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PLATFORM

# The Imperative for Impact Management

## Clarifying the relationship between impacts, system-wide risk and materiality

June 2023

The Impact Management Platform (the "Platform") is a collaboration between the leading providers of sustainability standards and guidance that are coordinating efforts to mainstream the practice of impact management.

As of the time of publication, the Platform Partners comprise:

B Lab; Capitals Coalition; CDP; Global Impact Investing Network (GIIN); Global Reporting Initiative (GRI); Global Steering Group for Impact Investment (GSG); International Finance Corporation (IFC); Organisation for Economic Co-operation and Development (OECD); Principles for Responsible Investment (PRI); Social Value International; United Nations Department of Economic and Social Affairs (UN DESA); UN Development Progamme (UNDP); UN Global Compact; UN Environment Programme Finance Initiative (UNEP FI); and World Benchmarking Alliance; with the IFRS Foundation and International Foundation for Valuing Impacts (IFVI) as Observers.

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# Acronyms and abbreviations

| | |
|---|---|
| **ESG** | Environmental, social and governance |
| **EU** | European Union |
| **GDP** | Gross domestic product |
| **GHG** | Greenhouse gas |
| **GIIN** | Global Impact Investing Network |
| **GRI** | Global Reporting Inititave |
| **IFRS Foundation** | International Financial Reporting Standards Foundation |
| **ILO** | International Labour Organisation |
| **ISSB** | International Sustainability Standards Board |
| **OECD** | Organisation for Economic Co-operation and Development |
| **PRI** | Principles for Responsible Investment |
| **SDGs** | Sustainable Development Goals |
| **TCFD** | Task Force on Climate-Related Financial Disclosures |
| **TNFD** | Taskforce on Nature-related Financial Disclosures |
| **UN** | United Nations |
| **UNEP FI** | United Nations Environment Programme Finance Initiative |
| **US** | United States |
| **USD** | US Dollars |
| **WHO** | World Health Organization |

# Executive summary

This paper makes the case that the widespread uptake of impact management by enterprises, investors and financial institutions is not only a human and environmental imperative, but also critical for the sustained economic and financial performance of the market as a whole. Impact management is understood as a holistic and systematic approach to managing environmental and social impacts in a way that, at a minimum, enables organisations to operate sustainably and that, for some, facilitates the pursuit of solutions to environmental and social challenges.

As a global community of public and private sector actors, we are not on track to meet the Sustainable Development Goals (SDGs) by 2030, which are set out to end poverty and inequality, and ensure health, education and a liveable planet for all. Human activity has already transgressed seven out of eight globally quantified safe planetary boundaries,[1] bringing the planet closer to tipping points that will severely limit its ability to sustain human life in the way that we know it.

The systemic nature of the relationship between the economy, people and the natural environment makes the management of impacts an economic and financial imperative as well. The economy's reliance on the viability and stability of environmental and social systems is acutely demonstrated by the consequences and costs of anthropogenic climate change. This reliance also holds true for nature more broadly, as well as for people and society. Inequalities in health, skills, income, wealth and well-being undermine our collective human potential, as well as the foundations of the social systems and institutions upon which business and finance depend.

A narrow approach to addressing sustainability issues focused solely on the management of entity-specific risks is insufficient, because it is not attuned to rapid environmental and social developments, and importantly, it does not take into account the *contributions* that enterprises make to the accumulation of system-wide risk, as well as their consequences. The mainstreaming of impact management is necessary to secure sustainable environmental and social outcomes, and to optimise the market's capacity to manage risks and opportunities as a whole.

This paper explores the specific implications of these observations for relevant actors and makes the following call to action:

- **Enterprises, investors and financial institutions** should adopt impact management in order to operate sustainably, increase well-being, and mitigate idiosyncratic and system-wide risks.
- **Governments** should encourage and enable the mainstreaming of impact management in order to achieve global policy objectives, including the Paris Agreement, the Kunming-Montreal Global Biodiversity Framework, and the 2030 Agenda.

1 Rockström, *et al.*, 2023, Safe and just Earth system boundaries, Nature

- **Standard-setters and international organisations providing impact management resources** should collaborate towards a complete and coherent system of standards and resources.
- Because information on impacts and impact management may be financially material, **standard-setters** and **policymakers** should appropriately recommend the disclosure of this information.

The Partners of the Impact Management Platform, as the leading providers of international public good standards and guidance for impact management, are committed to clarifying and mainstreaming the management of impacts on people and the natural environment. This paper outlines the Partners' commitment and roadmap to support this process.

# 1. Introduction

Recent years have seen accelerated policy, regulatory and market uptake of sustainability-related management standards and practices, such environmental, social and governance (ESG) integration, environmental and social risk screening and sustainability-related disclosures. Enterprises, investors and financial institutions (collectively referred to in this thought piece as “organisations”) are increasingly paying attention to their sustainability-related operational, regulatory, reputational and technology risks. In doing so, organisations are starting to manage some of their impacts on people and the natural environment.

Despite this progress, many organisations address impacts in a fragmented, reactive and short-sighted manner, primarily in an effort to manage the more apparent entity-specific risks as referred to above. Such a narrow focus on managing sustainability issues will neither enable the achievement of the SDGs, nor enable organisations to fully manage their environmental and social risks and opportunities. What remains lacking in current approaches to the management of sustainability issues is an understanding that the sustained financial performance of the market as a whole is reliant on the viability and stability of environmental and social systems.

With this paper, the Partners of the Impact Management Platform, aim to articulate the importance of a more deliberate and comprehensive approach to managing sustainability issues, namely impact management. The case made here is that impact management is the necessary starting point in the management of system-wide risk, in addition to entity-specific risk, and therefore needs to be practiced by all organisations. Impact management serves to address critical environmental and social challenges, but also to secure the sustained economic and financial returns of the market.

## What is impact and impact management?

The Partners of the Impact Management Platform have reached consensus on the following of the terms impact and impact management.

**Impact(s): the effect(s) of organisations’ actions on people and the natural environment.**

Impact(s) can be positive or negative, intended or unintended, and direct or indirect. All enterprises, investors and financial institutions have positive and negative impact(s).

