Instituto de Consejeros-Administradores
Asociación Española de Consejeros

Sustainability and **Non-Financial Information:** Implications for **Boards of Directors**

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Board Directors

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Instituto de Consejeros-Administradores
Asociación Española de Consejeros

SUSTAINABILITY AND NON-FINANCIAL INFORMATION: IMPLICATIONS FOR BOARDS OF DIRECTORS

Good Practice for Directors and the Board

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**WELCOME WORDS TO THESE RECOMMENDATIONS
ON THE IMPLICATIONS OF THE SUSTAINABILITY CONCEPT
FOR THE BOARD OF DIRECTORS AND THE COMPANY**

In recent years, there has been an increase in efforts to promote more sustainable development, both within the public and the private sectors, including through financial markets. This effort reflects a growing recognition of the significant potential economic and financial impacts of climate change and environmental, governance and social-related risks.

Securities regulators, and the international organization that unites them (OICV-IOSCO), share the core objectives of protecting investors, maintaining fair, efficient and transparent markets, and reducing systemic risk. Sustainability issues in general, and climate-related issues in particular, can raise important challenges in meeting these core objectives.

IOSCO has taken a very active role on sustainability issues. In 2017, it stablished its Sustainable Finance Network (SFN) to provide a forum for structured discussions and to exchange experiences on this issue. Furthermore, in January 2019, it published a "Statement on Disclosure of ESG Matters by Issuers," and in June 2019, it published a "Growth and Emerging Market Committee report on Sustainable finance in emerging markets and the role of securities regulators." This last publication was launched in the same month as the celebration of the international stakeholders' meeting. ([1])

This publication on Sustainability and Non-Financial Information: Implications for the Boards of Directors, prepared by the Institute of Directors-Administrators (IC-A), aims to collaborate in the relevant task of making known the implications of sustainability issues and the spirit that inspires new regulations for the performance of the fundamental functions of Boards of Directors.

This initiative and its recommendations will undoubtedly contribute to improve the training of Boards of Directors on this matter, and will help Boards stay updated, so that they can face with determination and confidence the challenges they face in their work – fundamentally, not only for their companies, but also for the whole of society.

Mr. Paul P. Andrews
Secretary General

International Organization of Securities Commissions, IOSCO
The Global standard setter for securities markets regulation.

[1] The Board of the International Organization of Securities Commissions. (April 2020). Sustainable Finance and the Role of Securities Regulators and IOSCO. Final Report. https://www.iosco.org/library/pubdocs/pdf/IOSCOPD652.pdf

FOREWORD

The IC-A's aim in producing this document, **"Sustainability and Non-Financial Information: Implications for Boards of Directors"** is to offer some observations to Boards and Directors that may provide help and guidance in improving the quality of Corporate Governance.

A fundamental change is taking place in what society expects from business in terms of the scope of corporate responsibilities and the role of business in society. Sustainability is a guiding concept which, in essence, requires businesses to address the priorities of today without damaging the potential for tomorrow, and to be conscious of the impact they have on their surroundings and on their different stakeholders. In recent years this trend has given rise in various countries to a series of regulations and recommendations on the responsibilities of business in relation to sustainability and non-financial information (NFI).

Both the new regulations and the underlying trends have profound implications for the way in which Boards of Directors must carry out their core inalienable duties. The IC-A believes it should set out its views on those implications and on how Boards of Directors should respond.

Work in preparing this document on "Sustainability and Non-Financial Information: Implications for Boards of Directors" has been led by the IC-A's Professional Standards Committee, chaired by Marcial Campos Calvo-Sotelo, which created a specific working group to perform the task. The members of the working group were Marcial Campos Calvo-Sotelo, Jaime Carvajal Urquijo, Fernando Igartúa Arregui, Luis Tejada Dunes, Antonio Abril Abadín and Alfredo Sanfeliz Mezquita, with an additional contribution from Antonio Fuertes Zurita. We would like to thank all of them for their commitment and contribution to the content and quality of this new publication.

The work has been supported by the Association's Governing Body and Executive Board, represented by Fernando Igartua Arregui, Jesús María Caínzos Fernández, Jaime Carvajal Urquijo, Juan Alvarez-Vijande García, Jesús Peregrina Barranquero, Luis Sancho Martínez-Pardo, Enrique Sánchez de León García, Luis Tejada Dunes, Julio Álvarez Cabo, Belén Amatriain Corbi, José Luis del Valle Doblado, María Eugenia Girón Dávila, Fernando-Gil Guerrero Gómez, Rafael Sánchez-Lozano Turmo, Idoia Bengoa Simón, Inés Juste Bellosillo, Pilar López-Aranguren Velarde and Estíbaliz Aranburu Uribarri. Their active and highly effective contribution has helped to ensure the publication of this document.

In addition to those mentioned above, we would particularly like to thank members of the Association who have contributed so effectively by voicing their concerns and opinions to us, whether directly or indirectly, and in so doing have helped to create this new IC-A document.

This document on "Sustainability and Non-Financial Information: Implications for Boards of Directors", contains the recommendations by the IC-A (the Spanish Association of Directors) on the standards to be applied by Directors in carrying out their duties.

