

EuropeanIssuers Response to the EFRAG Consultation on Draft EU Sustainability Reporting Standards Cover Note

EuropeanIssuers welcomes the opportunity to comment on the draft sustainability standards proposed by EFRAG. **In their current form, these standards are not acceptable to European companies as a major exercise of simplification and prioritisation of indicators is necessary to make them useful and practicable.** EuropeanIssuers regrets that the **deadline was too short to conduct an in-depth analysis**, in particular allowing to identify the concerns of undertakings newly targeted by sustainability reporting. EuropeanIssuers is overly concerned about the short timeframe left to perform the necessary structural changes in response to a consultation of such magnitude.

EuropeanIssuers also considers that these **standards pertain to reporting and must not be considered as mandatory requirements for the governance or the business conduct of companies.** The information to be provided must be **proportionate** to the needs of the different stakeholders who are directly interested in the operations of the company but cannot be prepared for any user or all stakeholders.

Furthermore, against the current international and economic background, European companies might face significant difficulties in the near future, and therefore an **extended delay for the implementation of the standards should be considered.**

I. Guiding criteria for the adoption of the standards (Art. 29b, CSRD)

The sustainability reporting standards must meet general criteria precisely as set out in CSRD. The final text of the Directive presents significant innovations compared to the text based on which the draft standards were prepared. Consequently, **the draft standards must be amended to adequately consider and align with the new version of the Directive.**

According to the criteria set forth in the (final) Directive:

- Standards shall ensure the **quality and relevance** of reported information, by requiring it to be comprehensible, relevant, verifiable, comparable, and is represented in a faithful manner.
- Standards shall **avoid disproportionate administrative burden** on undertakings, including by taking into account, to the greatest extent possible, the work of global standard-setting initiatives for sustainability reporting.
- Standards shall **consider the difficulties that undertakings may encounter** in gathering information from actors **throughout their value chain** (especially from those which are not obliged to report sustainability information) and shall specify disclosures on value chains that are **proportionate and relevant to the scale and complexity of the activities**, and the capacities and characteristics of undertakings in value chains.
- Standards shall not specify disclosures that would require undertakings to obtain information from **small and medium-sized undertakings** in their value chain that exceeds the information to be disclosed according to the sustainability reporting standards for small and medium-sized undertakings.
- Standards shall include disposals, as it is mentioned in CSRD, allowing the undertakings to **omit information that might be seriously prejudicial to their commercial position.**

These criteria are the legal basis (and limits) that must inform the content of the standards which is currently not the case as they require excessively detailed information, presenting numerous difficulties for companies which could harm their competitiveness.

II. Alignment with ISSB standards

An alignment of the European set of standards with the ISSB standards is crucial in order to prevent a situation in which EU preparers are required to report under both (potentially even non-complementary) standards because they have to comply with EU law and to respond to market expectations. Double reporting would result in unnecessary additional costs and reduced validity and comparability of data. Any deviations/non-alignments/inconsistencies that are not due to mere extensions to go beyond the global baseline should be avoided. **We recommend a close dialogue with the ISSB and the development of a collaboration model** that enables global alignment and ensures an elevated level of synchronisation of both standards.

III. Presentation of reporting requirements

All reporting obligations should be located in the disclosure requirements (DRs) and not in the application guidance (AG) to facilitate readability and applicability of the standards. The application guidance should only give information on how to apply the DRs without adding additional mandatory reporting requirements. AG must not give the impression that more detailed information is mandatory regardless of the previously identified policy or material impact/risk.

Certain draft standards, especially draft **ESRS 2, should be redrafted to simplify the reading**, so that a company or an auditor can effectively grasp the essence of the standards and implement the reporting obligations accordingly. Draft ESRS should be adapted to the newly concerned and smaller sized companies and avoid ambiguity about the approach to be followed.

IV. Double materiality

EuropeanIssuers supports the principle of double materiality in the framework of sustainability reporting, as enshrined in the CSRD, to reflect both company's activities and challenges, and to respond to the needs of the users of sustainability reporting.

However, **double materiality does not mean that all stakeholders must be satisfied in all their desiderata**, as this would **contradict the materiality principle itself**, and it is impossible in practice. The cross-sectors disclosure requirements should therefore **focus on essential information**, leaving room for sectoral indicators, which will provide a more relevant granularity. This presupposes a cross-sectoral reporting that is not as maximalist as the proposal stands.

The materiality assessment conducted by companies should be at the core of the application of the concept of materiality. The ESRS disclosure obligations should flow from the prior identification of material impacts, risks, or opportunities. Thus, draft ESRS should refer to the materiality matrix, allowing companies to prioritise stakeholders and respond to their needs and expectations.

We, therefore, suggest:

- **describing in more detail the criteria to be followed in the materiality analysis process**, following the GRI (GRI 3 Material topics, version 2021);
- making it clear that **materiality assessment is a process to be run at the level of general topic** (e.g., climate change, occupational safety) rather than at the level of individual impacts or information requirements;
- impacts must be **considered in the light of the significant sectors** of operation, business profile, characteristics, and size of the company, including when arising from companies in the value chain;
- leaving this materiality assessment to the **business judgment of the management** of the undertaking under the **control of the independent third party**.

