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Building a more sustainable economy in Europe

"Non-Financial Information and sustainable finance –what next?"

21 June 2017

DRAFT REPORT

On 21 June 2017, ACCA (The Association of Chartered Certified Accountants), AVIVA, Barclays and the International Integrated Reporting Council (IIRC) organised a conference called "**Building a more sustainable economy in Europe"** that revolved around the themes **"Non-Financial Information and sustainable finance –what next ?"**

After key notes speeches from **Richard Howitt**, CEO of the IIRC and **Sirpa Pietikäinen,** MEP, the first panel moderated by **Raymond Jack**, Executive Director, at ACCA discussed **NFI –IR** and was composed of **Nicolas Bernier-Abad**, European Commission, DG FISMA **Noemi Robert**, Senior Manager at AccountancyEurope; **Lé Quang Tran Van**, representing AFEP & EuropeanIssuers, and **Jacqueline Duiker**, Senior Project Manager Responsible Investment at VBDO also representing Corporate Human Rights Benchmark.

The second Panel on sustainable finance moderated by **Steve Waygood**, Chief responsible investment officer at Aviva Investors, entailed **Robin Edme**, DG FISMA-Financial Services Policy & International Affairs unit, European Commission, **Mark Lewis**, Managing Director European Equity Research at Barclays, who also delivered conclusions **Rahul Ghosh**, Vice President – Senior Credit Officer, Credit Strategy and Research at Moody's Investors Service, and **Davide dal Maso**, representing UNEP Inquiry. **Paulina Dejmek**, Member of Cabinet of European Commission President Juncker gave concluding remarks.

The debate confirmed that promoting financial stability and sustainable development by enhancing the links between investment decisions, corporate behaviour and reporting has become a global need. We have made important progress, but there is still a long way to go.

Main highlights

Richard Howitt, CEO, IIRC

- Momentum for European action in this area is greater than ever. With the EU Non-Financial Reporting Directive successfully transposed in the vast majority of EU member states, companies right now collecting information for first reports which will start to be published at this time next year. This Directive shows that it is possible to pass legislation in this field which can be both effective and popular.
- In the European Commission's public consultation on CSR, the Directive was described as "the most successful initiative" arising from the strategy, with a majority of companies themselves supporting that statement.
- Meanwhile a separate Eurosif survey found that 83 of 90 European institutional investors supported the Directive and believe it should lead to integration with financial information.
- The final report on the public consultation on the proposal for a directive said a large majority of contributors showed support for the concept of integrated reporting. The public consultation on the guidelines about to be published, showed four-in-five respondents did not want detailed guidelines which would replace existing frameworks such as integrated reporting. So, companies and investors see the value in doing this, and of making this an integrated not a separate report.
- Many of the requirements of the Directive reflect the principles of integrated reporting: that information provided is forward-looking; that there is identification of risk; description of business model; the potential to make this an integrated part of the management report. That sustainability is crucial, but that there is connectivity between companies' impacts on the economy, environment, on people, on society - what in integrated reporting we call the six capitals.
- Although the EU has traditionally used the term 'non-financial reporting' to ascribe value to what are sometimes called intangibles, sometimes externalities; the conception of integrated reporting is that these can be intensely financial - but sometimes only in the longer term. So this demonstrates that the principles of integrated reporting and the principles of the EU Directive are closely inter-twined.
- However, this does not mean that integrated reporting is a necessary or the only way to comply with the Directive. The major change in mindset by companies to address the more holistic, long-term approach to value-creation cannot be achieved by legislation alone. Companies should be encouraged to use integrated reporting to implement the directive, just as the Directive itself encourages but does not require companies to do so.
- Companies need to take that step. Integrated reporting is not a different, additional type of reporting available to companies. The International Integrated Reporting Council convenes the global Corporate Reporting Dialogue, in which the four main sustainability standard-setters and the two major financial standard-setters in the world are working together with us to align the different frameworks.
- Indeed, the public consultation on the Non-Financial Reporting Guidelines conducted last year, specifically called for what the final report called a 'convergence' of such frameworks. That echoed the same call for alignment we see in the report of the FSB Task Force on Climate-related Financial Disclosure, and in the final Report of the Business Commission for Sustainable Development on the business contribution to implementing the SDGs.
- In relation to the Directive itself, CDP, CDSB and the GRI have all mapped their frameworks against the requirements. And in a publication supported by the European Commission, CDP and CDSB produced a series of case studies showing how leading companies who have adopted integrated reporting in Europe, already represent 'best practice' in their existing reports when it comes to the requirements of the Directive.

