European Banking Federation
Response to the EFRAG consultation survey
1A. Overall ESRS Exposure Drafts relevance – Architecture

5 August 2022

CONSULTATION SURVEY

DRAFT EUROPEAN SUSTAINABILITY REPORTING STANDARDS

1A. Overall ESRS exposure Drafts relevance
- Architecture

April 2022

Open for comments until 8 August 2022

PTF-ESRS
Project Task Force on European sustainability reporting standards

EFRAG

1A. Overall ESRS Exposure Drafts' relevance – Architecture

Cross-cutting and topical standards

To facilitate a coherent coverage of the CSRD topics and reporting areas (as per Article 19a paragraph 2 and Article 19b paragraph 2 – see Appendix II) the Exposure Drafts ("EDs") submitted for public consultation are based upon two categories of standards:

- **Cross-cutting ESRS** which:
  - i) Establish the general principles to be followed when preparing sustainability reporting in line with the CSRD provisions;
  - ii) Mandate disclosure requirements ("DRs") aimed at providing an understanding of (a) strategy and business model, (b) governance and organisation, and (c) materiality assessment, covering all topics.
- **Topical ESRS** which, from a sector-agnostic perspective:
  - i) Provide topic-specific application guidance in relation to the cross-cutting DRs on strategy and business model, governance, materiality assessment;
  - ii) Mandate DRs about the undertaking's implementation of its sustainability-related objectives (i.e. on its policies, targets, actions and action plans, and allocation of resources);
  - iii) Mandate performance measurement metrics.

A full list of standards and whether they are cross-cutting standards or topical standards can be found in Appendix I.

Q1: in your opinion, to what extent do the structure and articulation of cross-cutting and topical standards adequately support the coverage of CSRD topics and reporting areas?

1/ Not at all 2/ To a limited extent with strong reservations, 3/ To a large extent with some reservations 4/ Fully 5/ No opinion

Please explain your reservations or your suggestions for improvement or any other comment you might have

While EFRAG has envisioned a structure and articulation of cross-cutting and topical standards which support the coverage of CSRD topics and reporting areas, there are concerns that the draft standards may be too extensive, complex and lack prioritisation.

More precisely, the topic of corporate due diligence is addressed under multiple standards, i.e., ESRS 2, G1, and G2. Although the ESRS 2 intends to target the governance of sustainability, while G1 and G2 consider governance more broadly, in practice there will likely be an overlap between reporting under the three standards. In addition, there is an overlap between the disclosure requirements under G1 and requirements stemming from the existing Accounting Directive. For those entities reporting under the latter, it should be possible to reference the corporate governance statement as to avoid the duplication of disclosure requirements.

Alignment and interoperability with international standards and frameworks

CSRD Article 19b paragraph 3a requires that "When adopting delegated acts pursuant to paragraph 1, the Commission shall take account of the work of global standard-setting initiatives for sustainability reporting, and existing standards and frameworks for natural capital accounting, responsible business conduct, corporate social responsibility, and sustainable development."

ESRS EDs were drafted accordingly, with the objective of fostering as much alignment as possible considering the constraints imposed by other provisions included in articles 19a and 19b as per the CSRD proposal. Details of these provisions and how they are covered by the ESRS EDs can be found in Appendix I.

The structure and organisation of the reporting areas was one aspect of alignment to which particular attention was paid. Thus, the two categories of standards are organised to cover the reporting areas in relation to governance, strategy, assessment/management of impacts, risks and opportunities, and targets/metrics (as considered by the TCFD and source of inspiration for the IFRS Sustainability standards). A detailed mapping of the ESRS EDs disclosure requirements with TCFD recommendations and with IFRS Sustainability Exposure Drafts can be found in Appendices 5 and 6.

Q2: in your opinion, to what extent is the TCFD framework of reporting areas (governance, strategy, risk management and metrics/targets) compatible with the structure of the ESRS?
1/ Not at all 2/ To a limited extent with strong reservations, 3/ To a large extent with some reservations 4/ Fully 5/ No opinion

Please explain your reservations or your suggestions for improvement or any other comment you might have

We appreciate the compatibility (in terms of content) between the ESRS and the TCFD. However, it is worth noting that the structures of the ESRS and TCFD differ. (Such difference, therefore, also exists between the ISSB standard and the ESRS, as the former has proposed a standard based on the four pillars of the TCFD, while the latter has inherited the structure of the NFRD (strategy, implementation, and performance measures). As a result of these diverging approaches, data collection may be more difficult, and analysts may need more time to reconcile disclosures. The main difficulty will stem from the lack of a specific pillar in the ESRS for "risk management" and "(metrics and) targets", which is instead addressed across the various Rds.'

