

JUNE 2020

SUBMISSION TO THE PUBLIC CONSULTATION ON REVISION OF THE NON-FINANCIAL REPORTING DIRECTIVE

The Danish Institute for Human Rights (**DIHR**) is an independent National Human Rights Institution (**NHRI**) established by the Danish Parliament in accordance with the UN Paris Principles. Under its legal mandate, the DIHR's main functions are to monitor human rights in Denmark and promote human rights internationally, including through engagement with non-state actors. The DIHR's [Business and Human Rights Department](#) has been working in the area since 1999 and is an internationally-recognised centre of expertise on the application of human rights norms to business actors, across all world regions and industry sectors.

We make this submission as part of the public consultation on revision of the Non-Financial Reporting Directive Directive 2014/95/EU (**NFRD**) drawing on our expertise from 20 years of working with companies, states and civil society to build a global environment in which negative impacts on human rights by business activities are minimised, including through implementation of the UN Guiding Principles on Business and Human Rights (**UNGPs**). Our work includes analysis of company reporting on human rights, developed indicators for companies, and advised companies on human rights due diligence (**HRDD**) including with respect to reporting.

Based on our expertise, our response to this consultation is focused on the aspects of the NFRD which touch upon human rights. There are three issues on which we make specific submissions:

1. the need for reform of the NFRD to align with other reforms, including any prospective regulation of mandatory HRDD;
2. the need for clarity of the obligations of reporting entities in relation to human rights, including with respect to application of the 'double materiality' principle;
3. the need for standardisation both in terms of the application of a consistent set of standards and in terms of the disclosure of information in a consistent, digital format enabling company reporting to be accessible and comparable by a range of stakeholders, in support of accountability.

REGULATORY ALIGNMENT

The adoption of the NFRD in 2014 represented an important first step towards increased corporate transparency as large businesses were required to report annually on risks including in relation to human rights.

Reference in the 2017 Guidelines to the UNGPs and the OECD Guidelines for Multinational Enterprises as key standards for reporting on human rights was a welcome further step. However, analyses of non-financial reports by European businesses show that businesses do not currently report adequately on human rights.

A [2019 report from the Alliance for Corporate Transparency](#) analysed the reporting practices of 1000 companies under the NFRD found that only 22.2% of companies disclosed information on their human rights due diligence processes despite 82.8% reporting a human rights policy. Further, only 25.5% of companies disclose specific human rights risks facing them despite 56.6% acknowledging those risks. Only 14.6% report on actual impacts and only 3.6% explain the outcomes of the management of those risks.

On its own, corporate reporting is insufficient to adequately compel responsible and sustainable businesses conduct. Reporting requirements such as the NFRD must work in concert with other regulation in order to effectively encourage or mandate responsible business conduct and respect for human rights by business.

There is a need to align reform of the NFRD with other regulatory developments, including efforts undertaken under the EU's Sustainable Finance Action Plan and any prospective regulation mandating human rights and environmental due diligence (**HRDD**). HRDD is a process outlined in the UNGPs designed to enable companies to discharge their responsibility to respect human rights through a cyclical due diligence process by which a company identifies actual or potential human rights impacts, takes action to address them, monitors the effectiveness of those actions and communicates on risks identified and actions taken.

Existing regulation which encourages or mandates due diligence of this kind incorporate a range of requirements, thresholds and standards. These existing regulations include the UK Modern Slavery Act, the EU Timber Regulation, the EU Conflict Minerals Regulation and the French Due Diligence Law. Each of these measures is framed differently in scope and obligation, creating a challenging regulatory landscape of potentially overlapping or misaligned obligations.

The current NFRD does not require companies to undertake HRDD, but it does oblige them to describe due diligence undertaken, or explain why due diligence is not undertaken. Under Article 19a of the NFRD, companies are required to disclose the "information necessary for an understanding" of their impacts on the four sustainability issues, including human rights. Companies must describe their policies on the sustainability issues, including any due diligence undertaken, as well as the outcomes of those policies. Companies are required to disclose the principal risks their operations pose to the four issues and how the company manages those risks.