- It is possible to comply with this Directive through separate reporting but it would be a huge mistake to do so. In the German Parliament, the Bundestag, there was a specific debate about whether Integrated Reporting complied with the Directive, and a specific change to the transposition of the text in Germany to clarify that it does.
- The message should be that no change to the EU text is needed; that this is a matter of choice. This is not simply about one framework, the <IR> Framework, but about the global movement towards integrating financial and non-financial reporting. 1,500 global companies already, 36 top companies in Spain, a third of all listed companies in Netherlands, all of the CAQ40 top listed companies in France within three years.
- This is a global but not just a European movement. Already the leading practice in Japan, mandatory in South Africa, adopted by the Chinese Ministry of Finance, recommended for the top 500 listed companies by India's securities regulator, part of stock exchange listing rules in Brazil.
- The opportunity of the EU Directive is that here in Europe, 6,000 - maybe 8,000 - companies are changing their reporting this year and next year. They are thinking about it and it is a huge moment to say that this thinking should be integrated thinking. If we get it right, Europe itself can be the next major step forward in the world for integrated reporting; to help the world's transition towards long-term investment, inclusive capitalism and sustainable development.
- Through our Business Networks, through our training programmes, through our champions in every market in Europe, the IIRC will work - with our partners - to support this.
- Integrated reporting is trying to change the mind-set of compliance and the face of existing reporting. Feedback shows that companies want to use integrated reporting and don’t see it as additional burden. The philosophy of integrated reporting is to make information more concise and more material. In order to transform corporate behaviour and to have more sustainability, we won’t do it by separate reporting – only by integrated reporting.

Sirpa Pietikäinen, MEP

- Climate change, resource scarcity and changes in biodiversity are speeding up fast. The right incentives and regulation is needed to address these challenges. It takes time for industries and economies to adjust. It also takes time to come up with the right legislation and to implement it effectively.
- It is not the time to make small improvements so the situation gets slightly better. The bar needs to be set high. We cannot lose opportunities – it is crucial to get it right.
- Environmental risks will undoubtedly affect economy in the long term. There needs to be a system change. Approximately 30 pieces of legislation need to be reviewed. Resources need to be valued, as well as the effect on ecosystem services.
- The indicators to measure change and rules governing e.g. transparency need to be harmonised and compulsory to everybody. If comparability is lost, the whole effort will be lost as well. Politicians need to acknowledge their responsibility.
- As regards to reporting, it is crucial to have transparency and comparability.
- GRI standards should be developed further and exist as a separate reporting path.

<u>Panel discussion on NFI –IR</u>

Raymond Jack, Executive Director of Finance and Operations ACCA

- Over the past decade or so, financial and corporate reporting has been steadily growing broader as companies are called to disclose more than the traditional figure-heavy financial report.
- Corporate reporting has never before been so complex, with increased mandated content and listing rule provisions, resulting in increased length and complexity of annual reports. There is an appetite for more relevant, focused and material reporting

with a recognised need for more relevant and concise narrative reporting, and greater alignment with corporate strategy, key risks and key performance indicators (KPIs).

- A growing number of companies are already using integrated reporting. Integrated reporting does bring challenges. but, as ACCA recent research shows, those companies who prepare integrated reports see them as an approach to sound business management, as well as a valuable form of corporate reporting. Integrated reports need to be of high quality if they are to be valued and respected.
- Non-Financial Information reporting underpins the understanding of a company's long-term economic value and contribution towards a more sustainable world. Traditional professional accountancy skills have proved useful in the development of NFI standards: it has required the gathering and analysis of data, a consideration of materiality, the management of risk, a valuation of assets and liabilities and an understanding of corporate reporting, amongst many other considerations.
- However, the situation cannot allow us to be complacent. We are facing sustainability issues on a global scale, and while the accountancy profession is already playing an important role in this arena, there is certainly much more to be done.
- In that vein, ACCA recently published a global study called Professional Accountants-the Future, which gives an in-depth insight into the future of the profession - the drivers of change through to 2025, the demands on the profession and the skills that will be required to meet those changes and demands. The report namely reveals that**,** as it becomes more holistic, corporate reporting will become less concerned with the numbers and more with the strong narrative, story, of the organisation, including sustainability, transparency, and ethics, to only name a few. These findings have led ACCA to make changes to its qualification, which now entails a stronger focus on non-financial reporting as well as an Ethics and Professional Skills module that focuses on developing the complete range of professional skills employers have told us they need.
- society's changing expectations of the corporate sector have been matched by the emergence of a range of new reporting guidance, some voluntary, some mandatory. However, the absence of agreed, standard terminology for describing and defining the components of the sustainability reporting landscape contributes to the confusion and complexity that currently characterises it. A recent joint ACCA CDSB research called **Mapping the sustainability reporting landscape: Lost in the right direction** shows that as far as sustainability reporting is concerned, we seem to be moving in the right direction, but we are still somewhat uncertain about our final destination.

