

Driving Sustainable Profitability in Europe

Next Steps for Responsible Investment and Reporting

Report

Brussels, March 2016

Frank Bold, with the support of ACCA (the Association of Chartered Certified Accountants), organised a roundtable on responsible investment and reporting. The event was particularly relevant in view of the two current consultations published by the European Commission on non-financial reporting and long-term and sustainable investment. The consultations served as a basis for the debate on EU policy developments and the role of business, investors and civil society in fostering a sustainable economy and responsible business behaviour.

The roundtable was composed of two panels of speakers followed by discussion under Chatham House Rule:

- **Will Martindale**, Head of Policy at UN Principles for Responsible Investment
- **Zsofia Kerecsen**, Policy Officer, DG Justice, European Commission
- **Flavia Micilotta**, Executive Director, EUROSIF
- **Ophélie Mortier**, Responsible Investment Strategist, Degroof Petercam)
- **Nicolas Bernier-Abad**, Policy Officer, DG FISMA, European Commission
- **Richard Martin**, Head of Corporate Reporting, ACCA
- **Michel Bande**, Senior Executive Vice President, Solvay
- **Jeremy Nicholls**, CEO Social Value International and Social Value UK
- Moderators: **Paige Morrow**, Head of Frank Bold Brussels operations and **Filip Gregor**, Head of Responsible Companies Section at Frank Bold

Main Highlights:

Will Martindale

UN Principles for Responsible Investment

In his introductory remarks, Will Martindale focused on how asset owners can drive responsible investment and the issue of fiduciary duties.

Asset owners

Even though many asset owners have made commitments to responsible investment, the majority have yet to ensure that these are effectively implemented. Issues include:

- Inconsistencies in investment practices in different asset classes
- High-level statements on sustainability or environmental, social and governance issues are often missing from investment beliefs
- Responsible investment commitments are not embedded in investment mandates

By implementing their commitments to responsible investment with sufficient scale and depth, asset owners can accelerate the development of responsible investment throughout the investment chain.

The weaknesses in asset owner implementation and the consequent effects on investment manager behaviour also affect the relationship between investors and policy makers. UN research indicates that many policy makers are sceptical about investors' motivations; they see piecemeal implementation of responsible investment as indicative of a deeper lack of commitment to responsible investment and sustainability.

Will identified five distinct barriers to asset owners taking a more proactive approach to responsible investment:

- The perception that ESG issues do not add value to investment decision-making
- The perception that significant additional resources are required to implement responsible investment
- The perception that investor duties, and in particular, fiduciary duty, prevent investors from taking a proactive approach to responsible investment
- The advice given by investment consultants, which is often seen as not supporting proactive approaches to responsible investment
- The products provided by investment managers, which often do not meet the responsible investment needs of asset owners

Therefore, the UNPRI recommends six steps for asset owners in order to drive responsible investment:

- Understand the investment environment
- Define investment goals
- Define investment beliefs
- Establish investment governance processes
- Formulate investment mandates
- Monitor, review and report

Finally, Will called for active engagement of investors in policy making processes, which he distinguished from political lobbying. There is still much scepticism about the effectiveness of policy engagement and a lack of understanding regarding how to influence policy processes.



It must be about working together to be sure that our industry serves its clients and can deliver on its purpose of providing the capital which will deliver long-term prosperity
David Pitt-Watson, UNEP Finance Initiative

Fiduciary duties

UNPRI report 'Fiduciary duties in the 21st century' concludes that fiduciary duties (or equivalent obligations) exist to ensure that those who manage other people's money act in the interests of beneficiaries, rather than serving their own interests. The purpose of the report is to end the debate about whether fiduciary duty is a legitimate barrier to investors integrating environmental, social and governance (ESG) issues into their investment processes. Key findings show that failing to consider long-term investment value drivers (including ESG matters) in investment practice is a failure of fiduciary duty. Despite significant progress, many investors have yet to fully integrate ESG issues into their investment decision making processes.