November 2020

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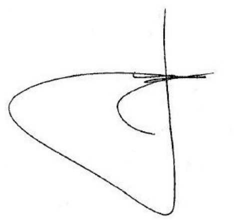

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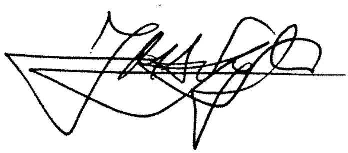

Juan Álvarez-Vijande García
Executive Director

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INTRODUCTION

Purpose of this document

In recent years a series of regulations and recommendations have been developed in various countries on the responsibilities of business in relation to sustainability and non-financial information (NFI). In Spain, the most direct impact on our companies comes from European Union directives, the Law on Non-Financial Information, and the updated recommendations in the Corporate Governance Code issued by the National Securities Market Commission (CNMV).

These regulatory initiatives reflect a profound change, in which new demands are made on the role of business in our society and the scope of its responsibilities towards sustainability. New legislation and regulations have introduced mandatory requirements in areas where society was already making demands and which the most forward-thinking companies were already looking to address.

Both the new regulations and the underlying trends have profound implications for the way in which Boards of Directors must carry out their core inalienable duties. The IC-A believes it should set out its views on those implications and on how Boards of Directors should respond.

This document has **two aims**:

- **Firstly, it seeks to highlight the implications which the concept of sustainability and the guiding spirit behind the new regulations have for the way in which Boards of Directors perform their core duties, and it makes recommendations to help Boards of Directors respond appropriately.**

- **Secondly, it aims to help ensure that the guiding spirit behind the legislation translates into positive changes in governance and corporate management that go beyond the strict letter of the law.**

We will begin by outlining the features that characterise the context in which companies are operating, before going on to address the implications for Boards of Directors and the impact on the way in which they perform their core duties.

PART ONE: CONTEXT

A fundamental change is taking place in what society expects from business in terms of the scope of corporate responsibilities and the role of business in society. Sustainability is a guiding concept which, in essence, requires businesses to address the priorities of today without damaging the potential for tomorrow, and to be conscious of the impact they have on their surroundings and on their different stakeholders.

The emphasis on sustainability translates into a series of multi-faceted demands on business: companies must take account of and be accountable to a much broader set of stakeholders: shareholders, regulators, employees, customers, suppliers throughout the supply chain, communities affected by the company's activities – in other words, society as a whole. New criteria for measuring – or at least evaluating – business impact are also under discussion which require more weight to be given to the long-term impact of the totality of companies' decisions. All in all, the concept of sustainability and its consequences clearly add to the complexity of governance and management.

This is a profound and evolving change, and circumstances such as the current pandemic may increase the pace of change. The new demands are reflected in the attitudes and initiatives adopted by regulators, institutional investors, business leaders themselves and public opinion. There are many voices (such as the World Economic Forum, European Round Table of Industrialists, Business Roundtable or BlackRock) calling for reform of the capitalist system so that value creation is not linked solely to short-term profitability, but businesses are also under a duty to provide value to their customers, reward their employees fairly, provide employees with training to develop their skills, treat their suppliers ethically, support the communities in which they work, and protect the environment. This new attitude is embodied in the new regulations mentioned earlier, such as European Union directives and the Law on Non-Financial Information and its potential implementing regulations.[2]

These demands have significant implications for the company as a whole and, in particular, for the way in which the Board should respond. On the one hand, they add to the complexity of planning and decision-making, because companies need to take account of the interests of a variety of different groups, and those interests may differ and even conflict in either the short or the long term. But the new demands also provide opportunities for increasing the company's value and improving its competitive position. (See Table 1 below).

[2]By way of example, the Bibliography includes details of the Study on directors' duties and sustainable corporate governance produced by the European Union.

Table 1

Sustainable or ESG investing offers opportunities

- For many investors, non-financial or sustainability information has become critically important. One of the most notable emerging developments is the rise in ESG investing. In January 2018 there were more than 30 trillion dollars of assets under management in sustainable investment strategies of various types (Global Sustainable Investment Alliance, 2018).

- Customers and consumers also care about a company's commitment to sustainability and ESG standards both within the organisation and across its supply chain. Complying with these standards may enhance the brand and strengthen loyalty, while failure to do so has in some cases led to boycotts.

- An increasing number of studies by academics and investors point to the conclusion that companies with good management of non-financial criteria also achieve better financial performance on a variety of parameters (such as cost of debt and capital, share value, profitability and volatility).

- This is consistent with the progressive inclusion of ESG criteria in ratings by credit rating agencies. We are also seeing a rise in loans and credit with interest rates linked to sustainability performance or improvements in performance as measured by particular indicators. The issue of green bonds (and social bonds) requires non-financial information, to enable third party verification of environmental and ESG aspects of operations.

- In both Europe and Spain, regulatory developments reflecting the Paris Agreement have highlighted the need to measure and report on environmental parameters, particularly greenhouse gas emissions and Board commitments to emission reductions.

- We can also expect to see sustainability requirements increasingly being included in government invitations to tender and in firms' purchasing decisions. Verified non-financial information will be essential in these situations.

PART TWO:
IMPLICATIONS FOR THE BOARD

2.1. Managing the Board

2.2. Defining corporate strategy

2.3. Being accountable to shareholders and others

2.4. Overseeing the management of the company

2.5. Overseeing and appraising the Executive

The Board is responsible for providing high-level leadership across all aspects of the business, except for matters that are reserved for the shareholders in general meeting. It therefore has full responsibility for leading the response to the challenges posed by the new reality.