**Impact management: the process by which an organisation understands, acts on and communicates its impact(s) on people and the natural environment, in order to reduce negative impacts, increase positive impact(s) and ultimately to achieve sustainability[2] and increase well-being.**

2 Throughout this paper, the term *sustainability* is used in the sense of the United Nations Brundtland Commission, i.e. “meeting the needs of the present without compromising the ability of future generations to meet their own needs”. (Brundtland, 1987)

# 2. The need for greater consideration of system-wide risk

The past decade has seen a rapid uptake of sustainability issues in business and finance, primarily through the adoption of sustainability-related risk management approaches, including ESG integration and increased attention to sustainability disclosures. Such entity-specific (or "idiosyncratic") risks have become harder to ignore due to increasing demands by consumers and other stakeholders for organisations to address their negative impacts. While such practices may contribute to the uptake of sustainable practices, they do not equate with a holistic and systematic approach to impact management.

Specifically, a narrow risk-based approach focused solely on idiosyncratic risks in the management of sustainability issues is not sufficiently attuned to the deep linkages between impacts, risks and opportunities, as well as the rapidly evolving changes in demands from consumers, employees, regulators and other stakeholders. More than that, a sole focus on managing idiosyncratic risks neglects the management of system-wide risks that both undermine the stability and well-being of humanity, and the sustained financial performance of the market as a whole. The next section explores the limitations of a narrow focus on risks and opportunities, and the importance of taking a system-wide perspective.

### Idiosyncratic and system-wide risk

In this paper, the term "**idiosyncratic risk**" is used to refer to risks that are specific to individual entities. Idiosyncratic sustainability-related risks may arise from an entity's current or future impacts or dependencies (e.g. reputational, regulatory, or operational risks), or they may result directly from system-wide environmental and social risks (e.g. physical and market risks).

The term "**system-wide risk**" is used here as an umbrella term to denote (1) non-diversifiable risk originating from the market's systematic dependencies on environmental and social resources (also referred to as "**systematic risk**"), as well as (2) any major disturbance in environmental and social systems that results in cascading effects for the economy and financial system (also referred to as "**systemic risk**").

# The limitations of a narrow focus on idiosyncratic risks and opportunities

Many enterprises, investors and financial institutions manage their impacts first and foremost because they give rise to idiosyncratic risks and opportunities. There are several ways in which an organisation's impacts on people or the natural environment may present risks to its own sustained financial performance, including by posing reputational, regulatory, operational and technological risks. An example is oil spills, which have negative impacts on people and the natural environment (see Figure 1 for an illustration). Such (potential) impacts give rise to idiosyncratic risk because of the potential for reputational risks that could drive down demand, as well as legal risks that could increase costs.

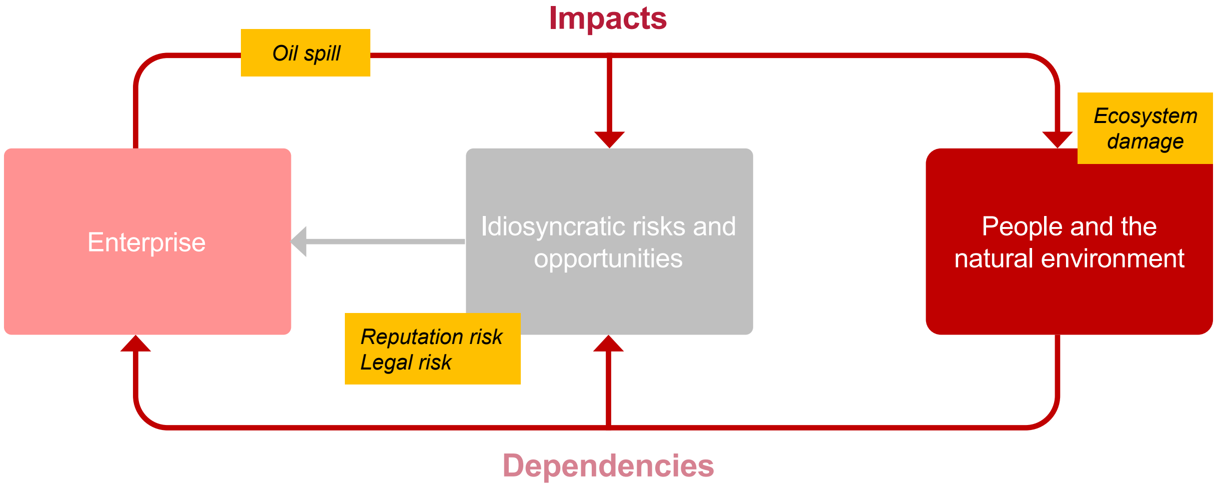


**Figure 1: An example of how an organisation's impacts (in this case a hypothetical oil spill) generate risks (in this case legal and reputational) that may affect its financial results**

Idiosyncratic risks also arise from an organisation's dependencies, or reliance, on environmental and social resources. An organisation's depletion of human, social and natural resources through negative impacts may directly affect its ability to continue to use such resources, and thereby give rise to operational risk. An example of nature-related dependencies is the use of water in agriculture. In the social area, an organisation's dependency on the health of the workforce may present risks, and it should therefore consider the impacts it has on its employees and other workers. Evidence suggests that employee health and well-being, which enterprises have an impact on, is associated with productivity and financial performance.[3]

Reducing negative and generating positive impacts can also give rise to opportunities. For example, an enterprise could gain a competitive edge and strengthen its future position relative to peers by managing its environmental impacts (e.g. by being an early adopter of green production technology), or by inducing productivity and innovation in the workforce as a result of greater employee well-being.

Without adequate impact management, which starts with a thorough and holistic process of identifying potential impact associations, enterprises may not be aware of the state and sustainability of their social or environmental resources and the risks and opportunities that

3 Krekel, et al., 2019, *Employee Wellbeing, Productivity and Firm Performance*, Said Business School.

may originate from them. In addition, evolving societal trends and abrupt environmental disruptions may rapidly give rise to new reputational, regulatory or other idiosyncratic risks originating from impacts. These limitations suggest that the entire spectrum of potential impacts should be on the radar of enterprises, even if they have not yet been deemed financially material in a given moment via a more holistic approach to impact management.

