Double Materiality Assessment: Fostering sustainable business practices

Foreword Summary:

A Double Materiality Assessment represents a pioneering approach in corporate sustainability strategies, offering a comprehensive framework to evaluate **environmental, social, and economic impacts** in a dynamic business landscape. Unlike traditional assessments that focus solely on a company's direct operational impacts, a Double Materiality Assessment expands the scope by concurrently considering the **external environment's influence on the organization** and the **organization's impact on the external environment**. This dual perspective encompasses not only the risks and opportunities posed by the company's operations but also the broader **social** and **environmental factors** that, in turn, affect the company's **viability and resilience**.

Embracing a **Double Materiality Assessment** is not merely a compliance exercise but a strategic imperative for businesses aspiring to thrive in an era where **sustainability** is integral to corporate success. By integrating a forward-looking, dual-materiality perspective into decision-making processes, companies can fortify their resilience, enhance stakeholder trust, and position themselves as responsible stewards in a world where economic, environmental, and social considerations are inseparable components of sustainable business practices. **At Nalba Advisors**, we navigate alongside businesses in an an ever-evolving landscape of expectations and challenges where the **Double Materiality Assessment** emerges as a transformative tool that not only measures impact but shapes a roadmap toward a sustainable and resilient future.

Context:

In recent years, there has been an increase in regulation involving sustainability practices and reporting across Europe and Spain:

Evolution of ESG-related regulation

- 2016 – Europe ratifies the Paris Accord
- 2017 – Task Force on Climate-Related Disclosures (TCFD)
- 2018 – Action Plan on Sustainable Finance
- 2019 – European Green Deal
- 2020 – EU Green Taxonomy
- 2021 – Spanish Climate Change and Energy Transition Law (Pending)
- 2022 – European Banking Authority (EBA) Pillar III
- 2023 – Non-Financial Reporting Directive (NFRD)
- 2024 – Corporate Sustainability Reporting Directive (CSRD)

The application of a **Double Materiality Assessment has been a mandatory first step** under the Corporate Sustainability Reporting Directive (CSRD) in order to achieve compliance. Although there is no specific method to perform a Double Materiality Assessment, the European Sustainability Reporting Standards (ESRS) provide a good starting point setting out a list of topics in which companies should report on.

The two types of materiality considered are **Impact Materiality** and **Financial Materiality**:

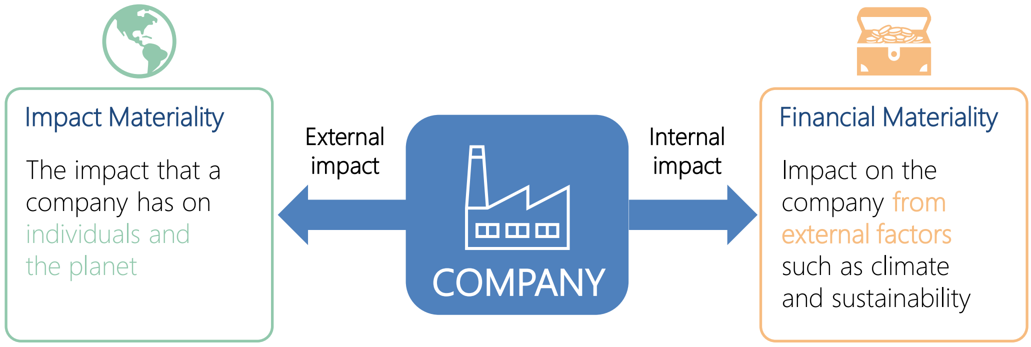
Impact Materiality refers to the external effects and consequences (positive and negative) that a company's actions and their value chain may have on the short, medium and long-run on individuals and the environment.

NALBA´s view:

A shift towards sustainable practices has been happening for businesses across Spain and Europe, caused by both regulatory requirements and the demands of individuals and businesses.

This has caused corporations to shift their focus inwards and analyse the impact their business has on individuals and the planet. **Double Materiality Assessments along with Risk Assessments and Sustainability Strategy plans have set the initial steps towards achieving verifiable sustainable practices benefitting internal and external stakeholders.**

Financial Materiality refers to the consequences that external factors or events may have on a company's financial performance. These factors could be related to the company itself or the value chain that may in turn influence the company.