The existence of new demands and opportunities does not change the nature of the Board's core inalienable duties. What has changed is that new factors need to be incorporated into the way the duties are performed, and the guiding spirit behind those demands and opportunities must be embraced and reflected in the company's Purpose, Mission, Strategy and Operations. The process needs to start with the Board and extend across the entire organisation.

To be effective, it must go beyond mere compliance with new regulations, requiring action from the Board on various levels:

- The first requirement is to **lead a real change in culture**, so that the whole company is committed to meeting the demands and practical consequences of sustainability. This is a profound change, which requires companies to recognise responsibilities to stakeholder groups other than shareholders, to address and monitor new criteria, and to adopt a long-term perspective.

- The second requirement is to have a **clear understanding of the various stakeholder groups** who are affected by the company's activities and of the **significance (or materiality) of the interdependencies** between them. Some stakeholder groups – employees, customers, members of the supply chain, for example – are easy to identify, and the materiality of the interdependencies is clear and even quantifiable. Other interests – such as those of local communities, the environment, or society as a whole – may be harder to pin down. Nevertheless, it is very important to construct and maintain a map of the relevant stakeholder groups, their interdependencies with the company, and possible communication channels, as a basis for moving on from general concepts to practical actions.

- A third challenge follows naturally from the first two requirements and is complementary to them. It goes to the heart of the company's operations and entails **setting the policies, criteria and metrics** that will support decision-making and will also be used to evaluate how the company responds to the new demands in practice and how it resolves conflicts between sometimes divergent interests.

In order to address these issues and set priorities, Boards of Directors need to exercise sound judgement. This can only be done on the basis of an in-depth knowledge of the relevant stakeholder groups and their interdependencies with the company. While the new legislation – the European directive[3] and the

[3] Directive 2014/95/EU and Communication from the Commission 2019/C 209/01.

Law on Non-Financial Information – propose different frameworks for reporting on non-financial information in accordance with the principles of materiality, they also allow companies a certain degree of discretion in deciding which frameworks to use, even allowing them to put forward alternative frameworks in some cases. The European Union (EU) has recently completed a consultation on non-financial information and plans to try to establish a common European reporting standard.[4]

In the remainder of this document we address a series of questions on how the context we have described affects the way in which the Board should carry out each of the five groups of core inalienable duties which flow from its primary function of providing high-level leadership of the business:

- **Managing the Board, its membership, structure and operation**
- **Defining corporate strategy**
- **Being accountable to shareholders and others**
- **Overseeing the management of the company**
- **Overseeing and appraising the Executive**

2.1. Managing the Board

The effectiveness of the Board, as a working group, is fundamentally dependent on its membership and organisation, the planning and management of its activities, and the criteria used in appraisal and remuneration decisions. The new demands and opportunities have implications for each of these elements.

2.1.1. Membership

In addition to the general criteria on Board membership and size, the Board must also have the skills needed to respond to the new demands. In many cases this means strengthening particular skill sets which may offer a competitive advantage in the new environment.

2.1.1.1. Boards of Directors need to identify which needs may not be properly covered and, if necessary, restructure the Board in order to fill the gaps. For example: additional understanding and knowledge may be needed of sustainability concepts, additional NFI reporting requirements, verification of regulatory compliance, or non-financial metrics.

2.1.1.2. Collectively, Board members must have the knowledge, judgement and experience required to evaluate the impact of their decisions; this requires a combination of different factors and both short and long-term considerations.

[4] Summary Report of the Public Consultation on the Review of the Non-Financial Reporting Directive 20 February 2020 – 11 June 2020.

2.1.1.2.1. Board members require a mix of talent that combines expertise and knowledge in financial, sectoral, operational, technological, international, regulatory and corporate governance matters.

2.1.1.2.2. Expertise may also be needed in societal, communications or cultural fields. Alongside Board members' professional skills and knowledge, it is also helpful to take into account their respective personal styles as regards caution, attitude to risk, intuition, etc.

2.1.1.3. The new demands mean that companies must give greater consideration and importance in corporate strategy and management to new concepts and knowledge, such as sustainability in the broadest sense of the term. However, this must not lead to the creation of a Board of specialists who may not have the necessary knowledge and expertise in running companies; the goal is to ensure that the Board as a whole has the required skills.

2.1.2. Internal organisation

The Board must be prepared and organised so as to carry out its responsibilities effectively and diligently. Of course, each company needs to decide for itself how best to organise its Board in order to respond to the challenges it faces, taking account of its size, the nature of its business and its particular circumstances. While there are no universal formulas, we have identified the following issues for consideration.

2.1.2.1. It may be sensible to establish specific roles within the Board to ensure that sustainability and new reporting requirements receive sufficient attention, and to guarantee coordination and consistency between the work of the various departments and functions involved.

2.1.2.1.1. It may be advisable to set up a Sustainability Committee, or something similar, with appropriate membership and specific terms of reference, as some Ibex companies have already done. The role of the committee would be to make proposals to the Board, which would have full responsibility for this area and take the relevant decisions.

2.1.2.1.2. Alternatively, the various functions can be allocated to existing committees. While the CNMV (2017, 2020) stipulates that the Audit Committee is responsible for validating non-financial information and has ultimate oversight of the control of financial and non-financial risks, a special committee can be established to perform the latter function.

