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COMMENTS ON THE DRAFT ESRS DELEGATED ACT

E3G CONSULTATION SUBMISSION

7 July 2023

The draft delegated on European Sustainability Reporting Standards (ESRS) comprises: the main text of the legal act; twelve draft standards (annex I); and a glossary of abbreviations and defined terms (annex II).

The twelve draft standards in Annex I are:

Group	Number	Subject
Cross-cutting	ESRS1	General Requirements
Cross-cutting	ESRS2	General Disclosures
Environment	ESRS E1	Climate
Environment	ESRS E2	Pollution
Environment	ESRS E3	Water and marine resources
Environment	ESRS E4	Biodiversity and ecosystems
Environment	ESRS E5	Resource use and circular economy
Social	ESRS S1	Own workforce
Social	ESRS S2	Workers in the value chain
Social	ESRS S3	Affected communities
Social	ESRS S4	Consumers and end users
Governance	ESRS G1	Business conduct

Each standard is divided into numbered paragraphs. Each standard also has an appendix A containing “application requirements” which are numbered as AR 1, AR 2 etc. Some standards also contain additional appendices.

To facilitate analysis of comments, respondents are kindly requested to use the simple template below when sending their comments.

Name of respondent/responding organisation: E3G (Third Generation Environmentalism)

1. General comments

E3G welcomes the possibility to respond to the open consultation launched by the European Commission on the draft Delegated Act containing the European Sustainability Reporting Standards (ESRS). We welcome the introduction of the ESRS under the Level 1 legislation of the CSRD. We believe that this is a crucial step to ensure businesses act collectively to report information on ESG-related matters, increasing transparency and clarity of data provided to investors.

However, we are deeply concerned for the about several aspects of the proposal, which have worryingly backtracked on the technical work delivered by EFRAG. We believe the new set of disclosure standards fails to sufficiently advance precise, reliable, and comparable information on businesses' impact on the people and the environment, and on the financial consequences arising from climate change.
Considering the ESRS's relevance in the EU sustainable finance agenda, **we strongly suggest the European Commission avoids further reducing the content of the current ESRS. Maintaining a full set of ESG-related disclosure requirements and establishing a working sustainability reporting framework in the European market is the most cost-effective way to channel investments towards sustainable business practices.** Easing of requirements would negatively impact the credibility of ESRS as a reporting standard, as well as reliability of reports produced accordingly across the EU market.

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We advise addressing potential regulatory incoherence between the current ESRS and other corporate regulation at the EU level. The proposal contained in the Delegated Act is not compatible with the mandatory reporting obligations set forth by the Sustainable Finance Disclosure Regulation (SFDR), and other key pillars of the EU sustainable finance architecture, such as the Benchmark Regulation and the Pillar 3 disclosure requirement. If the Commission were to proceed with the current ESRS proposal, it would create more inconsistency within the EU sustainable finance framework, failing to achieve a holistic corporate reporting framework in the European market.

After these considerations, **we recommend the following aspects of the draft Delegated Act to be modified**:

- Re-introduce set of mandatory, or to be precise **'always-to-be-disclosed' disclosure requirements**. We consider fundamental to request **transition plans**, **climate targets** and **GHG emissions to always be reported irrespective of materiality**.
- **Re-introduce 'always-to-be-disclosed' clause for datapoints present in existing EU legislation**. This is especially important for the principal adverse impact (PAI) indicators mandated by the SFDR.
- **Remove additional two-year phasing for companies with less than 750 employees for standards on biodiversity** (ESRS E4) **and social information** (S2, S3, S4), especially since it creates a potential loophole with the Level 1 legislation (namely with the minimum disclosure requirements set forward by the CSRD).
- **Reconsider the decision of reporting specific biodiversity and social indicators as voluntary**; this would dangerously undermine the evaluation of biodiversity-related impacts, risks, and opportunities and hinder data availability on working conditions of non-employee workers.

