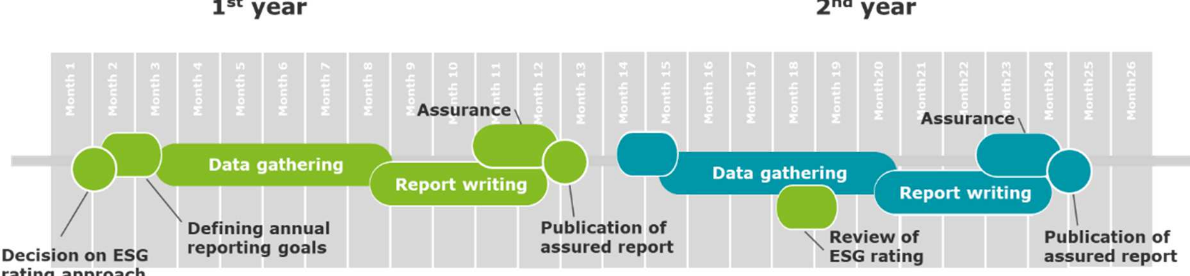
Building reporting capacity

The content of ESG reports is governed by the standard the company chooses to use and greatly limited by the data gathering possibilities. For companies new to ESG reporting, gathering data in accordance with disclosure standards may encounter significant difficulties. Therefore, a data gathering system gap assessment should be conducted. The results of the data gathering system assessment should identify the improvement opportunities and needs of data gathering in order to fulfil the standard requirements. After the gap analysis, a basic report may be created in the first year, after intensive data gathering and report writing processes. Upon implementing the identified developments to the data gathering system, the second report may be a standardised report. However, assurance poses a new layer of requirements and understanding, the management of which requires further resources. Assurance may be the aspiration of a three-year-long capacity building roadmap.



Advancing reporting capabilities

Companies on more mature stages of reporting, having assured standardised or integrated reports may consider further advancements to the content or channels of ESG performance communication. ESG ratings may be the advancement on reporting capability of the company. After deciding on the ESG rating approach of the company, the first year may serve as a baseline for rating, upon which results, new data gathering needs and disclosure opportunities may be identified. The result reviewing the first ESG rating should inform the second year reporting process.



Reporting frequency

It is general market practice that ESG reports are published at least on an annual basis. In case of listed companies the ideal delivery of such reports are together with the financial report referring to the same year. Some industrial sectors cover 2 years in one report. Non-listed companies typically prepare their reports at the beginning of a calendar year, and publish it at autumn.

When defining frequency however, it might be necessary to communicate sooner when a significant incident or controversy has taken place through ad-hoc disclosures rather than to wait for the next annual reporting cycle. The report content may be adopted for the different reporting frequencies.

Regulatory and Policy Landscape

Various rules of law oblige certain companies to disclose so called 'non-financial information' that are in close relationship to what we can call ESG information, however, these obligations are not very well defined yet, the legal requirements are relatively flexible and evolve rapidly. Moreover, the obligation to publish such non-financial information is binding only on the largest issuers, leaving out many smaller, but not much less significant firms.

It becomes more and more common practice that certain issuer companies may be subject to ESG-like reporting requirements under contracts. For example, sustainability-linked loans and bonds require borrowers and issuers to report on certain ESG metrics that may as well determine the interest payable under the loan or bond. Major rating agencies also now incorporate ESG factors in their ratings reports.

Companies tend to recognise that mandatory financial reports are not always the primary source of information for investors or other stakeholders, thus an increased pressure can be expected on listed firms to establish and enhance such reporting. The work to unify the currently existing numerous ESG-related standards and metrics already begun with participation of international and national authorities, the targeted companies themselves as well as advisors, civil organizations, and it is widely expected that ESG standards will be more aligned and comparable in the very near future. The following is a short overview of the development and the key milestones of the international, EU and Hungarian regulatory landscape regarding sustainability and non-financial disclosures.

In 2015, the United Nations (UN) adopted the **2030 Agenda for Sustainable Development and its 17 Sustainable Development Goals (SDG)** which call for concerted efforts towards building an inclusive, sustainable and resilient future for people and planet and intend to harmonise three core elements: economic growth, social inclusion and environmental protection.