2.1.2.1.3. An understanding of the stakeholder map must be the basis for establishing a framework for dialogue with stakeholders, drawing up communication policies and deciding which member or members of the Board should be the main point of contact with stakeholders.

2.1.2.2. **Whichever organisational approach is adopted, the scope of the new responsibilities must be reflected in the role of every Board member and Board committee.**

This applies to the Chair, Chief Executive or Managing Director, Coordinating Director, Secretary, individual Directors, Board committees (such as Audit and Control, Appointments and Remuneration, Compliance and Strategy) and committee chairs. It will never be enough to make a single person or committee responsible for the new requirements. As we said earlier, it requires a culture change across the company which is driven by the Board and embraced by all its members.

2.1.3. Planning and managing Board meetings

A Board's culture and values must be reflected in the issues to which it devotes its time and attention. It must give quality time to sustainability issues. The following questions provide a useful checklist.

2.1.3.1. **Agenda**

The annual schedule of Board discussions needs to reflect the importance attached to the new demands and opportunities and the company's response to them. Is there enough consideration of sustainability, and are the agenda items sufficiently comprehensive to ensure that the issue is given the importance it deserves?

2.1.3.2. **Management of meetings**

Are the presentations of a sufficiently high quality, and are the managers or experts giving the presentations sufficiently senior? Is enough time being allowed for discussion? Is the social impact of the company's decisions and plans being considered and evaluated? Does the company call on expert advice where the complexity of the issue makes this necessary?

2.1.3.3. **Rules, regulations and information**

The introduction of a new culture with aspirations, criteria and metrics that incorporate the new demands and opportunities must be reflected in the Board's internal rules and in company-wide procedures. The Board therefore needs to review and adjust its rules of procedure and the terms of reference for Board committees, as well as basic procedures, internal codes of conduct, (including whistleblowing procedures) and information systems (indicators and reporting frequency) for both the Board and the company as a whole, to ensure that they include management and monitoring of sustainability issues and the new demands.

2.1.4. Appraisal and remuneration

The implications we have identified have a direct impact on the criteria used to appraise Board members and Senior Managers, and on the resulting remuneration decisions.

2.1.4.1. **As a general rule, the appraisal of the Board, Board committees, Chair and Managing Director/CEO should be comprehensive** and follow all their respective responsibilities. If the scope of those responsibilities is expanded to include new factors and encompass new stakeholders beyond traditional interest groups, appraisal and remuneration criteria must also be expanded so as to achieve a comprehensive assessment of Board performance.

2.1.4.1.1. Where remuneration schemes are based, at least in part, on quantitative criteria, the Board will have to decide whether they should include new metrics introduced by the company to reflect non-financial objectives and achievement indicators, and what weight these should have.

2.1.4.1.2. The evaluation also needs to include non-quantitative criteria. Some companies are already including factors such as occupational health and safety or environmental issues (such as emissions reductions) in bonus calculations.

2.1.4.2. An important factor for consideration in appraisal is the **difference between measurement and evaluation**. Some sustainability and regulatory compliance concepts are not readily measurable, and in some cases it makes no real sense to quantify them as a figure or a percentage. But they can be evaluated in qualitative terms at least, and trends over time can help to improve understanding of the company's impact (for example, the balance between social contribution and shareholder returns, or between short-term profits and the long-term impact on society or the company). These issues can be evaluated, along with regulatory and procedural compliance, albeit not necessarily in quantitative terms.

2.1.4.3. All of these factors inevitably make the performance appraisal of the Board and senior management in relation to sustainability and non-financial aspects, and the resulting remuneration decisions, more complex. The Appointments and Remuneration Committee will have to adjust its processes, and possibly its skill set, in order to perform its task effectively.

2.2. Defining corporate strategy

Strategy consists of an integrated set of actions designed to achieve a strong competitive position and maintain it over the long term. It is therefore a fundamental determinant of a company's overall impact, and the Board is ultimately responsible for defining strategy and overseeing its implementation.

If a company's responsibilities are expanded to include stakeholder groups other than shareholders, and new metrics are introduced to measure the company's impact on those groups, then, inevitably, the Board must review all the elements of its strategy and seek to ensure coherence between the different strategic objectives.

The Board will need to address the following aspects.

2.2.1. Reviewing and reformulating the company's Purpose, Mission and Values, and establishing the sustainability policies required to implement them.

These overarching principles and guidelines set the direction for strategy and culture, and require a genuine commitment by the company to the new demands. If the Board decides to change them, it must do so in the full knowledge that they must be implemented rigorously.

2.2.2. Adjusting processes, criteria and metrics for evaluating the impact of the strategy and deciding between alternatives.

Incorporating sustainability and non-financial criteria into strategic planning options and decisions requires a rethink of traditional strategy formulation processes.

2.2.2.1. Strategic plans and decisions need to be evaluated not only in financial terms but also on the basis of a series of non-financial criteria. Evaluation must consider the impact on the various stakeholder groups, measure the company's investments against corporate values, and assess how the company's sustainability actions add value to its investments.

2.2.2.2. This makes evaluation and comparison of alternatives more complex, in that a range of heterogeneous factors have to be assessed, although some of these may be quantifiable (for example, the inclusion of the impact of an acquisition in the company's carbon footprint). As we explained above, a proper analysis requires an in-depth knowledge of the relevant stakeholder groups and the materiality of their interdependencies with the company.