Finally, we would also see benefit in adopting a similar approach of alignment between the biodiversity standard and the upcoming final TNFD.

Q3: in your opinion, to what extent does the approach taken to structure the reporting areas promote interoperability between the ESRS and the IFRS Sustainability Exposure Drafts?

1/ Not at all 2/ To a limited extent with strong reservations, 3/ To a large extent with some reservations 4/ Fully 5/ No opinion

Please explain your reservations or your suggestions for improvement or any other comment you might have

Taking the international dimension into account is crucial. While we support the ESRS EDs proposal for disclosure standards that go beyond those covered by the ISSB, to avoid unclarity both for preparers and users of sustainability reports, it is essential that EFRAG continues adopting a co-building approach with the ISSB to ensure interoperability. This approach should lead to the identification of common core standards which are complemented by clearly identified additional EU specific sustainability disclosure requirements (i.e., those not covered by the ISSB). Investors often operate internationally and, therefore, clearly highlighting the differences and common aspects between the two standards is needed to avoid confusion and complexity. This could be achieved only through a clear structure of the information (making it easier to compare EFRAG and ISSB disclosures). In particular, the duplication of reporting should be absolutely avoided by adopting a structure that allows stakeholders to clearly identify the disclosure requirements under the EFRAG standard that overlap with ISSB disclosure requirements. Moreover, **when reporting under the EFRAG standard, it should not be required to also report under the ISSB standard** as the former provides further granularity and covers a wider range of areas compared to the international standard. To this end, we would encourage continuous alignment between the standards.

The ESRS exposure drafts reflect EU ambition exceeding the ISSB exposure drafts in terms of scope and detail. With respect to interoperability, we would like to highlight the following differences which emerge between the European and international standards:

- The definition of materiality: while we support and agree with the definition of materiality provided in the ESRS (i.e., the concept of double materiality), the difference between the definitions of materiality of the ESRS and ISSB standard may hamper interoperability. In particular, the ISSB considers financial materiality explicitly and impact materiality implicitly (implicitly considered as a “source of risks and opportunities”, but subject to jurisdictions and entities interpretation), whereas EFRAG considers double materiality explicitly. This should be clear for all users of sustainability reporting: it could be achieved by providing clarity to users of sustainability reporting by way of a disclaimer to clarify the difference between the EFRAG and ISSB definition of materiality (as described on page 8 of EFRAG’s “Appendix V: IFRS Sustainability Standards and ESRS reconciliation table”). Moreover, to facilitate interoperability, the concept of single materiality for ISSB and EFRAG should coincide to the extent possible maintaining the concept of double materiality as expressed by the EFRAG.

- How materiality is applied in deciding what to disclose: the ESRS use materiality to decide what not to disclose, while in the ISSB standard, materiality is used to decide what should be disclosed. In the ESRS, everything included in the cross-cutting and topical standards is considered material and operate on rebuttable presumption, whereas the ISSB definition of materiality focuses on what is considered material and, specifically, relevant for a particular entity. The approach proposed under the ESRS poses the risk that efforts will be unduly directed towards providing evidence of what is not deemed to be material for the entity

- Transition plans are more demanding in the ESRS EDs (the ISSB standard does not consider the 1.5°C scenario) and disclosure requirements of transition plans are more detailed under the ESRS EDs. For example, when disclosing their alignment with the 1,5°C objective, undertakings must disclose their use of carbon offsets (carbon credits, carbon removal) separately and shall not include them as means to achieve their targets. They can instead be bundled under the ISSB disclosure requirement. Moreover, contrary to the EFRAG standard, there is no obligation to report on locked-in GHG emissions under the ISSB. In such context, we note that the EFRAG’s approach might avoid an unlevelled playing field between entities which can afford such tools, and those that cannot.