The Paris Climate Agreement is the first-ever universal, legally binding global climate change agreement, adopted at the Paris climate conference in December 2015. In particular, the agreement sets out a global framework to avoid dangerous climate change by limiting global warming to well below 2°C and pursuing efforts to limit it to 1.5°C and it also includes the commitment to align financial flows with a pathway towards low-carbon and climate-resilient development.

Directive 2014/95/EU on the disclosure of non-financial and diversity information – also called the non-financial reporting directive (NFRD) – requires large public interest companies to disclose certain information on the way they operate and manage social and environmental challenges in order to help investors, consumers, policy makers and other stakeholders to evaluate the non-financial performance of these companies and encourages the reporting companies to develop a responsible approach to business. Companies are required to include non-financial statements in their annual reports from 2018 onwards.

The Taxonomy Regulation (Regulation (EU) 2020/852 on the establishment of a framework to facilitate sustainable investment), establishes the criteria for determining whether an economic activity qualifies as environmentally sustainable for the purposes of establishing the degree to which an investment is environmentally sustainable. The Regulation requires investment firms to classify investments based on the NFRD reports and disclose ESG and Taxonomy related analysis.

Regulation (EU) 2019/2088 on sustainability-related disclosures in the financial services sector, entering into force on 10 March, 2021, lays down harmonised rules for financial market participants and financial advisers on transparency with regard to the integration of sustainability risks and the

consideration of adverse sustainability impacts in their processes and the provision of sustainability-related information with respect to financial products.

In June 2017, the European Commission published its **non-binding guidelines to help companies disclose environmental and social information**. These guidelines are not mandatory and companies may decide to use international, European or national guidelines according to their own characteristics or business environment. In June 2019, the European Commission published guidelines on reporting climate-related information, which in practice consist of a new supplement to the existing guidelines on non-financial reporting, which remain applicable.

The Sustainable Finance Action Plan, released in March 2018 by the European Commission as part of "the European Green Deal," aims at taking due account of environmental and social considerations when making investment decisions, leading to increased investment in longer-term and sustainable activities. The guidelines are built on the recommendations of the technical expert group on sustainable finance (TEG) and they integrate the recommendations of the Financial stability board's taskforce on climate-related financial disclosures (TCFD) and take account of the forthcoming taxonomy on sustainable activities that is under development.

In its 11 December 2019 Communication on the **European Green Deal**, the Commission committed to review the non-financial reporting directive in 2020 as part of the strategy to strengthen the foundations for sustainable investment. In line with that commitment, on 20 February 2020 the

The new **EU Climate Transition Benchmarks Regulation** (regulation (EU) 2019/2089 - CTBR) sets up two types of benchmarks in accordance with the impact investing, the EU Paris-Aligned Benchmarks and the less strict EU Climate Transition Benchmarks and lays down the minimum requirements for each of those benchmarks. The Regulation obliges the administrators to issue a statement whether their benchmarks qualify as one of these categories and they should also publish the methodology that they use for the calculation of those benchmarks.

The obligation to prepare a non-financial statement (as part of their annual financial statements) in accordance with the NFRD was implemented to the **Hungarian Accounting Act** in 2016. It applies only to large companies of public interest. As per the Accounting Act, the non-financial statement shall include

- a brief description of the business model of the company,
- description on policies applied by the company regarding environmental protection, social and employment aspects, anti-corruption measures, also outlining the internal and/or external assurance thereof,
- results of the above policies,
- material risks regarding the above topics and description on risk management,
- key non-financial data.

In case a company does not have one or more of the above policies, the Accounting Act requires the company to explain (comply or explain principle). Also, information may be left out of the report in case the company deems disclosure is detrimental to its legitimate business interests, as long as the missing information does not represent a misleading picture on the company's performance, development and activities.

Introduction to ESG Reporting Standards

BSE does not recommend one specific standard to use from the many ESG standards in use for reporting but rather provides a list of standards that could be applicable for issuers.

Prior to selecting a reporting standard, the company should get information from the organisations developing the particular standard or advice from subject matter expert advisors.