2.2.2.3. As a corollary of the above, the Board needs to decide on a case-by-case basis which criteria and metrics should be used in the evaluation of specific strategic plans and decisions. This is a complex task in itself: the criteria may not be readily quantifiable and in some cases there are no reliable benchmarks.

> 2.2.2.3.1. The exercise involves measuring the long-term impact of particular decisions on a series of not necessarily homogeneous aspects, including both positive and negative externalities.
>
> 2.2.2.3.2. The Board should also seek to identify strategic opportunities generated by non-financial issues.
>
> 2.2.2.3.3. In addition to the provisions in the Law on Non-Financial Information and Diversity, it is also important to know what metrics and criteria frameworks are available[5] and to select the ones that are most appropriate, taking account of sectoral requirements, the particular circumstances of the company and its commitments. We have already noted that the EU hopes to introduce European-wide standards.

[5] In Part B (Indicators and standards) of Section V (References and Bibliography) we include a list of sustainability and ESG standards, indexes and rating agencies.

2.2.2.4. **Perhaps the most important issue is that the Board needs to be prepared to take decisions in the face of a divergence or even conflict between the interests under consideration, or between short and long-term interests.**

A relevant example which can sometimes arise is a possible conflict between prioritising short-term preservation of employment and safeguarding the company's competitive position – and thus its ability to foster and generate employment in the long term. It is not possible to lay down fixed rules for resolving these issues; we can only reiterate that the Board must address them by making a rigorous evaluation of the impact of each alternative in all its dimensions and adopting the solution that best meets its key priorities in each case.

2.2.3. Protecting the confidentiality of the strategy while at the same time ensuring the transparency of the new criteria.

This requires the Board to exercise constant critical judgement. It is clearly not possible to make detailed recommendations on this point, beyond the general principle that the substance of the strategy must remain confidential while the criteria used in developing the strategy can be transparent.

2.2.4. Adjusting and strengthening the capabilities of the company and the Board.

Defining strategy in the new context inevitably entails a review of the Board's capabilities. As we noted earlier, this is not about building a Board of specialists but about making sure that the Board has access to the information and knowledge required to incorporate and give proper consideration to sustainability criteria. This may provide a competitive advantage in the present and future environment.

2.3. Being accountable to shareholders and others

The Board is under an obligation to be accountable, to treat all stakeholders fairly, to obey the law and comply with ethical standards, to provide a true and fair view and to ensure transparency.

These obligations traditionally apply to Financial Information and to accountability to shareholders and regulators. They now extend to cover Non-Financial Information, since a report on Non-Financial Information must be included as a separate agenda item and put to the shareholders in general meeting for approval.

With the introduction of the Law on Non-Financial Information, the requirement for accountability has expanded along the two dimensions addressed in this document. Companies must be accountable in some way to the various stakeholders other than shareholders; and they must report on a series of non-financial concepts, which call for new criteria and parameters.

The response poses complex questions which Boards of Directors will have to address.

2.3.1. As we noted earlier, a key issue is to prepare and maintain a comprehensive map of the various stakeholders affected by or interested in the company's activities and their interdependencies with the company. This knowledge will inform decisions on what needs to be communicated to each group and how it should be communicated.

2.3.2. Under the Law on Non-Financial Information, the Board is required to approve the framework for the report and the information, criteria and indicators to be included in it.

2.3.2.1. The items included must be significant and enable meaningful comparisons to be made between companies.

2.3.2.2. The report must be transparent while protecting confidentiality where necessary.

2.3.2.3. The Board must ensure that the report satisfies a number of conditions (See Table 2 below).

2.3.3. The report required by the Law is public and available to all stakeholder groups, but Boards of Directors will need to consider how to address issues arising from each group's interdependencies with the company and decide whether, for certain groups, the report needs to be supplemented by additional measures.

2.3.3.1. Boards of Directors must decide whether they need to address certain groups specifically, in view of the nature of the particular group, its interdependencies and its access to the general information. One example could be the local community.

2.3.3.2. They must identify any information that is particularly relevant for stakeholders, in addition to the non-financial information included in the general report.

2.3.3.3. They must establish policies and procedures for communication or dialogue with stakeholders and, where appropriate, they must make concrete commitments in specific areas.

Table 2

DESIGNING THE NON-FINANCIAL REPORT: TRANSPARENCY AND ACCOUNTABILITY PRINCIPLES

- **MATERIAL:** This requires a definition of the materiality threshold for relevant information that may influence decisions by information users.
  - The Board must identify the "information necessary for an understanding of the development, performance and position of the group and the impact of its activities" with respect to the matters specified in the Law.
  - It is a good idea to decide on the level of detail required for different types of information (for example: priority issues; significant issues; other relevant issues).

- **COMPREHENSIVE:** The report must include all material issues identified in connection with relevant topics.
  - The report must cover issues that impact internally on the organisation as well as those where the impact is felt outside the company.
  - Particular emphasis should be placed on the proper reporting of non-financial information that has a financial impact.

- **ACCURATE:** The information in the report must be free from material errors.
  - The report must follow the appropriate standards at both a general and a sectoral level, taking into account the particular characteristics of the company.
  - The Board should ask itself whether the method used to measure the impact of non-financial issues is the right one, and whether the measures put in place to manage non-financial issues adequately reflect key non-financial risks.