The **European Sustainability Reporting Standards (ESRS)** has established a set of datapoints for different sub-topics defined in the **Environmental**, **Social** and **Governance** pillars that have helped businesses create a pathway to a more precise reporting, implementing reporting mechanisms with the same rigorous tools to disclose their non-financial performance:

ESRS pillars & topics

ENVIRONMENTAL

1. Climate Change
2. Pollution
3. Water & Marine Resources
4. Biodiversity & Ecosystems
5. Resource use and Circular Economy

SOCIAL

1. Own workforce
2. Workers in the value chain
3. Affected communities
4. Consumers and end-users

GOVERNANCE

1. Business conduct

> *"I am convinced that the old growth-model that is based on fossil-fuels and pollution is out of date, and it is out of touch with our planet. The European Green Deal is our new growth strategy – it is a strategy for growth that gives more back than it takes away."*
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> *- Ursula von der Leyen, 2019*

Why do companies need to perform a Double Materiality Assessment?

When performing a Double Materiality Assessment, companies should look beyond the short-run and avoid a short-sighted approach, instead they shall look at medium and long-run impacts and consider the impact on individuals and the planet that their actions and those of their value chain may have.

A well-executed Double Materiality Assessment will provide undertakings with clear and concise ESG-related strengths and opportunities to consider in their strategic planning as well as their risks management. The insights provided by performing a Double Materiality Assessment can yield a better reputation among stakeholders, end-users, investors, and peers.

Conducting a Double Materiality Assessment also serves as a crucial initial measure for attaining compliance with the CSRD, It empowers companies within the scope to pinpoint the specific disclosure obligations outlined in the ESRS that are relevant to their operations..

It is crucial for companies to keep in mind that this assessment is not only a way for them to reflect on how their actions and policies affect individuals and the environment, but the other way around as well, how environmental, social and governance issues may pose a threat to the company's financial position or that of their value-chain.

Overall, businesses can greatly benefit from performing a Double Materiality Assessment and be more understanding of how their business interacts with the outside while tackling their areas of opportunity with more precise actions and attainable goals. In doing this, they will also have a more efficient way of reporting their non-financials to regulators and supervisory bodies, attracting more conscious external stakeholders pursing a greater sense of purpose in their business relationships.

How to perform a Double Materiality Assessment?

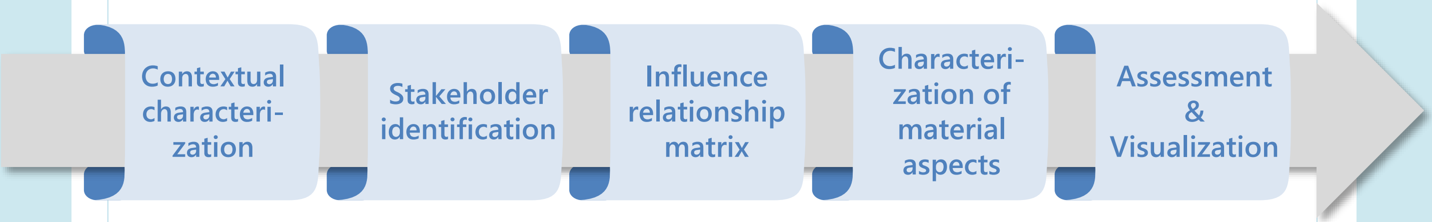
Although there is not a one-size-fits-all approach, **businesses have done things in a similar way** to what their peers have tried to set as unofficial guidelines. In many cases, businesses follow the same approach where after identifying a massive set of groups of interests, the same survey is sent to all the interest groups. This approach, however, can **yield bogus or unconclusive results**, as not all the stakeholders will take the proper time to make an insightful response to all the different topics and not all topics are material to all interest groups.

At **Nalba Advisors**, we work closely with businesses and institutions to get a **general perspective of the different internal and external stakeholders**, interest groups and others who may be materially impacted by their activities and the other way around. Once we have a robust and defined list of the interest groups, we proceed to define the **set of topics based on the ESRS standards** and provide a **tailor-made process of analysis for every business** based on their **industry, size, geography as well as the national and regional regulations.**

While working with the undertakings, we work with **specialists from different departments in workshops** where we provide guidance on how to properly define the **relevance of each topic** to **every interest group individually** to properly define if there is influence both from an outward and inward perspective. Afterwards, we define a **scale and a scope on each of the relevant influences** to **properly define the impact** and the **subsequent policies and actions to be implemented** by the undertaking to determine the **actions and goals** that can **aid the company in ameliorating or eradicating the negative impacts and enhance the positive influence they have**.