Global reporting standards to start with

The two most popular standards used by BSE listed companies are the GRI and the SASB. The standards have been developed to provide ESG information to stakeholders.

GRI disclosure provides information on how the company's actions are likely to impact the external environment to a broad group of stakeholders including investors, while SASB is targeted specifically at investors, communicating about the ESG issues likely to impact the companies' financial performance.

Besides being one of the most popular standards among BSE listed companies, GRI was created as a universal disclosure standard for a diverse group of companies, with additional sector specific disclosures applying specific metrics. It is one of the most widely used ESG disclosure standard.

SASB, as mentioned previously, is targeted at investors specifically. The standard contains 77 industry specific sets of ESG metrics, potentially having financial implications for the company.

For more information on the two standards, please consult the Annex.

Although GRI and SASB have different purposes, they can be and are in many cases used together. The two standards are not competitive, but complementary frameworks, using different definitions of materiality for different purposes.

BSE recommended ESG Reporting Global Standards

1. Global Reporting Initiative (GRI)
2. Sustainability Accounting Standards Board (SASB)

Issue specific global disclosure and target setting schemes

Besides the complex, overarching reporting standards addressing economic, environmental, social and governance aspects of company performance, due to the growing interest and investor demand for action against climate change, issue specific disclosure and target setting schemes arose.

There are various commitment and reporting schemes in place aiming at assessing and evaluating the short-, medium- and long-term impacts of climate change and safeguarding future interests of investors. There are several policy directions, guidance documents and global platforms such as UN SDGs, UNGC and UN PRI in the area of ESG. BSE recommends three central and widely known disclosure and target setting schemes below.

BSE recommended ESG reporting global disclosure and target setting schemes for specific issues

1. Task-Force on Climate-related Financial Disclosures (TCFD)
2. Science Based Targets Initiative (SBTi)
3. Carbon Disclosure Project (CDP)

For more information on the three standards, please consult the Annex.

Integrated reporting to enhance transparency and address interconnectivity

Existing non-financial reporting may be strengthened by implementing an integrated reporting approach. Integrated reporting enables the company ESG communication to report in a cohesive way, reducing duplication and miscommunication between business areas.

Guiding Principles and Content Elements govern the content of integrated reports according to the IIRC Framework, however, they often build on disclosures according to the GRI or SASB standards.

BSE recommended Integrated ESG Reporting Framework

1. International Integrated Reporting Council (IIRC)

For more information on the framework, please consult the Annex.

ESG Data from collection to issuers becoming rated

Main ESG Rating agencies

The increasing prominence of sustainability, environmental, social and governance considerations for evaluating a company's performance brought the emergence of related rating agencies. These ESG rating agencies are specialised in assessing the environmental, social and governance performance according to their respective methodologies. The methodologies applied by the ESG rating agencies vary, frequently using publicly available data.

ESG rating agencies aim to inform financial decision-making processes. ESG performance may influence credit rating positively.

The main ESG rating agencies globally are:

- Arabesque: Arabesque S-Ray assesses company performance and sustainability based on ESG and financial metrics. Currently covers approximately 7 000 companies, but applies no minimum limit to companies in size, region, sector or other aspects for inclusion in assessment.
- ISS: ISS provides ESG rating for corporations and countries as well. The corporate ESG rating uses general and industry specific criteria to assess ESG performance. ISS is a SASB alliance organizational member.
- MSCI: MSCI ESG rating aims to identify and assess ESG related risks in company operations. The rating uses publicly available data. The ESG rating combines weighted percentage of risks according to their impact, and is normalised relative to industry peers. MSCI includes approximately 8 500 companies, primarily equity issuers that are constituents of MSCI market capital Indexes and fixed income issuers covered in the Barclays Global Aggregate Indexes.
- Refinitiv: Refinitiv ESG score provides information on the relative ESG performance of the companies. Refinitiv collects ESG data from annual report, NGO websites, CSR reports, company websites, stock exchange filings and news sources. The rating covers over 7 000 companies globally.
- Robeco: RobecoSAM Smart ESG scores include financially material and industry specific ESG issues. The ESG rating and benchmarking services are now owned by and operating from S&P Global. The rating covers almost 5 000 companies worldwide.