- **BALANCED:** The information must not be biased or presented in a way that is designed to prompt either a favourable or unfavourable reaction from users.

- **CLEAR, COMPARABLE AND CONSISTENT:**
  - The information must be concise enough to be easily understood and accessible to users.
  - Information must be reported using the same parameters and methodology.
  - The standards used must enable the company to be compared with other organisations.

(Table 2 continued)

- **RELIABLE:** Internal procedures and controls must guarantee the quality of the data used in preparing the reports and ensure that it can be verified.

- **ADDITIONAL NOTE:** The Law does not include the option, provided for in the Directive, to omit information relating to impending developments or matters in the course of negotiation where the disclosure of such information would be seriously prejudicial to the commercial position of the company. Such information can be considered not "necessary" for an understanding of the development, performance and position of the group and the impact of its activities. In any event, the Board must ensure that the omission of such information does not prevent a fair and balanced understanding of the issues in question. In particular, it must ensure that the information included in the report does not lead users to draw different conclusions from the ones they would have drawn if the omitted information had been included.

2.3.4. The Board must review and, if necessary, adjust the functions of its own members and committees to ensure that they oversee and communicate how commitments and policies are being implemented. This review may affect the role of the Audit and Control Committee, the Compliance Committee or newly created committees.

2.3.5. The "explanation" part of the general maxim of "comply or explain" recommended as part of good governance practice seems particularly relevant here since, bearing in mind that two of the objectives of the Law are to facilitate an understanding of the company and to aid comparability with other companies, there will be areas where the differentiation in the information will in itself be highly informative.

2.4. Overseeing the management of the company

A commitment to sustainability requires Boards of Directors to expand monitoring and oversight processes within the company. The task of monitoring management effectiveness to ensure viability and profitability becomes much broader once it extends to include oversight of implementation of key non-financial issues and sustainability policies and commitments. It is fair to say that it will require a renewed management system.

2.4.1. Monitoring implementation of plans and budgets must include, alongside traditional financial and economic metrics, the new metrics introduced in response to the new demands. This requires a complete overhaul of data collection and verification procedures. While it may be helpful to create sustainability plans, as some companies have done, we must stress that the key point is to ensure that the objectives and metrics in those plans become an integral part of the company's strategy and business plans, rather than being treated as a separate add-on.

2.4.2. The task of overseeing compliance with policies, internal codes and commitments on sustainability is part of management supervision, which also becomes much broader. Procedures also need to be in place to **verify the materiality and accuracy of the data** in this area**.** The Board must review **Control and Compliance** functions and adjust them as necessary.

2.4.3. Identifying and monitoring corporate risks is a third area that is directly impacted by a commitment to sustainability. Alongside traditional risks, an entire new set of non-financial or ESG risks must be added, such as environmental, social or reputational risks. By reputational risk, we mean the gap between stakeholder expectations and actual company performance. Without prejudice to the responsibility held by the Board, in formal terms the Audit Committee is ultimately responsible for drawing up and monitoring the map of non-financial risks, although other bodies may also be involved. The Board has a duty to ensure that monitoring bodies include these risks in their full extent.

2.4.4. Once again it must be stressed that those charged with monitoring company performance must be able to draw on an analysis of the relevant stakeholder groups and the nature and materiality of their interdependences with the company, and this analysis must be regularly updated. Clear management metrics and indexes and reliable data collection and verification procedures are also needed.

2.4.5. The Board must ensure it has **the necessary means of Monitoring and Control, Internal and External Audit and Regulatory Compliance; it must verify compliance with the relevant procedures and ensure procedures are kept up to date.** This is particularly important in view of possible corporate criminal liability. It is a defence in law to show that organisational and management models have been put in place that contain appropriate monitoring and control measures designed to prevent crime, and that the models are subject to appropriate oversight.

The Board must ensure that sustainability concepts are properly integrated into its management systems and the company's operations in a manner appropriate to the company's size, activities and organisational complexity (See Table 3 below).

Table 3

INTEGRATING SUSTAINABILITY INTO MANAGEMENT SYSTEMS

Integrating key sustainability aspects into the company's management systems entails a fundamental overhaul of those systems. Earlier in this document we identified those aspects that impact on the way in which Boards of Directors carry out their core duties, and in this table we highlight the main issues to be taken into account.

- **Identifying stakeholder groups**: We have already highlighted this as a key issue. The company must identify the stakeholders who have a relationship with the company and are impacted by it. Where that impact is particularly significant, it may be advisable to perform the analysis at various levels of detail. Relationships with stakeholders will be determined and conditioned by their power, legitimacy, proximity and urgency.

- **Understanding interdependencies and materiality**: Understanding the nature of the interdependencies between stakeholder groups and the company is key to the materiality analysis, which is one of the cornerstones of sustainability.
  - Taking the relevant sector as its starting point, the company must identify and prioritise the issues that are relevant (material) to its stakeholders and to implementing its strategy.
  - Sustainability also incorporates the principle of double materiality, i.e. the impact the company has on the outside world, and the impact the outside world has on the company. A clear example of double materiality is environmental management. The company has an impact on the environment through its emissions, but global warming and related phenomena may also impact on the company in the form of physical risks (weather phenomena) or transition risks (a reduction in fossil fuels in the energy mix leading to asset impairment). Materiality must take account of the importance of issues to stakeholders and the potential impact on the company.