## Broadening the focus: system-wide risks and opportunities

What remains underappreciated is the fact that an approach that is exclusively focused on the management of idiosyncratic risk is also insufficient because impacts represent *contributions to* system-wide risks and opportunities, even when they do not (yet) pose quantifiable entity-specific risks. All economic activity as we know it is permanently embedded within and dependent on environmental and social systems, as many academic economists have pointed out.[4] As a consequence, enterprises, investors and financial institutions depend on the viability and stability of these environmental and social systems for their sustained financial performance.

Figure 2 below illustrates how, in an embedded economy, the impacts generated by organisations give rise to idiosyncratic risks *and* contribute to the accumulation of system-wide risks. Importantly, impacts can contribute to system-wide risk without presenting (significant) reputational, regulatory or operational risk for an individual organisation. While Enterprises A, B and C all have impacts on people and the environment, only Enterprises A and B face idiosyncratic risks associated with their impacts (e.g. reputation risks). The impacts of Enterprise C are not associated with idiosyncratic risks. However, the impacts of Enterprise C are still relevant to the market as a whole, and the impacts of A, B and C may contribute to the accumulation of system-wide risk to Enterprises D and E, even if these enterprises do not have impacts themselves.

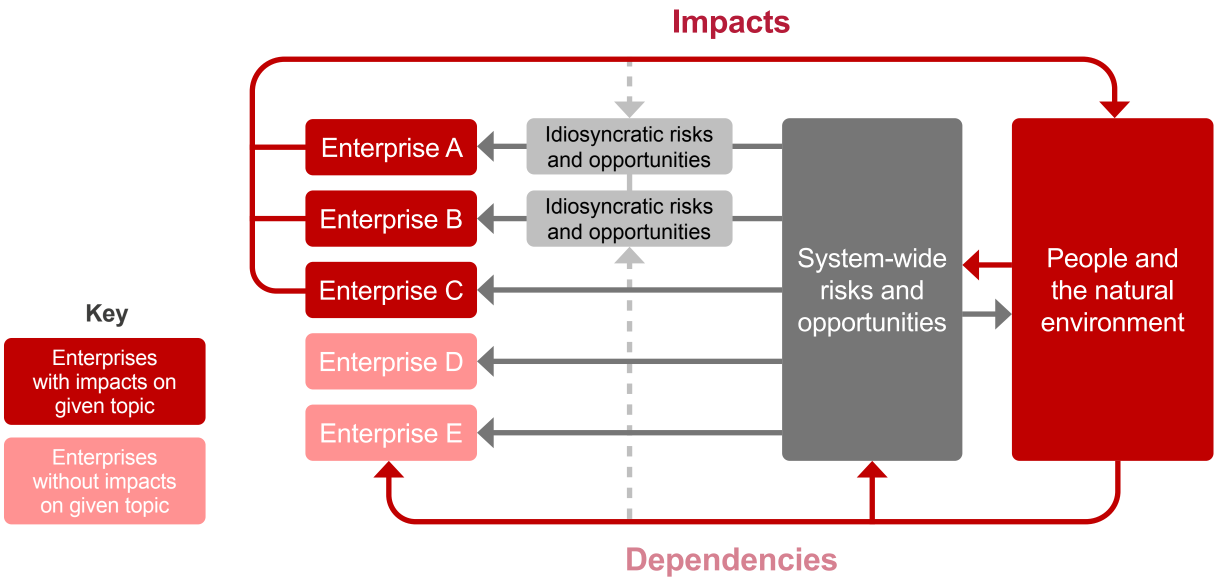


**Figure 2: Impacts (on a given topic) matter not only when they result in idiosyncratic risk, but also because they can contribute to systemic risks (and opportunities)**

4 Raworth, 2017, *Doughnut Economics: Seven Ways to Think Like a 21st-Century Economist*, Chelsea Green Publishing.

## Evidence on the link between system-wide environmental and social conditions, and economic and financial outcomes

Mounting evidence supports the idea that sub-optimal environmental and social outcomes undermine overall economic performance, and thereby undermine corporate and financial returns, since economic growth and corporate profits tend to go hand-in-hand.[5,6] In the environmental area, the possibility that cumulative impacts on climate and ecological systems could result in system-wide collapse is now well understood by enterprises and financial markets, partially thanks to the work of the Task Force on Climate-Related Financial Disclosures (TCFD) and Taskforce on Nature-related Financial Disclosures (TNFD). Already between 1992 and 2013, anthropogenic extreme heat has been estimated to have cost between USD 5 trillion and USD 29.3 trillion globally.[7] Recent research suggests that climate tipping points are considerably more likely to be breached than previously assumed, and such tipping points can cascade through to social and economic systems over timeframes that would defy societies' ability to adapt, undoubtedly wreaking economic havoc.[8]

It has been shown that sub-optimal people-related outcomes, such as excessive inequalities, also weigh on macro-level economic and financial outcomes. For example, across an average of selected OECD countries,[9] the increase in income inequality between 1985 and 2005 was estimated to have resulted in 4.7 percentage points of missed cumulative growth between 1990 and 2010.[10] There is also a relationship between inequalities and financial sector shocks. In the case of the Global Financial Crisis of 2008-9, the accumulation of inequalities in income and wealth are thought to have made the financial crisis more likely and more severe.[11]

Looking forward, the expert panel that informs the World Economic Forum's Global Risk Report suggests that potential social risks on the horizon may include the cost-of-living crisis, the erosion of social cohesion and societal polarisation, as well as geo-economic confrontation, and large-scale involuntary migration.[12] Indeed, occurrences of social unrest have increased significantly over past decades,[13] at a time of increasingly high levels of inequalities of income and wealth.[14] A deeper understanding of system-wide social and inequality-related impacts, dependencies and risks and opportunities is warranted and merits further work.

Table 1 provides a number of examples on the relationship between environmental and social outcomes and aggregate economic outcomes.