V. Rebuttable presumption of materiality

We do not agree with the rebuttable presumption based on the current proposals. Many disclosure requirements (e.g., in E2-E5) are not material across sectors or most companies. The rebuttable presumption would, however, create the impression that those are material across sectors. We expect a significant risk in terms of an emerging “need of justification” to the public, significant effort for documentation, materiality assessments, alignment with the auditor, stakeholder engagement, etc. It is essential that the materiality assessment is fully performed by the management. These decisions are then checked by the auditor. The standard setter can define relevance, but not materiality.

The rebuttable presumption of materiality is not consistent with the Directive and its recital 45, according to which (i) the materiality analysis should serve to identify what to include in the report, not what to remove from the disclosure obligation, and (ii) only at the level of sector-specific information can one reasonably assume the materiality of a piece of information and require a justification to the contrary (as it is the case in GRI 2021 standards). **This rebuttable presumption should therefore be removed, except for the eighteen mandatory principal adverse impacts laid down by SFDR**, which European companies accept to publish in any case to satisfy the needs of their investors who will need this information.

VI. Cross-cutting standards

- **Draft ESRS 1 and 2 should be merged and streamlined.** As mentioned above, the materiality assessment should be put at the centre of the reporting exercise and draft ESRS 2 should not be included in the AG of the thematic standards.
- **Draft ESRS 2 governance indicators should be better articulated with the draft ESRS G1 standard.** In line with the Directive, the reporting standards should not be extended beyond corporate officers. References to “senior management,” “senior executives” or “key personnel”, which are not defined elsewhere, should be deleted.
- **Reporting on sustainability topics dealt with by boards should be limited to general topics**, referring to public information, to prevent the risk of having to disclose confidential information on ongoing projects.

VII. Information on value chains

CSRD provides that information may cover the company’s value chain, if applicable. The Directive also provides that **standards shall avoid disproportionate administrative burden on undertakings and take**

account of the difficulties that undertakings may encounter in gathering information from actors throughout their value chain, especially from those which are not obliged to report sustainability information.

It should also be considered that, again according to the Directive, the **information must be of quality and thus based on solid data and established, reliable methodologies**. Therefore, any requested information on value chain must be **proportionate and relevant to the scale and complexity** of the activities and should be defined more precisely. This is not the case with the draft ESRS as they require an **extensive reporting on value chains which goes beyond the mandate of CSRD**. As companies typically have thousands of suppliers and customers, it is unrealistic to define the value chain as proposed in the exposure drafts. We urge for a clarification that only the most relevant stakeholders must be addressed.

The definition of the value chain also leads to legal problems. It is exceedingly difficult, if not impossible, for companies to obtain information from suppliers based in countries that do not fall under the scope of the CSRD. Some draft ESRS foresee the data collection for data which cannot be obtained in a legal manner by companies.

VIII. Social standards

Draft ESRS S2/S3/S4 address valid issues but they go beyond CSRD which only mentions, in the governance factors, the “management and quality of relationships” with affected communities, customers (not consumers and end-users) and suppliers.

Therefore, the draft ESRS S2/S3/S4 should be reviewed and considerably simplified to respect the wording of CSRD which does not justify extensive DRs on policies, targets, and impacts. It should neither attempt to replace or anticipate substantial European obligations, such as the future directive on European Corporate Sustainability Due Diligence, nor duplicate existing sectoral regulations.

CSRD sets up obligations to report and not obligations to do, meaning that the wording of some disclosure requirements has to be consequently reviewed, also in order to avoid disproportionate administrative burden on undertakings and take account of the difficulties that undertakings may encounter in gathering information from actors throughout their value chain, especially from those who are not required to report sustainability information.

IX. Environmental standards

Reporting on the climate issue should be prioritised by asking companies to focus on the metrics that can be collected or calculated at an acceptable cost, specifying the level of uncertainty associated with them.

Obliging all companies to comply individually with a 1.5°C objective is not realistic as activities face vastly different constraints and opportunities. Therefore, companies should indicate their best efforts to contribute to the objectives of the Paris Agreement, including the “well below 2°C” and not only the “1.5°C” objective.

Their **transition action** plans should distinguish provisions that fall within their decision-making power and provisions that require coordination with other players in the sector (upstream, downstream, private, and public partners).

For **climate and biodiversity**, DRs should not create direct result responsibility for companies when international legal frameworks enact a responsibility defined at Member State level.

DRs should be focused on information which can **enhance environmental transition investment decisions**.

Regarding **pollution, and water and marine resources**, consolidated reporting on sum of absolute emissions will not reflect the level of risks and makes little sense. Unlike for climate change where greenhouse gases have a cumulative impact, regardless of the place of emissions, these pollutants have to be dealt with for their local effects and not at the level of the company as a whole.