Nicolas Bernier-Abad, DG FISMA, Presentation of the NFI guidelines

- Around 6000 large EU companies will start applying in 2018 the provisions of the Non-financial reporting Directive. This definitely means progress and more transparency in annual reporting. Companies are realising the importance of these changes, they are making the effort and questioning themselves, improving systems and allocating recourses. Other stakeholders, and the European Commission, are also doing their part.
- The non-binding EC guidelines published on 27 June will help companies fulfil the requirements of the Directive. This is a humble contribution by the European Commission on how the companies can be helped when preparing their reports. The Commission has made an effort to make this document a helpful tool for companies. It was also very important for the Commission to maintain the balance that is set out in the European legislation. No new obligations are set out in the guidelines.

- It is regrettable that many companies are not taking advantage of transparency as a competitive advantage and explain their activities as regards to environmental and social dimensions.
- The main point is that non-financial reporting does not exist as such – comprehensive company reporting and transparency is what really matters. We need to remind ourselves that companies are the real protagonists. They need to realise that nowadays providing only financial information is not enough – stakeholders need to see the full picture of their activities.
- This is something that was missing in the European legislation. What has been done in the EU is very unique and it is, in our mind, the right approach. Being flexible and non- prescriptive is the right way to go.
- Company transparency is a must, not optional. Transparent companies are ultimately more successful.
- The High Level Expert Group on sustainable finance is working on transparency matters in the context of its mandate. This group believes that environmental and social related information is very important for the actual implementation of the new strategy of sustainable finance in the framework of the Capital Markets Union.
- Companies need to focus on useful information. It needs to help in the decision-making process.
- Asked what would prevent the Commission to endorse several standards by the IIRC, GRI or AFEP. Nicolas Bernier-Abad said that the debate is always there and the challenge is to get the right balance. There are many good standards out there. The Commission is choosing to take a step-by-step approach. The EU model is not to be prescriptive, but flexible.

Noémi Robert, Senior Manager, AccountancyEurope

- We are on a journey in corporate reporting. Anyone who is in front of the non-financial information needs to be able to rely on it. This is where assurance plays a big role.
- The Directive has foreseen that the auditor has to check whether the information is there but not whether it can be relied upon.
- An option is given to member states to verify information by an 'independent assurance provider', but very few countries seem to go that way. The profession is not very sure yet what verification means in this area.
- It has been noticed that a lot of companies are already asking for an independent assurance on non-financial information because investors and shareholders require it.
- Some comfort needs to be provided to the reader of the annual report that the information disclosed is the right story.
- As regards to challenges encountered by practitioners when providing assurance on NFI, practitioners have long history in auditing financial statements and strong standards and oversight in this area. In comparison, providing assurance on NFI is still very new.
- The profession needs to work towards a consistent application of how the information is assured because some discrepancies in approaches can sometimes be observed. There is also a challenge around the assurance standards and reporting framework. At the moment, assurance standards for NFI are not as well developed as they are for financial information.
- The profession is ready to step up to the plate and is already doing a lot.
- We should work more on defining materiality. If we properly tackle this issue, the length of reports could potentially be reduced.

Lé Quang Tran Van, AFEP & EuropeanIssuers

- If you want sustainable capital markets, you need to have capital markets. And in order to do that, you need to have companies. Large companies can deal with any conditions. Small companies are not able to do that and face tremendous challenges in terms of reporting obligations.
- There is general acknowledgement that current reporting obligations may not anymore deliver useful information. This is very disappointing because there are many reports out there.
- The next logical step would be to repeal all these obligations included in EU Legislation and not add any additional layer.
- If you repeal all these obligations, companies will stop doing compliance and will start to reflect on their activities and publish information that is really useful for their shareholders and stakeholders.
- We need to work together to raise awareness that anything that is not necessary needs to be repealed. New framework needs to be developed but **flexibility**, not new reporting requirements are needed. Any initiative aimed at simplifying and streamlining reporting but not adding more burden would be supported.
- Regarding the Integrated report, some of AFEP's members have published so called "integrated reporting". Numbers are growing.
- There is confusion between NFI, ESG reporting and integrated reporting or integrated thinking. ESG is just one component of the creation value process and of the holistic view that integrated thinking tries to achieve. But just one part.
- Integrated reporting should be aimed first at shareholders and investors. Companies should not try to address all stakeholders' concerns and should not have to.
- We need to be careful with certain concepts, such as natural capital.
- It can be agreed that companies need something simple, useful and flexible. We need to focus on what is material.

