Impact Investing Institute's response to the European Commission's public consultation on the revision of the non-financial reporting directive

About the Impact Investing Institute

We are an independent institute that aims to accelerate the growth and improve the effectiveness of the impact investing market, so that more capital contributes to achieving the Sustainable Development Goals and the wellbeing of people and planet.

We define impact investment as *investment made with the intention to generate positive social and environmental impact alongside a financial return*.

We aim to deliver change by:

- **Educating and raising awareness** through communications, events, and engagement programmes
- Providing **useful tools and information** on impact investing
- **Advocating** for regulation and policies that support impact investing

We are part of a global network of national advisory boards, grouped together in the Global Steering Group for impact investment. We actively engage across the spectrum of investors and investees – with individuals, asset owners, managers and intermediaries and with businesses, social enterprises and other organisations committed to making a social impact. We work with national governments, regulators and multilateral bodies to influence policy and advocate for impact investment.

We believe that organisations should measure, manage and report their positive and negative, intended and unintended outcomes which impact on people, planet, and the economy. This is critical both to the organisation's business strategy and also wider public interest, and it enables stakeholders to hold boards, asset owners and their investment managers accountable.

Our vision is for transparent, consistent, comparable reporting of outputs and outcomes that reflect and drive real, positive impacts on the environment and society. We advocate for the global convergence and increased adoption of high-quality standards for outcomes measurement, management and reporting.

Key extracts from our full response

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

Traditionally, non-financial reporting has focused on how an organisation avoids harm, mitigates risk and manages its reputation. The disclosures are within an organisation's control and can be captured from 'inside' the reporting organisation (internal focus). They are important for the immediate stakeholders of the organisation, but they generally do not measure or report the impacts, on the planet or people, resulting from the organisation's activities.

Impact reporting, on the other hand, strives to directly measure positive or negative changes to planet or people resulting from an organisation's activities. This necessarily has an 'external' focus, with impacts captured 'outside' the reporting organisation. Impact reporting focuses on how organisations can make a positive contribution to the societal and environmental challenges the world faces.

With rapidly accelerating climate change, increasing global inequalities and unsustainable business practices, social and environmental impacts must be viewed as key components of reporting, key influences on business strategy and key factors in investment and stewardship decisions. Impact investing and reporting have the potential to enable transformation of capital market systems to meet society's need for a sustainable future. They are an important part of a necessary wider systemic transformation.

The Institute therefore advocates for non-financial disclosures to include both those impacts arising from the activities of the business that are material to the company's ability to create sustainable financial value, and those that are material to the public interest, (i.e. material to people, the planet and/or the economy). Our vision is for 'transparent, consistent, comparable impact reporting that reflects and drives real impact'. We promote an integrated approach to environmental and social impact reporting, which anchors environmental and social impact in organisational purpose, strategy, culture and operations and facilitates transparency.

It is of paramount importance that non-financial disclosures are presented and measured in a manner that enables both investors and other users of corporate reporting to understand the nature of an issuer's metrics and their relevance (positive or negative) to the business model. Those relevant to investors should be integrated with financial information and have equal stature. The internal governance of non-financial information should be disclosed by companies, so that investors and other stakeholders can clearly see the board oversight over disclosures, and how they interact with management performance incentives.
We believe that there will be increased demand for reporting by companies on a range of non-financial disclosures relating to impact on people and the planet that are relevant to the public interest. These impacts should be disclosed in a separate, assured, report focused on the needs of wider stakeholders.

Section 2: Standardisation

The key elements for comprehensive non-financial disclosure already exist, therefore regulators should avoid creating additional new standards, but instead focus on convergence and promote global principles, standards, measurement and reporting frameworks. This will be a faster route to convergence on a global non-financial disclosure system that meets the needs of all stakeholders.

In the case of reporting of non-financial information by SMEs, while this should be mandatory to ensure investors have sufficient information to base their decisions on, any requirements should be proportionate and not overburden the SMEs or introduce too much cost. In the longer term, all companies need to be thinking about sustainability, so it is important that SMEs do disclose.

Additionally, EU legislation concerning corporate transparency should be streamlined in order to minimise any competing requirements between EU Directives, and alignment between corporate and investor disclosure obligations. Reporting should also include disclosures linked to the EU Sustainability Taxonomy, however this should not be limited to disclosures within the six current

Taxonomy objectives, as over time, new objectives may prove to be relevant, particularly relating to social factors, and could therefore be accidentally excluded from the disclosure regulation. It is fundamental that there be consistency of non- financial reporting standards around the world, so cooperation with other countries (e.g., the UK post Brexit) and international bodies in developing these standards is very important. While standards should be comparable across sectors, regulators should also provide guidance on sector-specific themes in reporting to help companies determine relevant sustainability issues. This guidance should not detract from comparability across sectors or create silos in disclosure.

Section 3: Application of the principle of materiality

We believe that companies should report on both those impacts arising from the activities of a business that are material to a company's ability to create financial value and those that are material to the public interest, (i.e. material to people, the planet and/or the economy). We note that there is a growing recognition of the inter-dependence of commercial and societal (people and planet) impact, i.e. the "double materiality perspective", which is gradually converging into a single perspective requiring companies to report on material impacts that effect a company's ability to create financial value and are also of public interest.