The concept of fiduciary duty is organic, not static. It will continue to evolve as society changes, not least in response to the urgent need for us to move towards an environmentally, economically and socially sustainable financial system
Professor Paul Watchman,
University of Glasgow



Reports references:

[How Asset Owners Can Drive Responsible Investment \(PRI\)](#)
[Fiduciary Duty in the 21st Century \(PRI, UNEP FI, UNEP Inquiry and UN Global Compact\)](#)
[The Case for Investor Engagement in Public Policy \(PRI\)](#)

Will Martindale is Head of Policy at [UN Principles for Responsible Investment](#)
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First panel

Long-term and sustainable investment

The public consultation on long-term and sustainable investment was launched in December 2015 and closed on 25 March. The issue has launched a big debate but there is little indication what the outcome of the consultation will be. The Commission will issue a feedback statement and then will start discussions on further actions.

It was mentioned that Europe needs significant new long-term sustainable investment to maintain and extend its competitiveness. The issue is not new, as the European Commission has already been working in this area, for example on the revision of the Shareholder Rights Directive.

It was also suggested that the current Capital Markets Union Action Plan works to foster long-term sustainable investment and achieve EU policy objectives, specifically those linked to climate change and resource efficient economy.

Relevant and reliable information disclosure

A panelist highlighted that companies are not the sole player when it comes to providing information, as there are also ratings agencies, financial advisers and traders. This can generate confusion as regards to which is the most crucial information.

It was underlined that, for investors, quality of information and transparency is key. Investors want to collaborate with ESG rating agencies although it does not help that they often have different methodologies which results in very diverse kinds of information. Companies are also screened and rated according to different criteria. These comments led to the conclusion that investors want to have a clear view on how to assess industries and how to assess ESG issues. A more prescriptive approach is needed and investors need easier access to information in order to have more clarity when making investment decisions. It was also noted that we should not make a distinction between stakeholders and investors.

Some speakers noted the importance of taking a comprehensive approach – defining what measures and data are material. Reporting must be material so we are able to use this information. This prompted the debate on how materiality is defined and to what it applies.

In terms of quantity, investors do not need too much data; instead they need data that can be used. Disclosure does not necessarily mean transparency. A concern was raised over the inclusion of SMEs in regulation, as large companies have more resources to disclose the necessary data, and they could apparently seem to be more transparent than other companies.

It was also suggested that a clearer definition of responsible investment is needed.



It is increasingly clear that sustainability and responsible business behaviour go hand in hand with prosperity and strong markets. If societies or the environment fail, so will financial markets

Paige Morrow, Frank Bold



Environmental and Social Issues

We cannot run businesses like before - It is important to integrate social and environmental matters. It was stated that companies with improved non-financial performance will outperform their competitors

in the medium and long-term. A remaining challenge is that financial markets remain focused on the short-term, and it is not easy to reconcile long-term value creation with shareholder pressure.

More emphasis needs to be put on education and training – we operate with more data that is becoming more complex and there aren't enough experts to work with it. Standards are increasing but we need also increasing expertise from the auditors and from the compliance and monitors services.

Second panel

Non-financial reporting guidance

The public consultation on the non-financial reporting (NFR) guidelines was published on 15 January 2016 and will be open until 15 April 2016. The speakers on the second half of the roundtable focused on this directive and debated the issues of materiality, concrete requirements/indicators for NFR disclosure, assurance as well as integration and strategy.

Corporate purpose, sustainability, and governance

The moderator and host of the event, Filip Gregor, stated that the reporting framework is fairly well developed to protect shareholders from financial mismanagement. However, it does not show other important matters that are key to corporate success, including culture, ability to innovate, management qualities, other intangible assets, long-term risks, and associated strategies. Connected but sometimes separate is the understanding of what role the corporations play in societal and environmental risks, some of which may be risks to companies and some may be systemic, endangering markets, society, or the environment that are corporations' life support.

