

European Lab consultation on future projects

1. Section 1: Introduction

Objective of the European Lab future projects agenda consultation

The European Corporate Reporting Lab @EFRAG (European Lab) was established by EFRAG, following a call by the European Commission in its March 2018 Action Plan on Financing Sustainable Growth. The European Lab serves the European public interest and its objective is to stimulate innovation in the field of corporate reporting in Europe by identifying and sharing good reporting practices through:

- (a) Facilitating dialogue between reporting companies, users and other relevant stakeholders and organisations; and
- (b) Documenting the content and outcomes of this dialogue in reports and other means, for making them available in the public domain.

Corporate reporting issues are part of a wider debate of communication to the markets and other stakeholders of sustainability and corporate social responsibility information, and that there is an interplay with various external factors, initiatives and discussions. The European Lab supports and contributes to the implementation of the EC Action Plan in areas within its competence.

More information on the governance and operation of the European Lab can be found on the [EFRAG website](#).

The first project of the European Lab, currently in progress, is on climate-related reporting. The project is assessing the current state of play for climate-related reporting by European companies, and the current and potential use of climate-related information by investors and other users. The primary focus is on the Task Force on Climate-related Financial Disclosures (TCFD) recommendations with consideration of other reporting frameworks as appropriate, while also taking account of the European Commission's non-binding Guidelines on non-financial reporting issued in July 2017 and their supplement Guidelines on reporting climate-related information issued in June 2019. Focus areas are climate-related disclosures and scenario analysis.

The decision to add a project to the European Lab agenda is made by the European Lab Steering Group, taking into consideration input from stakeholders in a public consultation.

This public consultation seeks views on European Lab future project topics and their prioritisation. We also seek your input on any possible alternative project that in your view would be more important and urgent for the European Lab to undertake than the three projects proposed in the public consultation. We welcome views on any of the points addressed by 30 September 2019.

Input required from stakeholders

In the next section (Section 2), the European Lab outlines three potential topics identified by the European Lab Steering Group to be considered as future projects of the European Lab.

The questions to stakeholders are found in Section 3.

Replies should be submitted by 30 September 2019.

All replies received will be placed on public record, unless confidentiality is requested.

For any queries contact europeanlab@efrag.org.

Proposed topics for future projects of the European Lab

The European Lab Steering Group has identified three possible future project topics:

- (a) Reporting of social matters and human rights.
- (b) Reporting of non-financial risks and opportunities, and linkage to the business model.
- (c) Reporting on the materiality assessment process and outcomes for Environment, Social and Governance (ESG) matters.

The next section (Section 2) presents a brief description for each of the proposed topics.

2. Section 2: Description of proposed topics

Project 1 – Reporting of social matters and human rights

The Directive 2014/95/EU on non-financial information reporting (NFRD) requires large European companies to report, amongst other things, on social matters and human rights. This area also forms an integral part of the United Nations Sustainable Development Goals (SDGs) which are increasingly integrated into companies' business strategies. Social and human rights play an important role in strategies relevant to SDGs, and regulations on corporate responsibility towards respecting social engagement and human rights is increasingly being enacted. However, with attention concentrating mainly on the environment including climate change and due to difficulties in quantification of social matters, the reporting of relevant information and its linkage to business models and long-term value creation is generally limited or even missing from corporate reports. The need for improved reporting on social matters and human rights was highlighted in a 2018 Alliance for Corporate Transparency report and through the European Securities Market Authority (ESMA) 2018 report on enforcement priorities.

At the same time, there is no commonly accepted definition or consensus on what topics fall under “social matters”. For example, a 2018 World Bank report on incorporating ESG factors into investments highlights that different organisations have different topics under their definition of “social matters”. Hence, a project that focuses on “social matters” may be too broad if it was to address all potential topics and there is need to focus on specific topics. For this reason, a European Lab project on this topic would aim at identifying good reporting practices on the use of relevant metrics and other disclosure of social matters and human rights in one of the specific focus areas to be selected as outlined below.

Need for a focus on sectors that have higher impact on human rights: Human rights is a cross-cutting issue across the specific focus areas considered below. Hence, as part of the analysis of good reporting practices, it will likely be necessary to focus on the sectors that have higher impact on human rights.