X. Governance standards

The role, composition, expertise, skills, and responsibilities of the administrative, management and supervisory bodies with regard to sustainability are addressed by draft ESRS 2 as required by CSRD. The definition of these different bodies should be clarified in order to understand who is targeted.

G1 goes beyond the mandate of CSRD which only provides for information concerning diversity policy (g) in relation to the undertaking's administrative, management and supervisory bodies. It is not desirable to go further as this would entail that non listed companies have to make a corporate governance report which is not foreseen by European law. Therefore, **all DRs on the general governance structure and composition, corporate governance code or policy, nomination process, evaluation, remuneration policy have to be deleted**.

The disclosure regarding diversity policy must be revised. Indeed, disclosures such as creed, ancestry, ethnic origin may lead in countries such as France to constitutional problems. In general, the **standards should not contradict the laws of the Member States** or should provide for exceptions where the information to be disclosed is contrary to national laws.

XI. Forward-looking information and financial planning

EFRAG standards call for the **publication of prospective information with predefined durations**. Here we see two main concerns:

- the difficulty of prefiguring long-term future scenarios based on reasonable and scientifically sound assumptions; and
- the consistency of sustainability prospective information with the customary practice of time planning in the financial sector, which usually has a shorter timeframe. There is a risk of two separate planning processes.

The requirement for forward-looking information should be flexible and shaped according to the type of forward-looking information to be provided. It also should be aligned with the practice of financial planning, with the option for companies to indicate targets with a longer time horizon.

XII. Prioritisation and gradual implementation of Disclosure Requirements

- **Start with information already required by the NFRD and SFDR**, respecting the precise wording and granularity of SFDR PAI (e.g., existence of policies does not mean its detailed description) and avoiding redundancies;
- **Gradually introduce more information regarding the supply chain**, particularly as this part of corporate reporting will be more difficult to construct, especially for new entrants in the scope;

- **At last, advance progressively on all three pillars of sustainability reporting** (E, S and G) whilst taking into account the unequal maturity of specific themes.
- Certain standards should not be as in-depth as foreseen in the exposure drafts. It should be sufficient that companies disclose a few relevant numbers of each draft ESRS.
- Some of the disclosure requirements in the draft ESRS that are included in the sector-agnostic standards should be transferred to the sector-specific standards. This for example applies to the pollution standard which is not relevant for non-manufacturing companies. It also applies for example to the standard regarding water.

XIII. Financial effects on sustainability risks

In environmental standards, it is required to determine the possible financial effects on the company's performance in the short, medium, and long term. This type of information is inspired by the principles set out in the June 2017 Recommendations of the Task Force on Climate-related Financial Disclosures (TCFD Report). However, the TCFD Report recommends **information of a qualitative nature at a prominent level**, while the **EFRAG standards also require timely information of a quantitative nature**.

At present, there are no reliable and established processes in place to construct this data. In this situation, each company would have to build its own process, which would also affect the comparability of the data. Should one wish to maintain this more analytical approach, one would have to indicate, also in the application guidelines, **precise operational methods for estimating these effects**.

XIV. Granularity of information and general clause for the omission of information

The EFRAG standards impose an **extreme level of detail and granularity** of the required information that is at a higher level than the experiences of international initiatives applied so far. This approach is **difficult to implement and extremely burdensome for companies**. It also **fails to meet one of the criteria for information quality**, namely comprehensibility, which requires concise information to be provided (draft ESRS 1, para 38 ff.).

The overly granular information to be provided by the companies may lead to competitive disadvantages vis à vis companies that do not fall into the scope of the CSRD. For example, the disclosure of plans regarding the resources of companies risks putting companies at a competitive disadvantage. This can be avoided by allowing reporting on a more aggregate level.

There is a need to make the application of the **EFRAG standards more flexible** in two respects:

- **revising some mandatory information requirements**, giving them the different nature of recommendations;
- **introducing a general clause allowing the omission of certain mandatory disclosures** or a lower granularity of information when there is reasonable justification.

XV. Reduced period for consultation and review of responses

We understand the ambitious deadlines that is set by the CSRD for submitting the first set of draft ESRS to the European Commission by November 2022. However, 100 days instead of 120 days consultation period makes it very difficult if not unrealistic for stakeholders to respond adequately to the consultation in due time. Approximately 400 pages of draft ESRS and approximately 200 pages of survey cannot be adequately looked through in this short period. Questions whether the disclosures are "sufficiently consistent with

relevant EU policies and other legislation” or “is aligned as possible to international sustainability standards given the CSRD requirements” cannot be answered comprehensively in such a brief period of time.

The summer holiday season made it even more challenging to respond to the consultation effectively. It is unclear to us how the expected 1.000 responses to the consultation can be reviewed in depth and implemented into the future standards in due time. In order to get practice-oriented high-quality sustainability standards, it is of **paramount importance that the responses to the consultation are thoroughly reviewed.**

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