EUROSIF RESPONSE TO THE EUROPEAN COMMISSION'S CONSULTATION ON THE FIRST SET OF EUROPEAN SUSTAINABILITY REPORTING STANDARDS

7 JULY 2023

General comments

High-quality, comparable, and reliable corporate sustainability-related disclosures are a cornerstone of the EU sustainable finance framework. Investors and other financial market participants have been calling for improved availability of ESG data for years.

Therefore, Eurosif is deeply concerned by the latest changes introduced by the European Commission (EC) to the draft Delegated Act (DA), including the cross-cutting and sector-agnostic European Sustainability Reporting Standards (ESRS), which significantly reduce the ambition of the standards as compared to the technical advice of November 2022.

EFRAG's final recommendations are a result of a **lengthy and rigorous due process and represent a compromise across a wide range of European stakeholders** within all relevant EFRAG bodies (Sustainability Reporting Board and Technical Expert Group). This includes representatives of companies (preparers), investors, other financial market participants and civil society. Following a public consultation during the summer last year, **EFRAG proposals for this first set of standards were already reduced nearly by half, with the number of data points reduced by 47% as compared to the initial EFRAG proposals**.

Following strict due-process rules, EFRAG delivered a first set of standards which stroke the right balance addressing the needs of different stakeholders and the objective of the corporate sustainability reporting **which is to improve availability, quality, comparability, and reliability of corporate ESG disclosures.** The latest substantial modifications applied to these standards by the EC distort this carefully struck compromise, to the detriment of investors, the financial industry, and other stakeholders calling for improved sustainability disclosures. **Following through on these changes would hamper the effectiveness of the Corporate Sustainability Reporting Directive (CSRD) as well as the implementation and coherence of the EU sustainable finance framework.**

Eurosif, jointly with PRI, IIGCC, EFAMA, UNEP FI and 93 investors and other financial market participants across Europe, call on the European Commission to review its draft Delegated Act. In particular, Eurosif considers crucial that the ESRS:

- **Consider as always material, the key environmental and social disclosures** necessary to comply with the SFDR, the Benchmark Regulation and Climate Benchmark Delegated Acts, as well as Pillar 3 disclosure requirements.

- **Consider as always material, the key climate disclosure indicators and topics**, including Scope 1, 2, and 3 GHG emissions, climate targets and transition plans.
- Require **explanations in case a sustainability topic is not deemed material.**
- **Reconsider the voluntary nature of disclosures on biodiversity and own-workforce** that would not be covered in the first point above, and require they are subject to materiality assessments.

Eurosif also regrets that the disclosures on diversity policies regarding ethnicity, age, minority or vulnerable group, and educational and professional backgrounds, which are relevant from the social justice perspective and considered by an increasing number of investors, **are not covered in the final first set of ESRS.** This contradicts the objectives of the European Union reflected in existing legislation on equality in the workplace[1]. Improved availability and quality of diversity-related disclosures is important for a just climate transition.

Eurosif's consultation response reflects **the concerns and perspectives of the responsible investors' community which is committed to implement an ambitious sustainable finance framework in the EU.** Sufficiently ambitious, comparable and reliable corporate reporting on sustainability-related risks, opportunities and impact is essential to enable investors to make informed investment decisions, comply with their own sustainable finance rules, and enable sustainable finance to support the transition towards a sustainable economy.

Specific comments on the main text of the draft Delegated Act

Eurosif expresses its deep concerns regarding the changes proposed by the European Commission on the technical advice delivered by EFRAG in November 2022, as they considerably reduce the level of ambition necessary to achieve a sustainable transition and meet the objectives of the European Green Deal.

Relevance of materiality assessments

Our most pressing concern with the current draft DA making all disclosure requirements, except for ESRS 2, subject to a materiality assessment is that, in practice, this would enable reporting undertakings to omit the entirety or part of sustainability topics or data points with limited transparency as to why they do not deem them material.

As recognised by the EU co-legislators in case of the Sustainable Finance Disclosure Regulation (SFDR) as well as by EFRAG, certain sustainability matters are inherently material to all companies regardless of sector, activity, or size. Reporting on e.g. climate change (including GHG scope 1, 2 and 3 emissions and transition plans) should be mandatory and not subject to a materiality assessment. This would have to be accompanied by EU level efforts to ensure that scope 3 GHG emissions are consistently measured and assessed. **Requiring a set of core indicators as always material would**

[1] Directive 200/43/EC implementing the principle of equal treatment between persons irrespective of racial or ethnic origin and Directive 200/78/EC establishing a general framework for equal treatment in employment and education.

indeed result in more complete and consistent disclosure, enabling investors to make informed investments decision and comply with their own sustainability-related rules. This is especially the case for companies whose securities are allowed to trade on regulated markets, in view of the increasing sustainability risks and their implications for the protection of investors, who are also showing a growing interest in the impacts of investment decisions.

It can also be questioned whether the latest Commission changes are in line with the requirements of the CSRD, which specifies that the ESRS should "*at least include the information*" necessary for financial market participants to comply with SFDR and "*take account*" of the information they also need to comply with the Benchmark Regulation and its Delegated Regulation on Climate Benchmarks, as well as for complying with Pillar 3 requirements. **To ensure consistency with the CSRD and the overall EU sustainable finance framework, the ESRS should mandate reporting on the relevant environmental and social indicators required under SFDR, EU Benchmark Regulation and Climate Benchmarks Delegated Acts, and Pillar 3 disclosures.** The remaining indicators on biodiversity and own-workforce that would not be covered in these regulations should be submitted to materiality assessment and not be considered voluntary (see below).