Focus area 1 – Reporting on social matters and human rights in the supply chain

Supply chains can be a significant driver for companies success, through value creation and innovation.

The complexity added to supply chains by the involvement of multiple countries, tiers, structures and interdependencies has a critical impact on business operations, reputations and investment performance.

As supply chains often fall outside of companies core operations and control, they may expose them to significant risks typically driven by ESG factors, such as human rights abuses, corruption, social issues within the work force and labour standards, fair operating and trade practices by and with suppliers, natural resources depletion, community engagement and development.

Public awareness of supply chain issues continues to grow, and companies are increasingly under scrutiny in respect of their action on major human right issues among their suppliers.

This focus area would primarily be on reporting human rights associated with supply chains. However other 'social' matters, as enumerated in paragraph 17 above, could also be considered.

Furthermore, companies are increasingly expected to understand and prevent or mitigate human rights risks that may occur in their supply chain as well as to manage their exposure to such risks. In support of meeting their responsibility to respect human rights and their reputation, and to ensure the resilience and sustainability of their business model, companies are called to include in their corporate reports information on indirect (third party suppliers) or internal (supply chain management) related risks and opportunities), together with their associated due diligence processes, and provide evidence on the effective management of these risks.

Focus area 2 – Reporting on human capital management

Human capital has been defined by a number of organisations as the knowledge, skills and attributes of the workforce and others across the value chain. Human capital management forms a significant part of business processes for enhancing business performance and value creation. Companies are therefore expected to include information on human capital management in their corporate reports in relation to the resilience and sustainability of their business model. Hence, this focus area would primarily be on good practices in the reporting of human capital management.

In addition to reporting on human capital management, and to the extent that the scope does not become too broad, this focus area may be extended to the way that companies report on how they manage issues related to social capital. Social capital often being defined as the value added to society by companies' products, services and activities, as well as the relationships within and between communities, groups of stakeholders and other networks. Depending on particular business models, different factors impact on social capital including but not limited to: community relations; customer data security; transparent information, fair advice and pricing; and measures to ensure product safety. Hence, this focus area could include examples of reporting on factors that impact on social capital.

Focus area 3 – Reporting on human capital and social capital impacts of climate adaptation and mitigation policies

Climate change impacts are systematic in nature. As such, climate adaptation and mitigation measures are prevalent across a variety of sectors. These measures can not only have internal impacts within companies but can also have broader impacts at a societal level. As highlighted in the recently published EC Guidelines on reporting climate-related information, many companies are dependent on human capital, such as the skills and motivation of employees for the purposes of climate adaptation and mitigation. For example, employees can be critical to the development of innovative low-carbon products and services or jobs can be eliminated due to new processes and technologies. In this respect, human capital management can be interrelated with companies' climate adaptation and mitigation measures.

Furthermore, as noted in the EC guidelines, climate mitigation and adaptation can also impact on companies' social capital including on the level of trust companies' enjoy amongst external stakeholders. Under the UN Guiding Principles on Business and Human Rights, companies are expected to address the human rights implications of climate change.

One example of how climate adaptation and mitigation policies are considered in relation to social matters and human rights is the extent to which Metals & Mining and Oil & Gas exploration and production companies with climate risk exposure consider the security and land rights of indigenous peoples in their operations and measures taken to mitigate climate risk. For example, whether an Oil & Gas company that is changing its energy mix towards renewable sources, does so while managing adverse social impacts that would arise if the human rights of affected parties were ignored. There are other examples of impacts on social capital that occur depending on particular business models, location of companies' operations and climate risk mitigation strategies. Hence, this focus area would be on good practices around how companies integrate information about impacts on human capital and social capital in the reporting of their climate-related adaptation and mitigation strategies.

Project 2 – Reporting of non-financial risks and opportunities, and linkage to the business model

Stakeholders need to better understand the business model of companies and the impact of non-financial considerations on their strategy and activities. The NFRD requires reporting on the business model, policies pursued by the group, outcomes of those policies, principal risks linked to the group's operations and non-financial Key Performance Indicators (KPIs). Apart from the NFRD requirements, reporting on the nature, position, performance and development of the business, together with the principal risks are included in Directive 2013/34/EU (the Accounting Directive) and through the International Accounting Standards Board (IASB) Management Commentary Practice Statement which provides voluntary guidance for IFRS reporting companies. Notwithstanding the multiple sources of guidance, a number of reviews of both EU and global companies' reporting practices have shown that there is scope for improvement in the linkage between the business model description and non-financial information including the related risks and opportunities.