- **Expanding information and monitoring systems** to ensure compliance with the principles, criteria, standards and plans that have been put in place, and to identify any non-compliance.

(Table 3 continued)

  - **Metrics and indicators:** Consistent with the above, the Board must select and follow metrics and criteria that reflect the way in which the company delivers on the sustainability commitments in its strategy and policies. These metrics must provide an analysis of the company's impact, including positive and negative externalities.
  - **Ratings and indexes**: The Board must know the sustainability ratings and indexes available in the market that enable an external assessment of the company's ESG performance. These assessments cover a wide range of issues and thus offer a very valuable set of judgements which should be taken into account. They also provide an objective opinion which enables comparison with other firms in the sector, as well as helping to identify opportunities for improvement.

- **Establishing communication channels with stakeholders:** As we said in the section on being accountable to shareholders and others, the Board has to decide how it should establish dialogue with relevant stakeholders and what channels it should use, so that it understands and can take account of stakeholder expectations. In some cases the report on non-financial information will be enough. In other cases it may be necessary to create a dialogue on specific issues that affect particular stakeholder groups - for example, the effects of mining operations or large public works on local communities.

- **Expanding the risk map:** The Board must ensure there is a risk map in place which is constantly updated. The risk map will need to be expanded to cover non-financial or ESG risks, including reputational risks. This process should also identify the measures and actions required to manage risks.

- **Establishing strategic policies and plans:** The integration of sustainability concepts must be fully reflected in the company's strategic policies and plans and also, of course, in the way these are implemented.
  - **The Board must ensure that its policies address the sustainability components** of the company's commitments to stakeholders, communication channels, and how it will oversee and monitor implementation. This overarching policy needs to be supplemented by more specific policies and concrete commitments (for example, on ESG procurement, health and safety, and the environment).
  - **Strategy and action plans:** Based on the information described above (materiality, expectations, risks, etc.) the company must establish integrated plans that set out all the actions the company will take to manage financial and non-financial issues, the new metrics and indicators, and information to be provided to stakeholders.

2.5. Overseeing and appraising the executive

There are various aspects to this function, and the role of the Board is to:

"ensure that the Chief Executive performs his or her role effectively. It must determine the selection process, the extent of the powers to be delegated to the Chief Executive, remuneration arrangements, relations between the Chief Executive and the Board, appraisal criteria and, where necessary, grounds for removing the Chief Executive." (Instituto de Consejeros-Administradores, 2016, p. 51).

The Board has the same functions with regard to the company's entire senior management team, as the same philosophy should apply throughout the organisation.

2.5.1. Chief Executive

2.5.1.1. **Selection**: When drawing up the selection criteria for the Chief Executive, the Board should include sensitivity towards the new demands and opportunities, and an understanding of their implications for management in all its different dimensions. These criteria should also be included in succession planning and in training and development for potential candidates.

2.5.1.2. **Appraisal and Remuneration**: We noted in the section on managing the Board that appraisal and remuneration of the Chief Executive must be linked to objectives and must be consistent with the company's Purpose, Vision, Mission, culture, strategy and plans. As we explained when addressing appraisal and remuneration for the Board, any expansion of the objectives and achievement indicators must be reflected in decisions on appraisal and remuneration.

2.5.1.3. **Relationship with the Board**: The Board must assess the extent to which the Chief Executive identifies with the criteria approved by the Board on all the issues identified in the Law, in particular the balance between the company's long-term profitability and its social justice and environmental protection objectives, and also as regards communication, transparency and stakeholder relationships.

2.5.2. Senior Management: The criteria that apply to the Chief Executive should also apply to the senior management team. The Board must "ensure the appropriate composition and remuneration of the senior management team at all times" (Instituto de Consejeros-Administradores, 2016, p. 51). The Board must therefore also ensure that the Chief Executive and the senior management team apply the criteria described above, disseminate and comply with company codes of conduct and ensure compliance by others, and develop communication channels with the various stakeholder groups.

2.5.3. Role of the Appointments and Remuneration Committee: As noted earlier, appraisal will become more complex, and the Appointments and Remuneration Committee will need to strengthen its processes and perhaps its capabilities in order to perform its role effectively. Part of its remit will be to ensure that the Board has the necessary skills and expertise in sustainability and non-financial information.

CONCLUDING REMARKS

The publication of this document is prompted by the presence of a profound and evolving phenomenon which places new demands on the role of business in society and on the scope of its responsibilities towards sustainability. Businesses must address the priorities of today without damaging the potential for tomorrow. They must be conscious of the impact they have in non-financial terms on their surroundings and on their different stakeholders, to whom they must be accountable. This change is reflected in the attitudes and initiatives adopted by regulators, institutional investors, business leaders themselves and public opinion. The new approach has given rise to new regulations, such as European Union directives and the Law on Non-Financial Information in Spain.