Although the basic elements of HRDD are included in the NFRD, there is little clarity on how a company should report meaningfully and adequately on HRDD as it is understood in the UNGPs. The technical standards for environmental, social and governance (**ESG**) disclosures by the financial sector currently

under consultation explicitly include disclosures on respect for human rights, including through integration of key elements of the UNGPs (e.g. HRDD). It is recommended that the revised NFRD aligns more explicitly with the concept of HRDD. The UNGPs remain the touchstone for any regulation designed to improve respect for human rights by business, and any reform of the NFRD should aim to align as closely as possible to their requirements. Aligning with the UNGPs would also facilitate alignment with any future regulation mandating HRDD.

In addition, the technical standards for ESG disclosures by the financial sector currently under consultation includes suggestions around the key performance indicators (KPIs) that should be reported on, including in the context of human rights. At the same time the NFRD requires companies to disclose “non-financial key performance indicators relevant to the particular business.” It is recommended that synergy between KPIs in the financial sector ESG disclosure regulation and the revised NFRD is actively pursued.

Specifically as it relates to human rights, it is further recommended that the NFRD acknowledges the difficulty in developing exhaustive KPIs on human rights that are meaningful across all businesses and as a result require businesses to develop meaningful context specific indicators, including indicators that track outcomes and impacts and report on these year-on-year.

We recommend that revisions of the NFRD:

- **are in line with the UN Guiding Principles on Business and Human Rights and align more explicitly the concept of human rights due diligence;**
- **be mindful of other regulatory developments, including suggestions on the technical standards for ESG disclosures for the financial sector currently under consultation; and**
- **develop meaningful context specific indicators.**

HUMAN RIGHTS DISCLOSURES AND DOUBLE MATERIALITY

What a business identifies as material shapes its actions. However, there is no standardised way in which businesses are regularly and transparently disclosing how and what they have decided is material, and how the business is addressing the issues identified as material. This information is important to for a range of stakeholders including ESG investors and civil society actors focused on corporate accountability.

Any revision of the NFRD must aim to clarify the obligations of reporting entities and enable as meaningful reporting practices as possible. This includes addressing some of the conceptual confusion connected with the current NFRD. The current distinction between ‘social and employee matters’ and ‘human rights’ is one example of the ways in which the

directive risks contributing to potential confusion amongst reporting companies, given that social and employee matters are also captured by human rights. It is our recommendation that reform of the NFRD actively addresses the shortcomings of the concept of materiality with respect to non-financial reporting.

While the concept of ‘double materiality’ included in the Commission’s reporting Guidelines on climate-related information marks a significant improvement in underlining the importance of ‘impacts on society’ in assessing materiality, in our experience, including through extensive collaboration with business, the term ‘materiality’ has a particular connotation due to its meaning in financial reporting and is not easily translated to the context of non-financial reporting without clear guidance given to a reporting entity.

Irrespective of well-intentioned efforts to redefine and apply the term in the context of non-financial reporting e.g. through the principle of ‘double materiality’ there is a significant risk that reporting organisations will rely on pre-conceived notions of ‘materiality’. There is a risk that an updated definition may not significantly impact or alter the type of information shared and so drive reporting on more meaningful information about risks to people, rather than risks to the company.

Specifically, within reporting on human rights, the materiality or even double-materiality lens does not make sufficiently clear to reporting

organisations the requirements to report on the *most severe* actual or potential impacts to people. The practice of carrying out materiality assessments for the purpose of the NFRD, including through the use of external consultants, is not adequately geared towards including perspectives from potentially affected rightsholders and their representatives, which means that reporting has not necessarily been done on the basis of prioritisation of the most severe impact areas from a human rights perspective. It is our recommendation that the revision explicitly include ‘severity’ as the main prioritisation parameter on which reporting organisations can determine which information should be included in the report. This is of particular relevance for reporting on human rights impacts.