For instance, a 2018 Climate Disclosure Standards Board (CDSB) report based on a review of 80 EU companies found that frequent failures in linking non-financial information such as climate risk with the business model description. Another study^[1] that reviewed the disclosures of 15 Oil & Gas companies found that many of these companies disclosed greenhouse gas emissions in terms of performance and future goals, but explanations of discussions about how targets related to the business model and strategy were rare. Similarly, a 2018 Alliance for Corporate Transparency report assessed the extent to which companies disclose their business strategies and products or services for pursuing opportunities connected with a sustainable economy. Based on the analysis of reporting by a sample of 105 companies, the report highlights that there is room for improvement enhancement in the information provided on strategies relating to social and environmental areas including information on related KPIs, targets, revenue and investments.

A robust description of the business model that conveys the sources of competitive advantage, risks, opportunities and the sustainability of the business model over time is a core input of users' assessment of companies' competitive position in comparison to peers. Furthermore, in the absence of a robust business model description, users can have difficulty in identifying the link between the business model and changes over time in companies' reported risk tolerance and principal risks including non-financial risks.

This project would focus on examples of companies' business model reporting and linkage to non-financial risks and related opportunities. Whereas non-financial risks that arise from the external operating environment could negatively affect the prospects, performance and risk exposure of companies, there can also be opportunities for enhancing profitability for companies that adapt their business models in response to the non-financial risks. For example, a company could improve profitability through the launch of new, high-demand products certified to environmental and/or social standards or through energy-efficiency driven cost savings or through steps that impact on companies' sustainability reputation and social license to operate. The project could consider the reporting of economic impacts of risks and opportunities and the positive or negative social or environmental impacts of companies' related strategies.

Project 3 – Reporting on the materiality assessment process and outcomes for Environment, Social and Governance (ESG) matters

Materiality is one of the fundamental principles of the non-financial reporting introduced by the NFRD. However, despite its relationship to the principle of materiality for financial reporting, it is widely considered to be more challenging because of (i) the higher level of subjectivity stemming from the typically less prescriptive nature of non-financial reporting requirements, (ii) the longer time-horizon, and (iii) the consideration of the information needs of, and the effects on, a wider range of stakeholders.

Complexity is also increased by the existence of multiple definitions and frameworks, and many organisations find it challenging to navigate the range of materiality definitions across reporting regulations, standards and frameworks. The project would provide insights for both users and preparers by identifying good practices in relation to reporting on companies' materiality assessment processes and outcomes in relation to Environmental, Social and Governance information. The reporting of the materiality assessment can be an input to users' assessment of the relevance of any disclosed ESG KPIs and targets, and to their understanding of which of the ESG factors have the greatest impact on a company's risks and opportunities.

The project would consider the dual perspective of materiality in relation to ESG information. That is, the project would consider the material impacts a company has on the environment and society, as well as material impacts the environment and society have on the organisation, including, but not limited to, the following:

- (a) Reporting about the materiality assessment process including the links with the organisation's strategy, governance, policies and risk management;
- (b) Reporting about the level of engagement with providers of financial capital and other stakeholders; and
- (c) Reporting about the outcomes of the materiality assessment process.

In carrying out this project, the European Lab would consider existing frameworks and definitions of materiality but would keep a 'neutral' approach by not giving precedence or prominence to any specific framework.

It should also be noted that, as in all the projects of the European Lab, because the frameworks regarding materiality for non-financial information are either recently applied by companies or are evolving, what is considered to be good reporting practices today is likely to evolve once companies get to a more mature stage of implementation.

3. Section 3: Questions to stakeholders

General information about the respondent

Please provide the following details:

(a) **Your name:**

Severine Neervoort

(b) **Your contact e-mail address:**

sne@nbim.no

(c) **Your job title/role:**

Senior Analyst, Corporate Governance

(d) **Name of the organisation on behalf of which you are responding:**

Norges Bank Investment Management

(e) **Country of operation:**

United Kingdom

(f) Which type of respondent are you representing?