5 The relationship between growth and equity valuations is more complex, partially because of the international nature of financial markets.
6 MSCI Barra, 2010, *Is There a Link Between GDP Growth and Equity Returns?*, MSCI Barra Research Bulletin.
7 Callahan & Mankin, 2022, *Globally unequal effect of extreme heat on economic growth,* Science Advances.
8 OECD, 2022, *Climate Tipping Points: Insights for Effective Policy Action*, OECD Publishing.
9 The Organization for Economic Co-operation and Development (OECD) brings together Member countries and a range of partners that collaborate on key global issues at national, regional and local levels.
10 OECD, 2015, *In It Together, Why Less Inequality Benefits All*, OECD Publishing.
11 Čihák & Sahay, 2020, *Finance and Inequality*, IMF Staff Discussion Note.
12 WEF, 2023, *The Global Risks Report 2023,* World Economic Forum.
13 Barrett, 2022, *Reported Social Unrest Index: March 2022 Update*, IMF Working Papers.
14 World Inequality Lab, 2022, *World Inequality Report*.

**Table 1: Actual and potential linkages between environmental and social conditions and economic and financial outcomes at the macro level**

| Environmental and social conditions | Economic and financial implications | Source |
|---|---|---|
| Climate change | Cumulative 1992–2013 losses from anthropogenic extreme heat likely fall between USD 5 trillion and USD 29.3 trillion globally. | Callahan & Mankin, 2022 |
| | The global cost of climate change associated with a 1.5, 2.0, and 3.2 degree rise in temperatures is estimated at −4.2%, −11.0% and −18.1% of global GDP respectively. | Swiss Re, 2021 |
| Ecosystems | A collapse in select ecosystem services could cost 2.3% (USD 2.7 trillion) in global GDP on an annual basis by 2030 (under a partial ecosystem collapse scenario). | World Bank, 2021 |
| Nature | Fifteen priority nature-related transitions have the potential to add USD 1.9 trillion in annual business value by 2030 in China. | WEF, 2022 |
| Water insecurity | Partial estimates of global economic losses related to water insecurity include USD 260 billion per year from inadequate water supply and sanitation, USD 120 billion per year from urban property flood damages, and USD 94 billion per year of water insecurity to existing irrigators. | Sadoff, *et al.*, 2015 |
| Income inequality | The economic cost of the increase in income inequality between 1985 and 2005 has amounted to 4.7 percentage points of cumulative GDP growth between 1990 and 2010, on average across selected OECD countries. | OECD, 2015 |
| Social unrest | Social unrest lowers confidence and raises uncertainty, resulting in significant potential macroeconomic impacts, amounting to a 1% reduction in GDP six quarters after an unrest event. | Hadzi-Vaskov, *et al.*, 2021 |
| Gender inequality | Fully closing the global gender gap in the labour market was estimated to add USD 28 trillion to global GDP (26% of global GDP) by 2025, relative to business in usual scenario | McKinsey Global Institute, 2015 |
| Ethnic and racial inequity | The lack of employment and educational equity in the United States is estimated to have cost almost USD 22.9 trillion between 1990 and 2019. | Buckman, *et al.*, 2021 |
| Good health | Good health has a positive, sizable, and statistically significant effect on aggregate output, channelled through improved labour productivity. | Bloom, *et al.*, 2004 |

It should be emphasised that the relationship between environmental and social conditions and economic and financial performance is not necessarily a future or long-term problem, as is illustrated by the evidence cited in this table. Accumulated historic impacts are weighing down economic and financial outcomes in the present, and the systemic nature of society and the natural environment mean that risks can arise rapidly and unpredictably.

As is the case at the enterprise level, at the systems level, too, impact management at a system level is not only about addressing problems, but also offers a collective economic and financial opportunity. The Principles for Responsible Investment (PRI) has previously laid out *The SDG Investment Case*, which argues that the SDGs present economic and financial opportunities for investors. As an example, fully closing the gender gap in the labour market has been estimated to have the potential to add 26% of global GDP, according to the McKinsey Global Institute.

# The role of impact-related information in sustainability-related financial disclosures

The implications of the link between impacts and system-wide risk has particular implications for sustainability-related financial disclosures, an area where the "financial materiality" of information on impacts and impact management has recently been the subject of discussion. The financial materiality of information on impact is a longstanding question that has regained interest as a result of the draft standards published by the International Sustainability Standards Board (ISSB) in 2022.[15]

## Sustainability-related financial disclosure and sustainability reporting

**Sustainability-related financial disclosures** are used to provide sustainability-related information about a reporting entity to the primary users of general purpose financial reporting who decide whether to provide resources to the entity. Information is disclosed if it is financially material:

> **"Information is material if omitting, misstating or obscuring that information could reasonably be expected to influence decisions that primary users of general purpose financial reports make on the basis of those reports, which include financial statements and sustainability-related financial disclosures and which provide information about a specific reporting entity."**
>
> **IFRS S1, 2023**

15 Market actors and standard-setters have already signalled that information on entities' impact on people and the natural environment (and the management thereof) may be relevant for users of sustainability-related financial disclosure, for example in responses to the ISSB's public consultation on its draft IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information (SRS1). A number of Platform Partners also emphasised this message in a set of common messages to the consultation. Since then, the ISSB has issued a clarification on the meaning of the term "sustainability", further acknowledging the role of impact and impact management within the concept of corporate sustainability in the context of its standards

Sustainability-related financial disclosures are separate from **sustainability reporting**, which concerns the disclosure of information on entities' impacts on people and the natural environment to a multi-stakeholder audience. In sustainability reporting, information is disclosed based on its 'impact materiality', which is described by GRI as:

> **"Information on the reporting company's impact on the economy, environment and people for the benefit of multiple stakeholders, such as investors, employees, customers, suppliers and local communities."**
>
> **GRI, 2022**

The relationship between impact, system-wide risk and the sustained financial and economic performance of the market presented in this paper provides an additional reason for why information on impacts and impact management may be considered financially material. Current interpretations and implementation of the concept of financial materiality do not always recognise the importance of information on entities' contributions to the accumulation of system-wide risks. Because of investors' exposure to and interest in managing system-wide risk, information on entities' impacts and impact management processes may well affect their decision-making, rendering the information material.