- The IFRS Sustainability ED’s are principle-based, while the ESRS’s are rule-based.

- In the ESRS there is a focus on stakeholders, whereas the ISSB refers to users. The ISSB EDs are only aimed at helping primary users of general-purpose financial reporting to understand how an entity’s enterprise value can be affected by significant sustainability risks and opportunities. The ESRS Eds, more completely, aim to provide information to both users and impacted stakeholders such as civil society.

- Some KPIs are European Union specific (such as those related to the EU Taxonomy).

Consideration given to EU policies and legislation

Article 19b paragraph 3 of the CSRD also requires that "*When adopting delegated acts pursuant to paragraph 1, the Commission shall take account of:*

(a) the information that financial market participants need to comply with their disclosure obligations laid down in Regulation (EU) 2019/2088 and the delegated acts adopted pursuant to that Regulation; **Sustainable Finance Disclosure Requirements;**

(b) the criteria set out in the delegated acts adopted pursuant to Regulation (EU) 2020/852; **Taxonomy Regulation;**

*(c) the disclosure requirements applicable to benchmarks administrators in the benchmark statement and in the benchmark methodology and the minimum standards for the construction of EU Climate Transition Benchmarks and EU Paris-aligned Benchmarks in accordance with Commission Delegated Regulations (EU) 2020/1816*8, (EU) 2020/1817 and (EU) 2020/1818;* **Benchmark Regulation;**

(d) the disclosures specified in the implementing acts adopted pursuant to Article 434a of Regulation (EU) No 575/2013; **Prudential requirements for Credit Institutions and Investment Firms;**

(e) Commission Recommendation 2013/179/EU; **European Commission recommendation on the life cycle environmental performance of products and services;**

(f) Directive 2003/87/EC of the European Parliament and of the Council; ***GHG allowance Directive;***

(g) Regulation (EC) No 1221/2009 of the European Parliament and of the Council; **EMAS regulation**.

Q4: in your opinion, have these European legislation and initiatives been considered properly?

1/ Not at all 2/ To a limited extent with strong reservations, 3/ To a large extent with some reservations 4/ Fully 5/ No opinion

Please explain your reservations or your suggestions for improvement or any other comment you might have

Q5: are there any other European policies and legislation you would suggest should be considered more fully?

First and foremost, there seem to be inconsistencies from the perspective of financial institutions and the data required for the implementation of the EBA's Pillar 3 ITS. While the CSRD requirements cover the information needed by financial institutions from their clients to report under the EBA's Pillar 3 ITS, according to the latter, banks will have to also provide data regarding entities not required to report under the CSRD (notably non-listed SMEs). From this perspective it will be crucial to have a voluntary standard for SMEs (in addition to the simplified reporting standard for listed SMEs) as to facilitate banks' interaction with smaller clients under a feasible and practical format which will lead to a standardized approach across the industry (fundamental for the comparability of data).

In addition, although the information required by financial institutions to comply with their Pillar 3 ITS reporting obligations are covered, financial institutions will also need further sectoral information regarding their exposures to physical risk.

We believe that this information should be foreseen in the future sector-specific standards with the same granularity as required under the Pillar 3 ITS, which requires information regarding the geographical localization of the counterparty or collateral and the percentage of turnover by country.

Moreover, there does not appear to be a link to the Accounting Directive, which would be particularly relevant in light of the link to the management report (covered by the Accounting Directive, which provides the financial materiality concept). It should be made clear that listed companies do not need to double-report the issues already disclosed under the Accounting Directive but can revert to cross-referencing instead.

The ESRS should also consider and leave flexibility to integrate upcoming EU legislation introducing new sustainability reporting requirements, such as the future Corporate Sustainability Due Diligence Directive. This should also be the case when existing legislation is amended, such as the PAI indicators under the SFDR. Cross-referencing similar to those to the Taxonomy Regulation could be considered.

Finally, we suggest considering the Circular Economy Action Plan by the European Commission and the proposal “Making sustainable products the norm” to extend references to Circular Economy beyond the ESRS E5.

Coverage of sustainability topics

Article 19b paragraph 2 of the CSRD proposal defines the sustainability subject matters (referred to as sustainability topics or subtopics in the ESRS) that the sustainability reporting standards shall address when defining the sustainability information required by article 19a paragraphs 1 and 2.