- Sustainalytics: the ESG rating of Sustainalytics is to be integrated into Morningstar Equity Research. The rating focuses on ESG risks, enabling cross-industry comparison between companies. The rating covers 12 000 companies.

As mentioned above, ESG rating agencies are often connected to and considered by global credit rating agencies, such as S&P, Moody's, Fitch and DBRS.

BSE Minimum standards

BSE acknowledges the importance of ESG issues and aims to support issuers in effectively addressing and communicating on ESG issues.

Guiding principles for issuers in developing their ESG approach:

1. Develop understanding of ESG issues
2. Incorporate ESG issues into decision-making
3. Define roadmap for continuous improvement in addressing ESG issues
4. Disclose ESG relevant issues

Besides respecting and implementing the guiding principles, BSE Issuers are required to perform certain tasks related to ESG reporting.

Requirements for BSE Issuers:

ESG categorisation	Entry level	Intermediate level	Advanced level
Disclosure	Standalone ESG disclosure	Standalone ESG disclosure	Integrated reporting
Frequency of disclosure	Annual report	Annual report	Annual report and quarterly ESG update
Reporting format	Basic report	Standardised report	Integrated (standardised) report
Report assurance	Not required	Not required	Required
Target setting	Not required	ESG target	Target set and monitored according to target setting scheme
Improvement	Required to advance to intermediate level in 2 years	Required to perform all aspects and advance to advanced level in 3 years	Required to perform all aspects in 3 years

All BSE issuers should be able to disclose their ESG performance at least annually in the format of their choice. This is categorised as entry level. Entry level issuers in line with Principle 3. should advance to intermediate level in 2 years. For advancing to intermediate level, the issuer must perform at least one of the intermediate level requirements.

Intermediate level issuers should be able to report on their ESG performance in accordance with an acknowledged reporting standard annually and publish ESG updates quarterly. They are required to set medium- or long-term (i.e. annual to 5 year) ESG targets. Intermediate level issuers should perform all intermediate level requirement and advance to advanced level in 3 years. For advancing to advanced level, the issuer must perform at least one of the advanced level requirements.

Advanced level issuers should publish an assured integrated report on their financial and ESG performance in accordance with an acknowledged reporting standard annually. ESG updates should

be shared quarterly. Medium- or long-term (i.e. annual to 5 year) ESG targets should be defined in line with target setting scheme(s). Advanced level issuers should perform all requirements in 3 years.