The new demands pose significant challenges for company Boards of Directors. They undoubtedly make the Board's job more complex, but they may also provide opportunities for increasing the company's value and improving its competitive position. The existence of new demands and opportunities does not change the nature of the Board's core inalienable duties. What has changed is that new factors need to be incorporated into the way the duties are performed, and the guiding spirit behind those demands and opportunities must be embraced and reflected in the company's Purpose, Governance and Operations. The process needs to start with the Board and extend across the entire organisation. To be effective, it requires action from the Board on various levels:

- **Leading a real change in culture**, to ensure that the entire company is committed to meeting the demands and practical consequences of the concept of sustainability.

- **Having a clear understanding of the various stakeholder groups** who are affected by the company's activities and of the **significance (or materiality) of the interdependencies** between them.

- **Setting the policies, criteria and metrics** that will support decision-making and will also be used to evaluate how the company responds to the new demands in practice.

The main aim of this document is to highlight the implications which the new regulations and underlying trends have for company Boards of Directors. The Board's primary responsibility is to provide high-level leadership of the business, and this must be reflected in how it carries out its core inalienable duties. In this document we have reviewed those duties and put forward some recommendations on a possible approach. We hope this will help to ensure that the guiding spirit behind these new demands translates into positive changes in governance and corporate management that go beyond the strict letter of the law.

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    b. International Integrated <IR> Framework, International Integrated Reporting Council (IIRC Framework)
    c. Sustainability Accounting Standards Board (SASB) Standards
    d. Taskforce for Climate Related Financial Disclosure (TCFD)
    e. CDP (previously Carbon Disclosure Project)
    f. Climate Disclosure Standards Board (CDSB) Framework
    g. Principles for Responsible Investment (PRI)
    h. United Nations Global Compact
    i. Sustainable Development Goals, 2030 Agenda for Sustainable Development
    j. United Nations Global Compact
    k. ISO 26000
    l. United Nations Business and Human Rights Framework

2. Sustainability indexes

    a. Dow Jones Sustainability Index (DJSI)
    b. FTSE4Good
    c. Euronext Vigeo World 120
    d. Euronext Vigeo Eurozone 120
    e. Euronext Vigeo Europe 120
    f. Ethibel Sustainability Excellence Europe Index
    g. Ethibel Sustainability Excellence Global Index
    h. MSCI ESG Leaders Indexes
    i. MSCI Global Climate Index
    j. Stoxx Global ESG Leaders
    k. Bloomberg Gender-Equality Index

3. Sustainability rating agencies

    a. S&P Global
    b. Morningstar Sustainalytics
    c. Moody´s Vigeo
    d. ISS ESG
    e. MSCI

4. Providers of sustainability information

    a. Bloomberg
    b. Thomson Reuters
    c. Clarity
    d. Truval Labs
    e. Arabesque S-Ray
    f. Refinitiv

OTHER USEFUL INFORMATION

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- Spanish Financial Futures Market www.meff.es
- Spanish Bond Market www.aiaf.es
- Ministerio de Economía y Competitividad [Ministry of Economic Affairs and Competitiveness] www.mineco.gob.es
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- Instituto de Consejeros-Administradores [Associaton of Directors] www.iconsejeros.com

ABOUT THE IC-A

INSTITUTO DE CONSEJEROS-ADMINISTRADORES

The Instituto de Consejeros-Administradores (IC-A)

The Instituto de Consejeros-Administradores (IC-A) is the Spanish association for Board Directors of businesses or organisations.

It is an independent, non-political organisation, whose membership comprises **individual** Directors. Its aims are to promote, disseminate and establish the most advanced models of Corporate Governance, the highest standards of professional regulation and the best ethical practices in business management, and to encourage training for Directors and others involved in Corporate Governance, based on tried and tested approaches, in order to develop their performance and increase levels of professionalism. It also comments on regulations and guidelines in the field of Corporate Governance both before and after they come into effect, and it represents and defends Directors' interests in dealings with Government and Civil Society.

The IC-A is highly respected both in Spain and internationally as an independent professional body that is an expert on corporate governance in listed and unlisted companies, family-run businesses, public bodies and not-for-profit organisations.

The IC-A represents Spain in the European Confederation of Directors Associations (ecoDa, www.ecoda.org), based in Brussels, which represents over 55,000 Directors in Europe.

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Sustainability and **Non-Financial Information:** Implications for **Boards of Directors**

A fundamental change is taking place in what society expects from business in terms of the scope of corporate responsibilities and the role of business in society. Sustainability is a guiding concept which, in essence, requires businesses to address the priorities of today without damaging the potential for tomorrow, and to be conscious of their impact on their surroundings and on their different stakeholders. In recent years this trend has given rise in various countries to a series of regulations and recommendations on the responsibilities of business in relation to sustainability and non-financial information.

The Board of Directors is responsible for providing high-level leadership across all aspects of the business, except for matters that are reserved for the shareholders in general meeting. It therefore has full responsibility for leading the response to the challenges posed by the new reality. These challenges undoubtedly make the Board's job more complex, but they may also provide opportunities for increasing the company's value and improving its competitive position.

The main aim of this publication is to highlight the implications which the new regulations and underlying trends have for company Boards of Directors. In this document we review those core inalienable duties, and put forward some recommendations on a possible approach. We hope this will help to ensure that the guiding spirit behind these new demands translates into positive changes in governance and corporate management that go beyond the strict letter of the law.

This document on **"Sustainability and Non-Financial Information: Implications for Boards of Directors"**, contains the recommendations by the IC-A (the Spanish Association of Board Directors) on the standards to be applied by Directors in carrying out their duties.

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