When conducting the analysis of a Double Materiality process, **we at Nalba consider five crucial steps:**

<u>Nalba's double materiality 5 crucial steps:</u>



1. Contextual characterization

- Identification of corporate risks such as PESTLE (Political, economic, social, technological, legal and environmental), this helps detect specific current and potential risks that may not be present across all industries or geographies, providing a broader view.

2. Stakeholder identification

- Pinpoint all possible internal and external stakeholders and classify them into large groups to later granularize them to greater detail.

3. Influence relationship matrix

- Outward influence from the company to its stakeholders.
- Influence over the financial performance and/or solvency of the company from stakeholders.

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4. Characterization of material aspects

- Assessment of magnitude and criticality in different time horizons of the aspects identified in the influence relationship matrix

5. Assessment of material issues and visualization of results

- Provide a clear and visual representation or all material aspects to fully comprehend the urgency and impact each may have on and from the company. This will help design a precise set of actions to be implemented that will in turn enhance positive impacts and mitigating negative impacts and potential risks.

What makes a good Double Materiality Assessment?

As it was previously mentioned, there is no specific set or rules on how to conduct a Double Materiality Assessment, however, the result should aim towards the same objective: a clear view of the highly relevant material aspects of a company which can in turn help when elaborating its sustainability strategy plan.

Key elements of a well-executed assessment include:

- Comprehensive ESG Factor Analysis: Identifying and evaluating a wide range of ESG factors, preferably following reporting standards such as ESRS. This should be done with an understanding of how these factors affect the company's financial performance and vice versa.
- Risk and Opportunity Assessment: Evaluate how ESG factors can pose risks or create opportunities for the company. This includes both direct impacts such as regulatory fines for non-compliance and indirect impacts such as reputational damage.
- Scenario Analysis: Using a scenario analysis to understand the potential impacts of different future states, such as a low-carbon economy or increased regulation on the company and its stakeholders, this will help implement actions around the new scenarios, identifying new potential strategies.
- Integration into Strategy and Reporting: Integration of findings into the company's strategy, decision-making processes, and sustainability reporting. This ensures that the insights from the assessment are actively used to improve the company's sustainability & business performance.
- Continuous Monitoring and Review: A good materiality assessment shall be regularly monitored and reviewed to ensure it remains up-to-date with emerging trends, new regulations, and changing interest groups' expectations.
- Transparency and Communication: Sharing the results of the assessment clearly and transparently to all stakeholders, explaining how the findings are being used to inform the company's strategies and operations. This yields a higher value, as it may not only have an impact on the company, but also among the market and its competitors.
- Alignment with standards and Frameworks: Align the assessment with relevant standards and frameworks such as ESRS, the Global Reporting Initiative (GRI), and the TCFD to ensure consistency and comparability of the data.

Implementing a robust double materiality assessment helps companies identify and manage ESG risks and opportunities more effectively, leading to improved sustainability performance and better long-term financial stability.

Conclusions:

As a consequence of the evolving increases in sustainability-related regulations and disclosure requirements, businesses must engage in the development and integration of Double Materiality Assessments to not only fulfil said requirements, but also identify any possible gaps in their most important ESG-relevant issues and provide a new insight in their business for internal and external shareholders.

Being the cornerstone for the identification of ESG impacts, risks and opportunities, the Double Materiality Assessment can provide businesses and decision-makers with the proper guidance for implementing effective sustainability strategies and practices. It is crucial for businesses in today's continuous and highly-regulated environment to be guided on their path by professionals who speak the sustainability language and are able to pave the way for businesses to perform a clear and concise materiality assessment that can help them establish initiatives and strategies while helping them take the initial steps in sustainability disclosures.

Nalba Advisors, as a boutique specializing in ESG, backed by professionals with over two decades of experience in the financial and sustainability sector, stands as the ideal partner to drive these competitive initiatives forward and reach a more sustainable frontier.

*At **Nalba Advisors**, we're dedicated to guiding out clients towards success and securing their position as industry leaders. With our expert services in ESG, we're here to help you realize and update your vision...*

...are you ready to embark on this journey with us?

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