Annex

Name	Global Reporting Initiative	Sustainability Accounting Standards Board	International Integrated Reporting Council (and Framework)
Short name	GRI	SASB	IIRC <IR>
Focus	ESG, wider environmental, social and governance objectives	ESG, industry and wider environmental and governance objectives	ESG, value creation for organisations through sustainable reporting
Logo			
Links	www.globalreporting.org	https://www.sasb.org/	https://integratedreporting.org/
Language	English + 10 languages, no Hungarian	English	English + 10 languages, no Hungarian
Organisation	International, independent, non-profit organisation	Foundation	Global, not-for-profit organization
Location	Amsterdam, the Netherlands (founded in Boston in 1997)	San Fransisco, California, USA	incorporated in England and Wales, registered office in London
Creation, history	1997, 2000 (first guideline)	2011 founded by Jean Rogers, 2017 first guideline	formed in 2010; Dec 2013 framework published
Format	CSR report	SEC Form 10-K, 20-F filings	Stand-alone or integrated report
Mission	GRI's mission to help companies to understand and communicate their impact on critical sustainability issues, such as climate change, human rights, governance and social well-being.	Mission: is to establish industry-specific disclosure standards across ESG topics that facilitate the communication between companies and investors about financially material, decision-useful information.	The International Integrated Reporting Council (IIRC) is a global coalition of regulators, investors, companies, standard setters, the accounting profession, academia and NGOs. The coalition promotes communication about value creation as the next step in the evolution of corporate reporting. The IIRC's mission is to establish integrated reporting and thinking within mainstream business practice as the norm in the public and private sectors.
Benefits	- most widely used standards for sustainability reporting - great support: renewed web page, academy on usage - global but can be linked to UN SDGs and other reporting initiatives or frameworks - established development story: the first version of what was then - the GRI Guidelines (G1) published in 2000 – providing the first global framework for sustainability reporting.	- investors focus: SASB connects businesses and investors on the financial impacts of sustainability. -SASB standards are helping investors to factor ESG and sustainability-related impacts into their decisions; align and engage with companies on the sustainability issues that impact value creation and performance; fulfil PRI signatory commitments Lot of updates and history over more than 8 years Direct mapping to UN SDGs Materiality Matrix: - 80 sectors in 10 industries with the relevant set of indicators - Sector level map: shows the issues that are likely to be material for the industries in a sector - Industry level map: shows the issues that are likely to be material for companies in the industry - investors can use the materiality map to analyse portfolio exposure of specific sustainability risks and opportunities represented by each issue	There are three fundamental concepts underpinning <IR>: 1) Value creation for the organisation and for others. An organisation's activities, its interactions and relationships, its outputs and the outcomes for the various capitals it uses and affects influence its ability to continue to draw on these capitals in a continuous cycle. 2) The capitals. The capitals are the resources and the relationships used and affected by the organisation, which are identified in the <IR> Framework as financial, manufactured, intellectual, human, social and relationship, and natural capital. However, these categories of capital are not required to be adopted in preparing an entity's integrated report , and an integrated report may not cover all capitals – the focus is on capitals that are relevant to the entity 3) The value creation process. At the core of the value creation process is an entity's business model, which draws on various capitals and inputs, and by using the entity's business activities, creates outputs (products, services, by-products, waste) and outcomes (internal and external consequences for the capitals).

Name	Climate Disclosure Standards Board	Task-Force on Climate-related Financial Disclosures	Climate Disclosure Project
Short name	CDSB	TCFD	CDP
Focus	ES, climate, environmental and natural capital	EG, climate related risks and opportunities	EG, Climate, Water, Forests
Logo	CDSB	TCFD	CDP DISCLOSURE INSIGHT ACTION
Links	https://www.cdsb.net/	https://www.fsb-tcfd.org/ TCFD Learning Hub: http://tcfdhub.org/ Financial Stability Board (FSB): https://www.fsb.org/	https://www.cdp.net/en
Language	English	English	English
Organisation	International consortium of business and environmental NGOs,	Organization governed by 31 members selected by FSB	CDP Worldwide is regulated by the Charity Commission for England and Wales
Location	London, United Kingdom	-	London, United Kingdom
Creation, history	Founded at the World Economic Forum meeting in Davos in 2007.	2015, final recommendations in 2017, Michael R. Bloomberg	Founded in 2000.
Format	Annual reports, 10-K filing, or integrated report	Annual financial filings (annual report)	CDP's online reporting platform
Mission	CDSB's mission is to align the global mainstream corporate reporting model to equate natural capital with financial capital. The framework offers the same rigour as financial information. Companies provide decision-useful information via the mainstream corporate report.	Help companies to understand what financial markets want from disclosure in order to measure and respond to climate change risks, and encourage firms to align their disclosures with investors' needs.	CDP wants to see a thriving economy that works for people and planet in the long term. To achieve this, it focuses investors, policymakers, companies, cities, states and regions on taking urgent action to build a truly sustainable economy.
Benefits	- works with the normal financial reports - compliance-ready materials - updated to align with TCFD and other mainstream reporting requirements	- Adoptable by all organisations - Included in financial filings - Designed to solicit decision-useful, forward-looking information on financial impacts - Strong focus on risks and opportunities related to transition to lower carbon economy The Task Force on Climate-related Financial Disclosures (TCFD) will develop voluntary, consistent climate-related financial risk disclosures for use by companies in providing information to investors, lenders, insurers, and other stakeholders. The Task Force will consider the physical, liability and transition risks associated with climate change and what constitutes effective financial disclosures across industries.	Connecting CDP data with the CDSB framework to successfully fulfil the TCFD recommendations

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