E3G appreciates the Commission's efforts in aligning the ESRS closely with the recently published ISSB standards (i.e., IFRS S1 and S2). We believe that all the recommendations above can be implemented whilst maintaining the definitions in the draft Delegated Act that would allow for interoperability to be ensured. We agree that aligning the ESRS with the ISSB standards signals the importance of a holistic, coherent, and comparable sustainability reporting architecture across different standards in different jurisdictions. Furthermore, we welcome aligning the ESRS' definition of financial materiality with the one contained in the ISSB standards. This compatibility allows the ISSB to take up the role of global baseline for sustainability reporting, whilst leaving space for the ESRS to build on and expand its disclosure requirements with the double materiality practice.

Lastly, **E3G welcomes the European Commission's intent to work closely with EFRAG in developing additional guidance for the materiality assessment process**. We strongly believe that entities reporting under the ESRS, and thus evaluating the material sustainability topics of their operations, would be facing a vast array of challenges coupled with interpretation and implementation risks. This could translate to higher responsibility on external supervisory authorities and auditors, and potentially to lower quality and comparability of data. Further guidance would highly benefit the materiality assessment process that undertakings will be required to do under the ESRS.

2. Specific comments on the main text of the draft delegated act

In the following section, we provide further details on E3G's four recommendations stated above, highlighting our main concerns with the amendments proposed by the European Commission on the ambitious set of standards developed by EFRAG. We reiterate that E3G does not support the Commission's decision to divert away from EFRAG technical advice on the ESRS. The four recommendations represent a minimum requirement to fulfil the policy objectives for which the ESRS were initially developed.

1. Mandatory disclosure requirements

We strongly oppose the Commission's decision to delete the 'always-to-be-disclosed' clause from a wide range of disclosure requirements. Particularly, E3G is concerned of the decision to subject all climate-related datapoints under topical disclosure ESRS E1 to materiality assessment.

The loss of mandatory disclosure requirements in the ESRS could bring about a series of concerning consequences, such as:

i. Under-reporting and lower quality of data

Subjecting all climate-related datapoints to materiality assessment could severely lower the quality of disclosures. Crucial information on transition plans, climate targets, and GHG emissions would be at risk of under-reporting, as entities would be allowed to avoid reporting entire disclosures or specific details within a single disclosure if deemed non-material. The disclosure exercise has been made even more complex, as undertakings are not anymore obliged to provide an explanation when a sustainability matter is labelled non-material. A potential side-effect is that disclosure verification becomes a critical step in achieving reliable data, thus putting more pressure on external supervisory authorities and auditors for the functioning of the sustainability reporting framework.

ii. Data comparability at risk

Leaving GHG emissions reporting up to materiality assessment increases the risk for potential omission of crucial information. As Scope 3 emissions are known to be difficult to estimate and are often subject to recalculations, the loss of the 'mandatory' aspect adds further complexity to the estimation

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efforts. Subjecting Scope 3 emissions to materiality assessment would make it more burdensome to achieve data comparability, even between companies of the same sector, as entities could under-report or partially omit relevant data in their GHG inventory.

Requesting mandatory (i.e., always-to-be-disclosed) indicators for a set of critical climate-related disclosure requirements would reduce the reporting burden for companies, auditors, and even investors. Investors and customers alike cannot make informed decisions without a full dataset of consistent, comparable data. Hence, requesting disclosure of transition plans, climate targets, and GHG emissions irrespective of materiality ensures a minimum reliability of sustainability information gathered through the ESRS. **We strongly suggest re-introducing the always-to-be-disclosed aspect for the following set of disclosure requirements:**

- ESRS E1-1: Transition plan for climate change mitigation
- ESRS E1-4: Targets related to climate change mitigation and adaptation
- ESRS E1-6: Gross Scopes 1, 2, 3 and Total GHG emissions

2. Inconsistencies with the SFDR and other EU legislations

Removing the 'always-to-be-disclosed' nature from almost every set of the ESRS creates inconsistency with the SFDR obligations. In drafting the ESRS, EFRAG made sure that financial market participants reporting the new mandatory standards would also meet their SFDR-related reporting obligations. However, leaving reporting of company information up to the materiality assessment creates regulatory uncertainty with the mandatory SFDR PAI indicators, because the equivalent SFDR indicators in the ESRS standards are not mandatory anymore. The same issue applies not only to the datapoints covered by the SFDR PAI indicators, but also to relevant information connected to other EU legislations, such as the Benchmark regulation, the Pillar 3 requirements of the Banking regulation, or the disclosure of data sources in the recent ESG ratings regulation proposal.