A consequence of this observation is that the information needs under a comprehensive and forward-looking financial materiality perspective overlap with the information needs under an impact materiality perspective to a greater extent than is sometimes believed. The relevance of impacts and impact management for sustaining long-term financial returns means the perceived dichotomy between impact and financial materiality and their associated information needs may be somewhat overstated, even if the starting point, usages and objectives under these materiality perspectives remain distinct.

This refined understanding of the information needs in sustainability reporting and sustainability-related financial disclosure is presented in Figure 3.

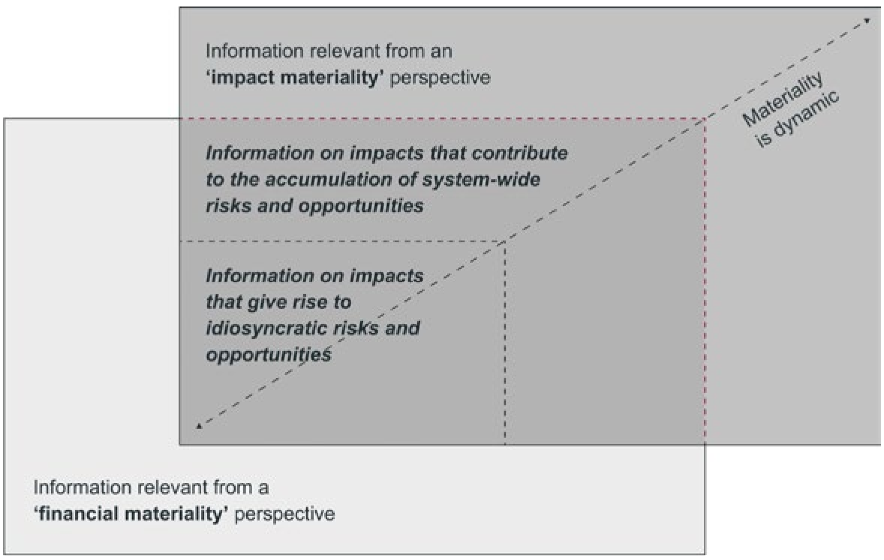


**Figure 3: A refined understanding of the impact-related information needs from a financial and impact materiality perspective**

It should be noted that the determination of what information is considered financially material differs by context and jurisdiction. There is a strong case to be made that information on entities' impacts on people and the natural environment is important to investors, and increasingly so, as they grapple with mitigating emerging system-wide risks in the social and environmental areas. In analysing laws around fiduciary duty around the world, the *Legal Framework for Impact* report came to the conclusion that asset owners and asset managers are likely to have a legal obligation to consider pursuing sustainability impact goals where doing so can contribute to achieving their investment objectives. Investors have called for more robust, comprehensive and comparable disclosures on entities' contributions to system-wide risks; a few such accounts are featured in Table 2 in the box below, which presents excerpts from responses to the ISSB's public consultation in 2022.

### The specific interest of institutional and universal asset owners in information on contributions to system-wide risks

Responses to the ISSB's draft consultation on its *General requirements* exposure draft in 2022 confirmed that asset owners and asset managers are interested in information that would enable them to measure, assess and act on their investees' contributions to system-wide risks. The responses in Table 2 also suggest that investors view this type of information as financially material. The lack of harmonised information on impacts (and on how these impacts are managed) stands in the way of these investors' ability to safeguard long-term value creation.

**Table 2: Selected excerpts of responses from asset owners, asset managers and banks on the ISSB S1 draft consultation that are indicative of investor interests in information on impacts and contributions to systemic risks**

| Respondent | Location | Citation |
|---|---|---|
| **HSBC Bank Pension Trust** | UK | "**…standards should facilitate an assessment by asset owners of the real world impact of corporate entities. If corporate entities are only obliged to disclose [on impact] where it is "significant" and "material"** then, when aggregated across an asset owner's portfolios, **there is possibly an unquantified and potentially substantial risk exposure.**" |
| **Ontario Teachers' Pension Plan** | Canada | "To fulfil our mandate to provide pensions to all generations of our members, **we need to act on systemic and global challenges** such as climate change, resource scarcity and social inequality. Relevant, comparable, and effective reporting on the sustainability performance of companies would facilitate the allocation of capital toward businesses that address these challenges and away from those that exacerbate our challenges." |
| **Amundi** | France | "Investors such as asset managers and their clients will want to be able to **consider material "impacts" of an entity on the people and the planet** "as such" and over time, **in addition to the impact on the enterprise value.**" |

| | | |
|---|---|---|
| **BNP Paribas Group** | France | "It is important to recognize that broadly diversified **investors use corporate disclosures for a variety of purposes, including to evaluate portfolio and economy-wide systemic risks, not solely risks to enterprise value.** Without an explicit requirement to disclose certain key external impacts, investors, policymakers—and issuers—will remain inadequately equipped to mitigate the most significant financial risks we face." |
| **Bank of America** | United States | "We acknowledge the need for a concept of materiality that encompasses an entity's impact on the environment and society as subsumed by the notion of long-term value creation" |

**Source:** IFRS Foundation, 2022, Exposure Draft and comment letters: General Sustainability-related Disclosures

# A need to better understand the relationship between impacts and system-wide risk

The existing evidence and knowledge base on the contributions of enterprises, investors and financial institutions to system-wide risks and opportunities remains incomplete. Modelling the relationship between impacts, environmental and social systems and economic and financial outcomes is challenging, given the complexity of these relationships and systems. While the relationship between climate change drivers (e.g. GHG emissions) and system-wide risk is well understood, this is not always the case for nature-related and social impacts. A 2003 OECD report on *Emerging Systemic Risks in the 21st Century*[16] noted that effective management of systemic risks requires going beyond traditional risk assessment approaches and should take into account the environmental, human, behavioural and social factors that affect the transmission and exposure to risks. Further multi-disciplinary and stakeholder informed evidence needs to shed more light on the linkages between business impacts, community and societal systems, as well as resulting risks and opportunities.