Companies’ impacts on societies are contextual in nature – they are linked to geographies, to selected business activities, products or services or to specific business partners etc. Many businesses struggle to meaningfully disclose impacts at an aggregate level e.g. at the level of the parent company. As a result the review should explore whether disclosure requirements could assist companies in disclosing more meaningful information at the aggregate as well as disaggregate levels. The revised NFRD should ensure that companies share both group level information about impact areas as well as information that may not be relevant to the whole group but is key to e.g. managing severe human rights risks in a specific high-risk

context. Companies should be required to clarify whether the information they are sharing is true corporate-wide, and how this has been substantiated, or they are giving a context-specific example. Again, the concept of severity can serve as a key parameter based on which companies can ensure that information around the most critical impact areas is included, rather than necessarily information that may be relevant corporate wide, but of a less critical nature.

We recommend that revision of the NFRD:

- **Actively addresses the shortcomings of the concept of materiality with respect to non-financial reporting;**
- **Use the principle of ‘severity’ to prioritise reporting on critical impacts; and**
- **Requires business to report on aggregative or cumulative effects.**

STANDARDISATION AND STRUCTURE

In addition to challenges associated with improving the substance of reporting, there are challenges in relation to the accessibility of company reports and how reported information is prepared and presented. Corporate reports use a variety of different standards as a point of departure and their own formats when preparing their reports. As a result, corporate reports are prepared in different ways with differing formats and content. Requiring the use of a common standard, or standards, would be a large step

towards standardisation in reporting. This could be achieved through a new common EU standard, or through reference to existing standards, such as the forthcoming revised Global Reporting Initiative (**GRI**) human rights standards.

In addition to variation in standards used, there is considerable variation in the presentation of data on human rights issues in current company reporting which presents considerable difficulties when attempting to assess and compare company practice. The capacity to easily access, analyse and compare company reporting is crucial for a range of stakeholders including ESG investors and civil society groups focused on corporate accountability.

Useful work has been done by the [Alliance for Corporate Transparency](#), the [Corporate Human Rights Benchmark](#) and others to analyse both what companies report in relation to human rights as well as assess the human rights performance of companies through manual analysis of company reporting. Each of these projects has resulted in useful data on the state of company reporting on human rights capable of assisting a range of stakeholders identify trends and gaps in current company practice on human rights. However, efforts to undertake large scale qualitative analysis of company reports are limited by the resource intensive nature of the review, requiring manual review of company reports which provide relevant data in often quite different formats and without

reference to common standards. This makes qualitative analysis of this kind a resource intensive exercise which can be challenging to scale up.

In our view, it is possible to supplement qualitative analysis of this kind through big data analysis assisted by an algorithm. The DIHR has successfully undertaken a similar project using big data analysis of 145,000 recommendations from the international human rights system, assisted by an algorithm resulting in the creation of the [SDG-Human Rights Data Explorer](#).

This project was assisted by the standard format used in Universal Periodic Review reporting which simplified the process of extracting text for analysis by the algorithm. The DIHR has since attempted to adapt this algorithm to undertake an analysis of corporate reporting on human rights from a Sustainability Disclosure Database of over 40,000 company reports from a 20 year period maintained by GRI. The aim of the project is to assess the state of company sustainability reporting on human rights and contribute to the literature by supplementing existing qualitative analysis of company sustainability reporting with quantitative data generated by algorithm assisted analysis.

However, the DIHR has faced challenges in adapting the algorithm to the company reports dataset. This has stemmed in part from the lack of standardisation of reporting and the machine readability of the company reports.

From a review of the dataset, potentially relevant information is contained in a range of formats, including tables or text boxes in picture format which were challenging to convert into a machine readable format.

Standardisation of reporting would greatly assist this kind of big data analysis, enabling efforts to analyse company reporting to be scaled up. Ensuring that company reports are made accessible and digitised in a machine readable format is essential not only for big data analysis projects like the one described above, but for all stakeholders wishing to assess and compare the human rights performance of reporting companies. An official EU repository, where businesses are required to deposit up-to-date reports, is important for a range of stakeholders including ESG investors and civil society actors focused on corporate accountability.

We recommend that revision of the NFRD:

- **Requires that reports are prepared and presented in a standardised manner and utilise common standards;**
- **Are digitised in a machine-readable format and be deposited in an official repository, to be established by the EU; and**
- **Use the principle of ‘severity’ to prioritise reporting on critical impacts.**