Jacqueline Duiker - Senior Project Manager Responsible Investment, VBDO

- VBDO has been benchmarking on responsible investment for pension funds for more than 10 years and we have seen that these Dutch pension funds have substantially improved their responsible investment. The benchmark creates awareness and provides a practical tool to assess and manage responsible investment. Benchmarks provide transparent, material and measurable data that can be compared over time.
- VBDO is one of the co-founders of the Corporate Human Rights Benchmark. Human rights is a very important issue when it comes to sustainability and may also pose material financial risks for companies. Human rights are very challenging to measure, manage and monitor. The Corporate Human Rights Benchmark is a unique multi-stakeholder initiative, which developed a methodology of assessing companies in order to improve their human rights performance. This tool and the findings are publicly available www.corporatebenchmark.org
- Traditional financial reporting alone is not capable of painting the full picture of a company. Adding non-financial information will lead to more transparency and enable investors to allocate their capital more appropriately.
- The non-financial information is still difficult to control and assure. Benchmarks can provide an alternative, providing precise and standardized non-financial information and be effective for driving change.
- In the upcoming years we need to focus on what is material for companies but also what is relevant in terms of sustainability.

Panel on sustainable finance

Steve Waygood, Chief responsible investment officer - Aviva Investors

- For finance to be sustainable every intermediary needs to act on the information promoted by Integrated Reporting. This means Investment Banks should integrate

material Environmental Social and Governance (ESG) issues into their Buy and Sell recommendations.
- Credit Rating Agencies should similarly reflect ESG performance when considering business risks of insolvency. Stock exchanges should promote Integrated Reporting via listing rules and company guidance.
- And fund managers should integrate ESG in their investment decisions - including how they vote at company annual meetings. And all this should also be able to be seen and understood by the end client whose money it is too.
- Aviva has published a Roadmap for Sustainable Capital Markets.

Robin Edme, DG FISMA- Financial Services Policy & International Affairs unit, presentation of the work on sustainable finance/experts group
- The High Level Expert Group on Sustainable Finance has been set up last December, as part of the reflection on the Capital Markets Union. It comprises 20 members from the entire financial industry, as well as NGOs and Think Tanks, and 9 observers mainly from investor institutional initiatives and regulators.
- The mandate of this group is to help the Commission to design an overarching framework for integrating (hardwiring) sustainability into its financial (services) policies; however, a special focus on environmental issues is to be made because of the relative maturity of certain aspects of the so-called 'green finance'.
- The High Level Group was required to think outside the box. It should be noted that discussions in the group have been very open and covered a broad range of topics, such as ESG integration in investment and lending decisions, mismatch of horizons, green assets taxonomies, capital requirements, accounting rules, cultural practices in the investment and lending chain favouring short termism, benchmarks and credit ratings, etc. The group has indeed a very large remit, and does not focus on responsible investment in its narrow definition.
- Expectations are high. After six months of intensive work, the Expert Group is currently in the process of finalising its first findings and policy options in its Interim Report to be published in July 2017, prior to the European Commission public hearing on sustainable finance which will take place on 18 July in Brussels.
- The proposed policy options will cover 'hard' regulation aspects, as well as non regulatory initiatives The Interim Report will also propose a set of recommendations to the Commission, related to issues which have been identified in Priority N° 6 of the CMU Mid-Term Review, but not only.

Mark Lewis, Managing Director European Equity Research – Barclays
- Information is at the heart of how capital markets work and they can only work efficiently when we have proper information.
- Three main risks for companies are: physical, liability and transition risks. Sustainability issues are more relevant than ever. Companies are taking more holistic approach.
- It is important to standardise and harmonise on global level on how companies disclose information around the risks so that other stakeholders are able to make more informed judgements.
- The recommendations of the industry-led task force will be on voluntary basis. It is important to make sure that those recommendations find their way into more mandatory framework, which eventually is the goal. The more standardised it is – the more powerful it becomes.
- If we think of finance system as the engine in the car, the vehicle as the real economy, and the terrain that we have to cross as the broader environmental, social and political landscape – we need a car that is productive and an engine that is fit for purpose. The financial crisis showed us that there was a short-term focus in our economies – there was an overheating of the engine. We are reaching a point where

sustainability issues are becoming mainstream and the terrain is becoming more challenging. Climate change, as well as many other environmental and social issues, cannot be ignored anymore. We need to take these issues into account and re-design the engine so it is fit for purpose. And the engine cannot be the purpose in itself.