The ESRS architecture was designed to cover all the detailed subject matters listed in article 19b paragraph 2 for environment-, social- and governance-related matters and to ensure that sustainability information is reported in a carefully articulated manner.

In terms of timing of adoption of European sustainability reporting standards, article 19b paragraph 1 of the CSRD requires the Commission to adopt:

- a first set of sustainability standards covering the information required by article 19a and at least specifying information needed by financial market participants subject to the SFDR reporting obligations[1]
- a second set of standards covering information that is specific to the sector in which undertakings operate.

Also, article 19c of the CSRD proposal on sustainability reporting standards for SMEs requires the Commission to adopt SME-proportionate standards in a second set.

As a consequence, as per article 19b paragraph 1, are only included in this first set of ESRS Exposure Drafts:

(i) the two cross-cutting standards on General principles (ESRS 1) and on General, strategy, governance and materiality assessment (ESRS 2)

(ii) the eleven topical (sector-agnostic) standards covering environment- (ESRS E1 to E5), social- (ESRS S1 to S4) and governance-related (ESRS G1 and G2) sustainability topics.

A detailed list of ESRS EDs can be found in Appendix I. And the detailed provisions of the CSRD and how they are covered by the ESRS EDs can be found in Appendix II.

Q6: in your opinion, to what extent does the proposed coverage of set 1 adequately address CSRD sustainability topics?

1/ Not at all 2/ To a limited extent with strong reservations, 3/ To a large extent with some reservations 4/ Fully 5/ No opinion

Please explain your reservations or your suggestions for improvement or any other comment you might have.

Q7: in your opinion, to what extent does the proposed coverage of set 1 (see Appendix I) adequately address SFDR reporting obligations?

1/ Not at all 2/ To a limited extent with strong reservations, 3/ To a large extent with some reservations 4/ Fully 5/ No opinion

[1] SFDR reporting obligations are set by the European Commission Delegated Act supplementing Regulation (EU) 2019/2088: https://ec.europa.eu/info/business-economy-euro/banking-and-finance/sustainable-finance/sustainability-related-disclosure-financial-services-sector_en. Annex I of the Delegated act, which prescribes the indicators on principal adverse sustainability impacts that financial market participants have to publish as per Regulation (EU) 2019/2088.

Appendix III of the cover note (accessible here) lays out how SFDR indicators are covered by the ESRS DRs.

If you think this coverage and its implementation could be improved in any way, please specify how and to what specific SFDR indicator your comment relates

We regret that the draft does not include a disclosure requirement for sustainable revenue linked to the definition of "sustainable investment" as per the SFDR. Currently, the EU taxonomy in its current scope is too narrow to serve as the sole definition of sustainable investment. Without this disclosure requirement, the financial industry will be left with the task of calculating which share of each company's turnover constitutes a sustainable investment.

Sustainability statements and the links with other parts of corporate reporting

For clarity and ease of use, standardised sustainability reporting shall be easily identifiable within the management report (MR). To that effect, ESRS 1 – General principles (paragraphs 145 to 152) prescribes how to organise the information required by ESRS. It offers three options (paragraphs 148 and 149) for undertakings to consider when preparing their sustainability reporting:

– a single separately identifiable section of the MR;

– four separately identifiable parts of the MR:

  (i) General information;

  (ii) Environment;

  (iii) Social;

  (iv) Governance

– one separately identifiable part per ESRS in the MR.

The first option is the preferred option. When applying the other two options the entity shall report a location table to identify where disclosures are presented in the MR.

In order to foster linkage throughout the undertaking's corporate reporting, ESRS 1 also:

- prescribes that the undertaking adopts presentation practices that promote cohesiveness between its sustainability reporting and: (a) the information provided in the other parts of the management report, (b) its financial statements (FS), and (c) other sustainability-related regulated information (paragraphs 131 to 134)
- promotes the incorporation of information by reference to other parts of the corporate reporting in order to avoid redundancy (paragraphs 135 and 136)
- organises connectivity with the financial statements by prescribing how to include monetary amounts or other quantitative data points directly presented in the financial statements (paragraphs 137 to 143).