The difficulty of modelling and predicting systemic risks, however, should not stand in the way of the appropriate management of impacts. A holistic identification of sustainability topics and potential impact associations of the organisation is a first step in understanding what impact topics are relevant to manage. Adequately measuring, assessing and valuing impacts is equally necessary in determining the relative scope and magnitude of impacts. An assessment of the importance of these impacts to an entity can be done through valuation, which points to the need for embedding a systemic perspective within valuation methodologies.

In addition, in the context of materiality assessments for sustainability-related financial disclosures, enterprises need more guidance on how impacts contribute to the accumulation of system-wide risks, and on determining the financial materiality of information on different impacts. For an individual entity, it may be hard to discern the systemic significance of its impacts, which merits appropriate guidance on assessing the materiality of information on impacts with a systems perspective.

16 OECD, 2003, Emerging Risks in the 21st Century: An agenda for action, OECD Publishing.

# 3. Mainstreaming impact management

This paper has highlighted three key motivations for enterprises, investors and financial institutions to manage their impacts on people and the natural environment: to achieve sustainability and promote well-being, to manage idiosyncratic risks and opportunities, and to prevent the accumulation of system-wide risks and to contribute to system-wide opportunities.

It is therefore time for organisations to take impacts as the starting point in the consideration of sustainability issues and to embrace impact management. In doing so, organisations both contribute to and benefit from the stability and sustainability of societies and the natural environment. Continuing down the current path, where organisations focus on their sustainability-related risks without questioning their contributions to rising inequalities and ecological overshoot, will inevitably lead us to collectively face major environmental and social tipping points, the consequences of which will be costly. As such, impact management is not a “nice-to-have”, but a fundamental means to securing sustained economic and financial performance.

## The actions and fundamentals of impact management

A fundamentally different approach to the management of sustainability issues is necessary, one that takes identifying, understanding and addressing entities’ impacts as a starting point; in short, impact management. Mainstreaming impact management requires a robust common understanding of what impact management involves, as well as a complete, coherent and interoperable set of standards, guidance and tools for implementation.

The Partners of the Impact Management Platform, as the leading international providers of impact management resources, are coordinating efforts to improve how impact management serves different segments and sectors of the economy. A consensus view of impact management is emerging among the Partners, as set out in the *Actions of impact management*. The actions illustrate how enterprises, investors and financial institutions can systematically embed impact management into their entire business practice, and points to the relevant resources that can be used to perform each action. The exact execution of these actions may not be identical for all enterprises, investors and financial institutions, but they provide an overarching set of steps that are universally relevant.


**Figure 4:** **The Actions of Impact Management**[17]

Organisations may already carry out aspects of the actions for a sub-set of sustainability topics. This may be in an ad-hoc manner or according to a specific impact objective. However, a holistic approach to impact management, as portrayed in the actions, is needed to address both risks (idiosyncratic and system-wide) and opportunities, to achieve sustainability and to promote greater well-being.

Impact management is not in contradiction with other sustainability-related practices, such as ESG integration and sustainability risk management, among others. However, it goes beyond these, and thereby sets itself apart.

The fundamental characteristics of impact management are:

- **Taking action to, at a minimum, operate sustainably.** Striving to operate within sustainability thresholds, and taking action accordingly, is the minimum level of ambition associated with impact management. Deliberately contributing to solve environmental and social problems and to promote greater well-being is a further strategic objective associated with impact management. In sum, impact management implies that addressing negative impacts and creating positive impacts is part of the organisation's vision and/or purpose.
- **Holistic consideration of impacts.** People, society, nature and climate are intimately interconnected and interdependent. This means that impact management requires taking a holistic approach that considers all impacts that are potentially associated with an organisation and addresses all significant impacts.

17 Impact Management Platform, 2023

- **Consideration and engagement of stakeholders and affected parties.** Identifying, considering and, where possible and appropriate, directly involving those who are affected (stakeholders) is an integral part of the holistic approach and critical to ensuring accountability. Specifically, this can help determining what impacts may occur or have occurred, how important these are, how best to measure them, defining goals and strategy, and ensuring reported impact is a fair and true representation of reality.
- **Consideration of context.** Environmental and social needs and aspirations vary from one place to another. Impact management can only be effective if these contextual elements are properly understood and factored in from the start.
- **Integration across strategy, governance and activities.** An organisation can only address its negative impacts and maximise its positive impacts if impact management is embedded directly into an organisation's company strategy and governance, and across its activities. This includes adopting a level of quality checks and balances for impact management analogous to what is done for other aspects of business management.
- **An iterative and evidence-based process.** Addressing negative impacts and maximising positive impact can take time. Impact management involves understanding what works, through repeated measurement, assessment, monitoring and evaluation, and integrating learnings into organisational practices and policies.
- **Transparency on practice and performance.** Communicating information about impact performance and impact management processes with all relevant stakeholders is an essential feedback and accountability mechanism for impact management.

# The role of different actors in mainstreaming impact management

The widespread uptake of impact management is far from a reality. Despite the inherent interest that enterprises, investors and financial institutions have in managing system-wide risk, a coordination problem remains. System-wide risks tend to originate from "tragedy of the commons" and "tragedy of the horizon" type problems; situations where common resources are depleted as a result of individual actors' pursuit of their own, short-term interests without regard for the sustainability of the commons.[18,19] Enterprises and investors may face an apparent short-term trade off between financial returns and managing the environmental and social commons. All actors, including enterprises, investors and financial institutions, and governments, therefore have a role to play in mainstreaming impact management.

The following sections highlight the respective implications for and roles of various types of actors in the mainstreaming of impact management.

18 Hardin, 1968, *The Tragedy of the Commons*, Science.
19 Carney, 2015, *Breaking the tragedy of the horizon—climate change and financial stability*, Bank of England.

## The role of enterprises

Enterprises are very much exposed to the consequences of impacts, whether it is in the form of the deterioration of environmental assets and services, breakdowns of institutions and social contracts as a result of inequalities, or the damaging effects of extreme weather events associated with climate change. However, while enterprises are exposed to system-wide sustainability-related risks, they may have less of an incentive to manage their contributions to system-wide risks because of any asymmetries between the enterprises that cause the impacts and those who are affected by them. For this reason, many enterprises need signals from investors, consumers, policymakers and regulators to manage their contributions to system-wide risks.