User

Please specify:

(g) Short description of activity/industry:

Norges Bank Investment Management (NBIM) is the investment management division of the Norwegian Central Bank and is responsible for investing the Norwegian Government Pension Fund Global.

(h) If you are responding on behalf of a reporting company, are you directly involved in the preparation of corporate reports?

No

Information required on proposed projects

(i) Please rank the proposed project topics outlined in the previous section (Section 2) by order of priority, and explain your selection with details of the distinct added value you would expect of a potential European Lab project on each topic:

	Priority			Reasoning for your selection and scoring
	3	2	1	
Project 1.1 – Reporting on human rights and other social matters in the supply chain	X			As a financial investor, NBIM expects companies to respect human rights, and address human rights issues in their business practices. In line with the United Nations Guiding Principles on Human Rights and the OECD Guidelines for Multinational Companies, NBIM encourages companies to identify human rights areas which may be at risk of severe negative impact through the company's activities and operations, including in supply chains and other business relationships. For reporting on human rights to be meaningful, we see the need for defining reliable, useful metrics to assess companies' exposure to risks and performance in addressing issues. We support initiatives which aim at developing better ways to evaluate business respect for human rights, such as the Shift Project. We would welcome the input of the European Reporting Lab in this area.
Project 1.2 – Reporting on human capital management			X	It would be valuable for the Lab to identify good practices for company reporting as regards to 'human capital' (a concept which would need to be defined). However, we recommend that the Lab focuses on human rights in supply chains as a priority, before extending its work to a wider range of employment and social topics.
Project 1.3 – Reporting on human capital and social capital impacts of climate adaptation and mitigation policies			X	We note that this requirement has already been introduced in the recent EU Guidelines on Climate-related Disclosures.
Project 2 – Reporting of non-financial risks and opportunities, and linkage			X	It is important for investors that company boards address and report on material issues that could affect companies' future performance. We expect company boards to integrate the relevant sustainability risks and opportunities in their business management, such as investment planning and risk management, and include this in their reporting. As an investor, we seek to understand how a company's business model might be affected by a sustainability matter, such as climate change. We would like companies to describe how their strategy may evolve in light of sustainability considerations. The European Lab could review existing guidance in this area, as well as best practices for integrating this information in company reporting. The Task-force on Climate-related Financial Disclosures (TCFD) and the recent EU Guidelines on the same topic already provide

to the business model		<p>some clarity to companies. We believe the logic of the TCFD – around governance, strategy, risk management and finally metrics and targets – could be used as a basis to develop reporting on other categories of non-financial risks and opportunities. We also noted that the International Accounting Standards Board (IASB) is planning to revise the IFRS Practice Statement 1 Management Commentary issued initially in 2010. This is expected to provide further guidance to companies for their reporting on how sustainability issues may impact their business.</p>
<p>Project 3 – Reporting on the materiality assessment process and outcomes for Environment, Social and Governance (ESG) matters</p>	X	<p>As a starting point, and to be relevant for investors, sustainability disclosures should be driven by financial materiality, focusing on issues specific to a company's sector or business model. However, we recognize that companies have a wide set of stakeholders which have a legitimate interest in receiving information on the activities and impacts of the company, and its products and services. Financial materiality is therefore not a limit, but a starting point for companies to assess what information they need to disclose. NBIM expects companies to disclose the selection criteria and assumptions made when determining which issues are material for the business. Useful guidance on materiality can be found in existing reporting frameworks, such as the Sustainability Accounting Standard Board (SASB), which focuses on financial materiality. However, we recognise that the sustainability reporting landscape is fragmented, and we are concerned with the increasing reporting burden on companies. We therefore welcome the efforts of the Corporate Reporting Dialogue, which seeks to establish common principles of materiality, drawing upon the different frameworks' definitions. Given this existing initiative, we see less need for the Lab to focus on a similar issue.</p>

(j) Are there other topics that you advise the European Lab to add to its agenda? If so, please provide a description of the topic and the priority you would assign to it:

(k) Please provide any details of interaction you may be aware of with the work of other initiatives, in respect of the topic you rank as highest priority:

4. Thank You!

Thank you for taking our survey. Your response is very important to us.