Q8: Do you agree with the proposed three options?

1/ Yes 2/ No 3/ No opinion

Q9: would you recommend any other option(s)?

If so, please describe the proposed alternative option(s)

We would see benefit in the possibility of having the options made available (as proposed in the first release of the draft) and of also adding a fourth option in order to consider the approach already pursued by some companies to provide sustainability information through fully integrated reporting:

- While this should **not be mandatory**, allowing for the integration of the disclosures required by ESRS into the management report would enable undertakings to provide a clear and concise management report with all the information necessary to comprehensively assess an undertaking, including in relation to sustainability.

- In addition and in order to avoid duplication and not overburden users of sustainability reporting with excessive details, **incorporation by reference should be allowed** for companies on governance issues already made public in the ways prescribed by the Accounting Directive, i.e., the corporate governance statement as a separate report published on the company's website, to which reference is made in the management report. As already done for the management report, material governance information may be included in the report, while directing to other documents (via hyperlinks) for further details.

Q10: in your opinion, to what extent do you believe that connectivity between the sustainability reporting and other parts of the management report has been appropriately addressed?

1/ Not at all 2/ To a limited extent with strong reservations, 3/ To a large extent with some reservations 4/ Fully 5/ No opinion

Please explain your reservations or your suggestions for improvement or any other comment you might have

We believe that there is only consideration for references to the Management Report. Some of the governance related disclosures reside in sections of the Annual Report or another report, which are separate from the Management Report.

Q11: in your opinion, to what extent does the incorporation of information in the Sustainability section by reference to other parts of the management report support cohesiveness throughout corporate reporting?

1/ Not at all 2/ To a limited extent with strong reservations, 3/ To a large extent with some reservations 4/ Fully 5/ No opinion

Please explain your reservations or your suggestions for improvement or any other comment you might have

The current proposal does not foster readability and creates the basis for an overly extensive report in terms of length.

Cohesiveness between the management report and sustainability section is key in any way. Therefore, it is crucial that:

- the link between the management report and the sustainability section should be unilateral (i.e., the sustainability section should contain the references to the relevant sections of the financial statement and not vice versa) as to avoid increasing the complexity of financial statements
- the connection to the management report should be clearly indicated
- when the undertaking uses incorporation by reference, it should disclose an index listing the relevant disclosure requirements subject to the references.

Finally, it should be noted that financial institutions will face a significant burden due to the duplication of reporting requirements as, according to par.135 of ESRS 1, they cannot provide references to reports other than the management report. This, therefore, excludes the possibility to reference Pillar 3 ITS disclosures, covering information included in ESRS E1-5, or to corporate governance disclosures included in the Annual Report.

Q12: in your opinion, to what extent do the requirements and provisions on how to include monetary amounts and other financial statement-related quantitative data into sustainability reporting support connectivity with the financial statements?

1/ Not at all 2/ To a limited extent with strong reservations, 3/ To a large extent with some reservations 4/ Fully 5/ No opinion

Please explain your reservations or your suggestions for improvement or any other comment you might have.

To ensure cohesiveness between the financial statements and sustainability reporting, the following would be appreciated:

- When sustainability reporting includes monetary amounts or other quantitative data points presented in the undertaking's financial statements, the undertaking shall explain how these relate to the most relevant amount(s) presented in the financial statements
- Where appropriate, a reconciliation, including in a tabular form, may be provided
- Medium- and long-term projection regarding "significant financial effects on the undertaking, i.e., generating "risks or opportunities that influence or are likely to influence the future cash flows and therefore the enterprise value of the undertaking", may be difficult to implement and this is an area where the reconciliation with financial reporting at the reporting date will be very challenging
- Moreover, it should be noted that consistency between the financial statement and sustainability reporting may not be achievable as financial statements of banks are conducted according to the statutory perimeter, whereas the CSRD applies a prudential perimeter (therefore there may be mismatches).

In addition, we do not believe that information should be reported twice and therefore paragraph 138 of ESRS 1 should read as follows "When monetary amounts or other quantitative data points that address sustainability-related information or disclosure requirements are directly presented in financial statements, the undertaking shall include a reference in the sustainability report to the relevant paragraph of its financial statements where the corresponding information can be found".