Indeed, it is in the real economy that a large share of positive and negative impacts on people and the natural environment occur. The drivers of environmental and social impacts originate directly from the actions of enterprises. The widespread uptake of impact management by enterprises, whether voluntary or by pressure from investors or regulatory action is an absolute prerequisite for ensuring the sustainability of human and environmental systems.

Many enterprises already consider some of their impacts as part of their idiosyncratic risk management processes. There are also examples of enterprises that recognise the responsibility they play in addressing urgent social and environmental challenges, and the number of companies that choose to prioritise the attainment of certain impact objectives alongside financial objectives as their primary purpose appears to be growing.[20] However, given the critical role that enterprises have in mitigating negative and improving positive impacts, further mainstreaming of impact management by enterprises is critical.

## The role of investors and financial institutions

Due to the broad nature of their portfolio exposure and long investment horizons, large institutional investors, otherwise known as "universal owners", may be particularly interested in managing the contributions of their investee companies to such risks.[21,22] Evidence suggests that a large share of financial returns can be attributed to the performance of the market as a whole (or "beta"), as opposed to the excess returns of a specific investment relative to a market benchmark (or "alpha").[23,24] Because they can steer the real economy in the direction of addressing negative and generating positive impacts, investors play a critical role in mainstreaming impact management.

20 OECD, 2023, *Policy Guide on Legal Frameworks for the Social and Solidarity Economy*, OECD Publishing.

21 Quigley, 2020, *Universal Ownership in Practice: A Practical Investment Framework for Asset Owners*, Winner of Best Paper for Potential Impact on Sustainable Finance Practices, GRASFI 2020

22 In a 2011 report on Universal Ownership, UNEP FI and PRI recommended investors to evaluate the impacts of investee companies on natural resources as a way of preventing future long-term impacts on the financial value of their portfolios. See: UNEP FI & PRI, 2011, Universal Ownership – Why environmental externalities matter to institutional investors.

23 Hawley & Lukomnik, 2018, *The Long and Short of It: Are We Asking the Right Questions? Modern Portfolio Theory and Time Horizons, Seattle University Law Review.*

24 Ibbotson, 2010, *The Importance of Asset Allocation*, Financial Analysts Journal.

Among investors, the case for managing idiosyncratic environmental and social risks is now widely accepted. This is evidenced by the rise of ESG risk screening[25] and the adoption of well-established frameworks for sustainable finance, including the nearly 5,000 signatories of the PRI, representing USD 121.3 trillion of total assets under management in March 2022.[26] In addition, a growing number of investors are explicitly seeking positive impact objectives alongside financial return. The Global Impact Investing Network (GIIN) estimates that the worldwide impact investing market has surpassed USD 1.164 trillion in assets under management.[27]

At present, there is a need to direct all investors' and financial institutions' attention toward considering their contributions to system-wide risks and therefore the adoption of impact management. The PRI, UN Environment Programme Finance Initiative (UNEP FI) and UN Global Compact's vision on *Active Ownership 2.0* is rooted in the idea that investors need to address structural myopia and fully internalise their social and environmental externalities.[28] Indeed, the *Legal Framework for Impact* report noted that impact management is legally permitted and even a legal obligation in some jurisdictions. The report noted that impact management by investors can reduce risks and enhance the prospects of attaining both impact and financial objectives.[29] Some frameworks (in particular, the Principles for Responsible Banking, which follows UNEP FI's report on *Rethinking Impact to Finance the SDGs*[30] *and* UN Development Programme's *SDG Impact Standards for Private Equity Funds and Bond Issuers* go beyond risk management to impact management.

## The role of governments and regulators

Governments have a major incentive to encourage and enable impact management, given that impact management by enterprises, investors and financial institutions is a critical lever to achieve social and environmental policy objectives, including the SDGs. As stated, while organisations have an inherent interest in managing their impacts, actions by governments remain indispensable to encouraging and enabling organisations to operate sustainably and contribute to solutions. International agreements such as the *Paris Agreement*, the *Kunming-Montreal Global Biodiversity Framework* and the World Health Organization (WHO's) *Pandemic Preparedness Treaty* set the tone for policy directions, but policy coherence and clear expectations for all types of organisations are critical.

Governments can contribute to the mainstreaming of impact management in a number of ways:

### Environmental, social and economic policy

National (and international) legislation affect the management of specific impacts in areas ranging from environmental protection and climate change to wages and occupational health and safety. Laws and governmental standards can directly and indirectly steer organisations in the direction of impact management. Examples include standards on food quality, chemicals,

25 See for example: OECD, 2020, OECD Business and Finance Outlook 2020: Sustainable and Resilient Finance, OECD Publishing, Paris.
26 PRI, 2022, 2021/2022 Annual Report.
27 Dean Hand, Ben Ringel, and Alexander Danel, *Sizing the Impact Investing Market 2022* New York: GIIN, Octboer 2022, https://thegiin.org/research/publication/impact-investing-market-size-2022/.
28 PRI, et al., 2019, Active Ownership 2.0: The evolution stewardship urgently needs
29 Freshfield Bruckhaus Deringer; PRI; UNEP FI; The Generation Foundation, 2021, *A Legal Framework for Impact*.
30 UNEP FI, 2018, *Rethinking Impact to Finance the SDGs: A Position Paper and Call to Action prepared by the Positive Impact Initiative*.

waste management, or statutory minimum wages. However, policies can also steer organisations away from the management of certain impacts. In 2021, fossil fuel subsidies of 51 major economies worldwide skyrocketed to USD 1 trillion, by far the largest value on record and up from USD 362.4 billion in 2020.[31] Such policies work squarely against the management of negative impacts on climate stability. Policy coherence is necessary for sustainable development, and it is critical to provide consistent signals to enterprises, investors and financial institutions.