Investors play an important role in corporate governance, but in leading companies the primary users of the “non-financial” information are the senior management. It was then stressed that people and systems have a tendency to manage what gets measured, but we must not forget there is a complex system that influence corporate decisions. Where possible, the non-financial reporting framework should provide clear indicators and methodology for specific matters. For some matters it is easier than for others. In general, a company's reporting should produce information enabling to understand the business' strategy. These two perspectives are not contradictory.

Key issues for the NFR guidelines

A statement was made affirming that Europe has taken a big step forward in non-financial reporting aspects and has introduced a system that can be considered unique in the world. It is an horizontal legislation that applies to large companies in all sectors, which involves around 6,000 businesses.

The European Union is determined to make the transparency of large companies part of the solution.

Along these lines, it was mentioned that this directive is supposed to push companies to act more responsibly. Importance, compliance with the directive will not be based on the comply or explain principle, as we are accustomed to in corporate governance.



Non-financial reporting is a tool; it must be integrated in decision and strategy making as well as in the overall corporate governance framework

Filip Gregor, Frank Bold



One speaker affirmed that under the EU accounting directive as amended by the new NFR directive companies have an obligation to disclose information that is relevant for understanding their business and the impact of their activities. The Commission is undertaking a consultation process that will result in non-binding guidelines on the methodology for non-financial reporting, and this will neither be a detailed nor long document.

It was also stated that we need to think big about the consultation and aim at good deliverables. The guidelines will not be an operational document; it most probably will not be a “how to” document, but rather an inspirational one. The debate on what is ‘material’ was brought up again by one of the speakers who specified that EU legislation has already defined materiality – article 19 of the Accounting directive – which includes content and impact of the activity.

Main challenges and opportunities for improving NFR framework and practice in the long-term

Some speakers stressed that information needs to be comparable while others disagreed and pointed out that comparability is a secondary objective. One of the issues raised in this respect is that investors need to know that the information has a level of standardisation that permits comparability, not of the things in it, but the process and decision-making that led to it.

“Companies need to integrate transparency requirements into their strategies, and link them with their financial and non-financial performance indicators”
Richard Martin, ACCA

There were also some doubts expressed about the scope of the directive and the success of it in improving transparency: “are we reaching enough of the European economy by targeting the biggest corporations?” It was then stated that this directive can be seen as a first step, but we need to ensure that the result of it will be high quality reporting.

Another issue debated was that a lot is left to member states to expand. As for all directives, this is considered a sort of minimum, a benchmark to which member states can add. But it was pointed out that member states may impose very different requirements on specific issues, such as the degree of assurance provided for non-financial information.

One speaker hoped that companies will use the transparency requirements to integrate some of these issues into their strategies. If not, the risk is that this will become a list of things that people have to report on but the quality of that list may not be poor and the relevance to the individual corporation may be low.

In the discussion, it was also mentioned that there is a danger of people perceiving the production of non-financial information as a burden or cost. We need to work with companies that stand up and recognise that high-quality non-financial information is useful to drive their financial decisions - the two types of information should be seen as complementary.

Lastly, it was mentioned that the legislation has not determined the audience for non-financial statements, and this might be problematic. The current reporting framework primarily relies on investors to monitor and enforce the quality of disclosure, whereas non-financial disclosure is arguably for a broader set of stakeholders. It is not clear that mainstream investors are currently able or willing to assess the quality of non-financial reporting, and conversely there is no mechanism for civil society organisations or other stakeholders to enforce these rules.

About the organiser

Frank Bold has initiated the Purpose of the Corporation Project to provide a strategic, open-source platform for leading experts and organisations interested in promoting the long-term health and sustainability of publicly listed companies policy-making and business management. The Project works with academics and practitioners to develop a new vision for corporations and society, and to identify best practice and improvements to corporate governance.

As part of the Project, Frank Bold organises the Corporate Governance for a Changing World series with roundtable events in Europe and the U.S. The outcomes of the series will be presented in a report in September 2016.

www.purposeofcorporation.org
<http://en.frankbold.org>