However, currently there is still significant divergence between commercial and non-financial concepts of materiality, so a separate standard of materiality for non-financial information should be clarified. A revised NFRD could specify the double-materiality perspective and provide guidance to companies on how they should fulfil their reporting obligation, ideally pointing to existing standards as discussed below. Contextual information, such as baselines, thresholds etc. should also be reported to assist users of non-financial information to establish whether an outcome is positive or negative, and to understand which economic activities are contributing to wider impact goals. Contextual information will also assist companies in recognising that materiality may differ across areas of operation and should be reported as such.

SASB and GRI together provide good coverage of materiality standards for the users of non-financial information. SASB identifies sustainability topics that are likely to be financially material in the short or medium term and are therefore typically most relevant for investors. GRI takes a wider view of materiality: it requires companies to report against topics that substantively influence the assessment and decisions of a broader range of stakeholders including civil society, trade unions and others. Thus, SASB and GRI's complimentary use cases can help companies supply non-financial information compliant with the NFRD's double materiality perspective.

The current definition of materiality set out in Art 2(16) of the Accounting Directive is inadequate for the purposes of public interest users of non-financial information. Any concept of materiality in non-financial reporting should be linked to achieving an issuer's public interest obligations. This broader concept of materiality will differ in application from organisation to organisation.

Section 4: Assurance

There are multiple standards (reporting standards, metrics and disclosure standards) in this space, for example AccountAbility AA1000 Assurance Standard and the IAASB's ISAE3000, and these should be brought together to help develop an assurance standard.

For sustainability measurement and reporting to be credible, it requires high-quality independent assurance, and assurance requires triangulation (validation of data through cross verification from more than two sources). Technology and data providers need to help validate measurement and reporting by obtaining evidence to substantiate claims and comparing and contrasting with relevant market data, which is a key input into the assurance process. Emerging technologies, especially Blockchain, will play a potentially transformative role in this task.

This can be challenging where progress against sustainability themes is context specific; for example, a manufacturing company could report progress on reducing water consumption when compared in simple terms to the wider industry. Data providers could examine and contextualise this statement and discover that the manufacturing plants in question are actually in highly water stressed areas, indicating that water remains a material issue requiring continued focus. Through a broader understanding of the data landscape and an objective perspective on an organisation's sustainability measurement and reporting, technology and data providers can reduce reliance on company disclosure, and simultaneously push companies to report more meaningfully.

We acknowledge that high-quality independent assurance may overburden SMEs, and so a phased approach may be appropriate for companies with fewer resources newly in scope of the directive.

Section 5: Digitisation

It is again of paramount importance that non-financial disclosures by issuers are publicly available and easily accessible, using the appropriate technology that is available at the time.

We understand that the long-term vision for digitisation of non-financial information is use of XBRL by all issuers, however it will take time to develop non-financial standards and educate issuers about the required disclosure. It is important that standards for reporting are developed, adopted and embedded before regulators rush into digitisation of disclosure at a detailed level.

In the meantime, system-wide mechanisms for reducing the reporting burden should be created. A public depository of data, metrics, KPIs, tools and approaches, properly governed, accessible by and distributable to all, will be key to reducing the non-financial reporting burden. Across stakeholder groups there should be improved awareness of key terminology, and public sharing of effective approaches and data sets, to accelerate the drive towards impact transparency and comparability, and terminology should be drawn from existing global standards.

However, even with the digitisation of non-financial information it is important to note that regulators and users should not under-estimate the availability and need to use third party data alongside and to make sense of corporate non-financial information.

Finally, issuers should be able to use a single access point (similar to the EDGAR system in the US, or the EU's pilot EFTG) to review the non-financial information of issuers across the EU.

While the benefits of digitisation against set standards may not be evident in the first year or two, as it will take issuers (and indeed in some cases users of non-financial information) some time to understand the new system, it should greatly assist in ensuring transparency in the long term.

Please also refer to a report, "Technology-enabled impact reporting practice across the investment chain (2019)", published by the Impact Investing Institute in partnership with Deloitte, in which we highlight the importance of technology in effective impact reporting.

Section 6: Structure and location of non-financial information

Non-financial reporting and governance should not be segregated but integrated. Non-financial reporting on the themes which are material to an organisation could be included in the management report section of a company's annual report, integrated with financial information (enhanced integrated reporting). However, the current integrated reporting structures must be modified to effectively accommodate enhanced non-financial reporting. Non-financial information included in this annual report (or equivalent document) should be subject to the same level of supervision as financial information from national and regional authorities.

Additionally, reporting on a wider range of non-financial themes relevant to public interest could be highlighted separately in an ancillary non-financial/impact/sustainability/environmental and social responsibility report, which could be published at a different time to the annual report.

Over time, we expect that the single annual report (or management report) will evolve into (1) a core stakeholder-neutral report which deals at a high level with governance, strategy, risk management, metrics and targets in an integrated way, using for example at a high level the TCFD metrics extended to issues other than climate supplemented by (2) a set of detailed financial statements and in time (3) a public interest report But an integrated approach to reporting – focused on the needs of investors and giving financial and non-financial information relevant to business model equal stature – will provide more meaningful disclosure in the meantime.

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