Governments can also play a role in encouraging the generation of positive impacts in other ways. Policies that encourage the development of enterprises and investors with a sustainability focus include accommodating fiscal policies, contributing to market development, access to capital and financial incentives, leveraging procurement policies, offering business development services, capacity building and support structures. Such policies can contribute to enacting a paradigm shift towards generating positive impacts.[32,33]

**Setting ambitious standards on responsible business conduct and corporate governance**

Existing international standards, such as the UN *Guiding Principles on Business and Human Rights*, the OECD *Guidelines on Multinational Enterprises*, and the International Labour Organisation (ILO) *Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy,* already set minimum expectations on the management of adverse impacts by enterprises. Some jurisdictions are increasingly considering how to embed expectations on risk-based due diligence into law. Such standards and legislation contribute to the management of adverse impacts, specifically by enterprises. Laws and standards around corporate governance can also encourage companies to focus on long-term sustainable value creation. The potential of such instruments to further impact management in its full sense should be fully exploited.

**Enabling impact transparency and accountability through legislation of sustainability-related disclosures**

The implementation of mandatory sustainability reporting requirements can facilitate greater transparency on impacts, allowing investors, consumers, and other stakeholders to adjust their decisions based on enterprise impacts. Various jurisdictions and standard-setting bodies, including the European Union, US Securities and Exchange Commission and ISSB, are in the process of developing sustainability-related disclosures. Information on impacts and impact management already features centrally in some standards, such as those by the Global Reporting Initiative (GRI), and will also feature in the EU's standards. However, as highlighted in this piece, some information on impact and impact management may also be relevant for those standard-setters and jurisdictions focussed exclusively on financially material information.

31 IEA, 2023, *Fossil Fuels Consumption Subsidies 2022*, IEA, Paris.

32 OECD & EU, 2017, Boosting Social Enterprise Development: Good Practice Compendium, Local Economic and Employment Development (LEED), OECD Publishing.

33 Giddens, et al., 2018, *Catalysing an Impact Investment Ecosystem—A Policymaker's Toolkit*, GSGII.

# 4. The road ahead

This thought piece has highlighted that the mainstreaming of impact management is not only an environmental and human necessity, but also an economic and financial imperative. It identifies the implications for and role of a range of players to achieve this. These implications are embodied by the following calls for action, which lay out the necessary steps that various actors should take to contribute to the mainstreaming of impact management.

## A call to action

- **Enterprises, investors and financial institutions should adopt impact management in order to operate sustainably, increase well-being, and mitigate idiosyncratic and system-wide risks.** For this, enterprises, investors and financial institutions need to take a holistic and systematic approach to the management of environmental and social impacts, including the mitigation of negative and generation of positive impacts.

- **Governments should encourage and enable the mainstreaming of impact management in order to achieve global policy objectives, including the Paris Agreement, the Kunming-Montreal Global Biodiversity Framework, and the 2030 Agenda.** Governments have a critical role to play in encouraging impact management and coordinating the management of our shared environmental and human resources, or our global commons. They can do this by mandating responsible business conduct and transparency on impacts and impact management, as well as by developing and enforcing broader legal and policy frameworks on environmental and social issues.

- **Standard-setters and international organisations providing impact management resources should collaborate towards a complete and coherent system of standards and resources.** Impact management is a multi-faceted and complex emerging practice, and there are numerous norms and resources to guide its implementation. In order to enable the mainstreaming of impact management, standard-setters and international organisations have a responsibility to ensure that this system of standards and resources is complete, coherent and interoperable.

- **Because information on impacts and impact management may be financially material, standard-setters and policymakers should appropriately recommend the disclosure of this information.** The market's fundamental reliance on environmental and social systems implies that information on entities' contributions to system-wide risks and opportunities and the management thereof may be financially material in sustainability-related financial disclosures.

# Building a consensus view of impact management

In order for different actors to contribute to improved environmental and social outcomes, and play their role in mainstreaming impact management, there is a need to arrive at a common understanding of impact management, and to establish an interoperable and coherent system of the related norms and resources.

Through their unique collaboration as the leading standard-setters and international organisations, the Partners of the Impact Management Platform ("Platform") are committed to spearheading the delivery of complete and coherent system of norms and resources for impact management. To do so, they will draw on their own wealth of expertise and practitioner networks, but also invite the growing body of like-minded initiatives that understand that only system-level collaboration can address the challenges we face. The Platform's work programme revolves around three core components that are outlined below

## Clarifying the concept and practice of impact management

The mainstreaming of impact management requires greater clarity on what impact management consists of, as well as how it differs and/or builds on other sustainability-related practices such as sustainability risk management and ESG integration. The Partners will continue to iterate the *Actions of impact management* (a consensus view of impact management), and provide clarity on the frameworks, resources and guidance that organisations can use to manage their impacts.

## Driving interoperability and coherence across resources

Interoperability and complementarity between international public good standards, guidance and tools is critical. As the practice of impact management continues to mature, so do these standards and resources. The Partners are united around a shared effort to enable interoperability and coherence, including by:

- Agreeing *key terms and concepts* to provide clarity and strive towards harmonisation on the use of key terms and concepts;
- Mapping and providing *clarity on the nomenclature of sustainability topics;*
- Mapping *sector nomenclatures and classifications* and making these fit for purpose for impact management; and
- Using the Platform's System map to identify areas of potential harmonisation and gap-filling among their existing and pipeline content.

## Informing and engaging standard-setters and policymakers

As seen in the previous section, governments have a critical role to play in mainstreaming impact management. Based on their work on clarification, interoperability and system coherence, the Partners aspire to engage with and inform governments and policymakers, and to act as a source of inspiration on how to embed impact management into policy and regulation.

By committing to this joint effort, the Partners are working to unite all enterprises, investors and financial institutions, as well as standard-setters and policymakers, around a set of objectives that ensure people's well-being and the liveability of the planet, both for their own sake and as the only possible foundation for future prosperity.

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IMPACT MANAGEMENT PLATFORM

The Impact Management Platform is a collaboration between the leading providers of sustainability standards and guidance that are coordinating efforts to mainstream the practice of impact management.

These Partners are working together to identify opportunities to consolidate existing sustainability resources, collectively address gaps, and coordinate with policymakers and regulators.



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