<u>Verification of materiality assessments</u>

We understand the EC trusts companies to perform and follow a robust and reliable materiality assessment, as well as the auditors' verification of such process. However, the reality is much more complex, and materiality assessment is a burdensome and costly process, with results which are often not clear cut. **Making some disclosure requirements mandatory could de facto simplify the reporting process and lighten the administrative burdens for companies, especially smaller ones.**

- The EC must consider the fact that **the concept of double materiality is relatively new**, and implementation and expertise on the related reporting are still not highly developed. This underdeveloped expertise is also present at assurance/verification level. There is a risk auditors may not fully capture the relevance of materiality assessments regarding certain topics. **For those reasons, setting key disclosure requirements as mandatory would level the reporting practices of European undertakings while fostering consistency and comparability**. By having mandatory disclosure requirements, verification of the reported information will be more accurate and effective.

- **Keeping key mandatory disclosure requirements as mandatory can decrease the reporting burden on companies**. Given the extensive range of topics and sub-topics, carrying out materiality assessments can be a costly process for the reporting undertaking, as companies usually use the help of external consultants to conduct their materiality assessment. By establishing some key disclosure requirements as mandatory, the EC would limit the number of disclosures subjected to materiality assessment and the associated costs and simplify the reporting landscape which would especially be beneficial for smaller companies.

<u>Voluntary disclosures</u>

Eurosif is also concerned by the proposal of the EC of making additional disclosure requirements voluntary regardless of the result of their materiality assessment. According to the EC's proposal, disclosures on biodiversity transition plans, as well as on certain information regarding own-workforce, would be fully voluntary. Additionally, the explanations on why certain topics are not deemed material are no longer required, which would prevent understanding and verifying the rationale behind this decision.

However, **biodiversity and social topics are acquiring considerable relevance amongst investors**, and should not be reported only on a voluntary basis:

- Biodiversity is highly interconnected with climate, as most of the risks, opportunities, and impacts arising from or affecting climate also have implications for biodiversity and ecosystems. Therefore, disclosures on biodiversity are essential to capture a more accurate picture of the overall environmental performance of the investee company. Information on biodiversity is also relevant for investors to assess companies' strategies and business models alignment with the EU Biodiversity Strategy for 2030 and the Global Biodiversity Framework.

- Social topics are essential to ensure a just transition towards sustainability, which is one of the main ambitions of the European Union in the context of the Green Deal. Investors are increasingly interested in contributing to a positive social impact, promoting investments through the justice, equity, diversity, and inclusion lens or at least avoiding harm.

We also regret that the disclosures on diversity policies regarding ethnicity, age, minority or vulnerable group, and educational and professional backgrounds, which are relevant from the social justice perspective and considered by an increasing number of investors, **are not covered in the standards**, even though they were included in the initial EFRAG proposals of April 2022. This is contrary to the objectives of the European Union reflected in existing legislation on equality in the workplace[2]. Increased availability and quality of data in these topics would enable to better identify and effectively address any discrimination trends in the workplace and improve the inclusion and diversity policies and actions. Improved availability and quality of diversity-related disclosures is important for a just climate transition.

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The European Commission is now presented with a final opportunity to find a compromise that would truly reflect all industry and stakeholders' needs and better match the ambition of EU climate neutrality targets and the EU Green Deal. We acknowledge the implementation challenges of ESRS and hence recognise that a reasonably phased-in approach might be necessary for their application.

At the same time, together with EFAMA, PRI, IIGCC, EFAMA, UNEP FI and 93 signatories across Europe, Eurosif calls for the European Commission to review its draft Delegated Act.

In particular, Eurosif calls for the ESRS to:

- **Consider as always material, the key environmental and social disclosures** necessary to comply with the SFDR, the Benchmark Regulation and Climate Benchmark Delegated Acts, as well as Pillar 3 disclosure requirements.

[2] Directive 200/43/EC implementing the principle of equal treatment between persons irrespective of racial or ethnic origin and Directive 200/78/EC establishing a general framework for equal treatment in employment and education.

- **Consider as always material, the key climate disclosure indicators and topics**, including Scope 1, 2, and 3 GHG emissions, climate targets and transition plans.
- Require **explanations in case a sustainability topic is not deemed material**.
- **Reconsider the voluntary nature of disclosures on biodiversity and own-workforce** that would not be covered in the first point above, and require they are subject to materiality assessments.

Eurosif also calls for including disclosure requirements on diversity policies regarding ethnicity, age, minority or vulnerable group, and educational and professional backgrounds, which are important for a just climate transition.

Specific comments on Annex I

Standard	**Paragraph or AR number or appendix**	**Comment**
ESRS 1	*Para 29*	Should remain as drafted by EFRAG in its technical advice. Disclosures included in ESRS E1, ESRS S1, and additional indicators should also be mandatory.
ESRS 1	*Para 57*	Should remain as drafted by EFRAG in its technical advice. Brief explanation in case of a topic being assessed as not material should be mandatory.
ESRS 1	*Appendix C*	Should remain as drafted by EFRAG in its technical advice. Additional phase-ins introduced by the EC should be deleted.
ESRS 2	*Appendix C*	SBM-3 should also include ERS E4 – Biodiversity
ESRS E4	DR E4-1	Should remain as drafted by EFRAG in its technical advice. Disclosure of biodiversity transition plan should be mandatory.
ESRS S1	DR S1-7	Should remain as drafted by EFRAG. Disclosure of characteristics of non-employee workers in the undertaking's own workforce should be mandatory.