- As regards to natural capital protocol, there is not much pressure from investors yet, although it is a very important topic. The Commission has kicked off a dialogue on financing the Blue Economy.

Rahul Ghosh, Vice President – Senior Credit Officer, Credit Strategy and Research, Moody's Investors Service

- There are a lot of different actors involved in sustainable finance. Moody's look at ESG risks in the context of its role in the capital markets, which is to seek to capture, on a forward-looking basis, all meaningful issues that may impact the credit quality and therefore the credit rating of an entity or sector.
- Moody's established a global ESG group in early 2015. Until recently, environmental risks were not seen to be main driver of rating outcomes. They have been always taken into consideration, explicitly so for some obvious sectors such as utilities, but for others the impact was incorporated indirectly.
- Moody's undertook a comprehensive qualitative study of the relative exposure of 86 sectors ($68trn) globally to environmental risks. It looked at five environmental risks and what kind of credit exposure different companies have to those risks. The study looked at the magnitude of the exposure and also the time horizon; it determined which industries were most exposed to environmental risk today and where it has immediate impact on ratings, but also which sectors may face risks over the coming years.
- After the study, Moody's is rolling out sector-by-sector and issuer level research. Through this work, it is intended to comprehensively and consistently create a way to engage with investors, issuers and market participants to better understand and capture the credit implications of areas such as carbon transition and physical climate risks.
- From a credit perspective, materiality and time horizons are important for investors. As recommended by the FSB Task Force for Climate-Related Financial Disclosure, it is suggested that companies outline short, medium and long-term horizons themselves because they will differ depending on industry and provide greater detail on scenario analysis and key targets and metrics. If widely adopted, this will enhance our ability to integrate such risks into our credit analysis.
- As regards to regulation, wherever we look in the value chain, the direction is towards a greater accountability, oversight and, in some instances, regulation. The demand is there. Regulation can often help solidify and strengthen internal processes and procedures. However, as we have shown through our extensive work in recent years, we are not waiting for regulation and instead seek to respond to market-driven needs for greater transparency on the impact of ESG as a driver of credit risk. We need to be ahead of the curve.

Davide dal Maso, UNEP Inquiry

- In order to have a sustainable financial market, it's not sufficient to improve the sustainability performance of single financial institutions, we need a systemic reform (which is exactly the purpose of UNEP Inquiry).
- An example of how this type of change can be promoted is the Italian National Dialogue on Sustainable Finance, a platform launched one year ago by the Environment Minister and powered by Unep Inquiry, that has involved a number of different actors across the financial community. More than 80 professionals from different sectors are involved in this platform.

- A number of good practices have been reported in Italy. There are signs of change, however it is not yet systemic – sustainability is not completely embedded in the strategies and the policies. Together with all stakeholders, 18 policy options have been identified to address key issues in the areas of (i) policy frameworks (ii) innovation (iii) disclosure and governance and (iv) capacity, awareness and knowledge
- This work has provided value not only in term of practical output but also in terms of process. It contributed in creating a community of interest amongst people representing different viewpoints.
- Sustainable finance is a part of a wider programme of structural reforms of the economy. It redesigned the rules of the game and how the financial system works.
- This work has provided input that Italian government put forward in its G7 Presidency. Sustainable finance is at the heart of the final statement of the seven environment ministers that highlighted importance of promoting financial centres for sustainability and strengthening policy agendas for real economy, SMEs and sustainable development.
- In order to make the structural changes possible, we need a strong commitment from the government, spirit of cooperation from private actors and technical support.

Paulina Dejmek Hack, Member of Cabinet of European Commission President Juncker

- The momentum around the issues of green and sustainable finance is substantially increasing in Europe and is more important than ever in light of international developments. It is encouraging that the situation is changing and the topic is definitely becoming more mainstream. This is also visible in the Commission's own work, for example in the context of Capital Markets Union.
- Genuine interest is now coming from the EU institutions, as well as from private actors. The Commission is also better lined up and internal coordination has improved on these matters compared to the past. Different pieces and work-streams, not only in the financial sector, are slowly coming together and results are on their way. The High Level Expert Group on Sustainable Finance is presenting its interim results in July, followed by a large stakeholder conference. The Commission is looking forward to follow up this work in an as tangible and concrete way as possible.
- The European Commission is half way in its mandate. The economy is picking up but we are at a critical juncture and the Commission has launched a more general discussion on the Future of Europe via its White Paper published in March. In that context, the Commission has also presented a number of reflection papers – for example on the social dimension of Europe and on globalisation – which touch on sustainability aspects in various indirect ways. When taking forward the positive agenda for jobs and growth in the European Union over the next months and years, it is important to make sustainability issues an integral part of our work. .