This removal of mandatory indicators in existing regulations adds further complexity and inconsistency within the EU reporting framework. The Commission's proposal risks compromising the objectives set forward by the EU sustainable finance agenda and undermines the reliability of the sustainability information provided by undertakings. Furthermore, this decision clashes with the ongoing review of the SFDR PAI indicators by the European Supervisory Authorities (ESAs).

We strongly recommend that the Commission re-introduces the SFDR PAI indicators as always-to-be-disclosed, to ensure that sustainability reporting standards at least include information needed to comply with SFDR obligations.

3. **Additional phase-ins add inconsistency and further complexity**

We believe the two-year additional phasing-in for the standards on biodiversity and social indicators for companies with less than 750 employees should be cancelled, as it would add inconsistency and further complexity with the Level 1 legislation – the CSRD.

Starting from the fact that CSRD already includes later application dates for companies that have not been previously covered by the Non-Financial Reporting Directive (NFRD), the additional phase-in periods proposed by the Commission risk infringing the requirements set forward by CSRD. As the Level 1 legislation entered into force in January 2023, to avoid potential violation of CSRD requirements, the draft Delegated Act has added in ESRS 2 (precisely, paragraph 17) a set of minimum disclosure requirements to be disclosed if an undertaking decides to use the additional two-year phase-ins option of the biodiversity and social standards. We argue that, if a company has already set in place the procedure to assess material sustainability matters under these standards (in order to comply with CSRD requirements), then it could easily cover the remaining information to report the entire topical standards.

In this context, it is necessary to mention that the social standards covered by the two-year phase-in do not include any metrics, therefore the undertakings can comply with them merely by describing their process to identify material impacts, risks and opportunities, and their policies and actions to address identified impacts, or by acknowledging that they have not (yet) adopted such policies and actions.

A similar concept applies to the biodiversity standards – although this topical disclosure does include metrics, the EFRAG technical advice only asked companies to consider their application rather than firmly prescribing them.

E3G therefore suggests removing the two-year additional phase-in period for the standards on biodiversity and social matters for companies below 750 employees, as CSRD already provides sufficient time for the implementation of the standards.

4. **The declassification of numerous disclosure requirements to voluntary**

We do not support the Commission's decision to declassify a series of disclosure requirements from up to materiality assessment to completely voluntary, particularly for the case of biodiversity impact indicators and for working conditions of non-employee workers. This declassification is particularly dangerous because it does not provide companies with lower requirements to undergo a learning curve, but rather it raises potential greenwashing risks and promotes dangerous business practices.

Specifically, **we insist on the Commission removing the voluntary nature on the following disclosure requirements**:

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- ESRS 2, paragraph 57

This disclosure requirement allows an undertaking to avoid providing an explanation for when it deems a sustainability matter to be non-material. E3G suggests that, as a minimum requirement, at least the 'comply or explain' option should be re-introduced, mandating entities to provide concrete explanations for omitting information.

- ESRS E4

Biodiversity transition plans (ESRS E4-1) and impact metrics related to ecosystems (ESRS E4-5) have become completely voluntary under the new draft Delegated Act. We believe this strongly undermines the role that nature-related impacts, risks, and opportunities play in the resilience of EU companies. We suggest that the Commission reconsiders the voluntary nature of these standards and reverts them back to the previous definition in EFRAG's technical advice.

- ESRS S1

Here, datapoints regarding non-employee workers have been declassified to voluntary nature. This dangerously exposes agency workers to higher risks than entities' employees, since making information regarding their working conditions voluntary would shield companies from any disclosure obligations regardless of materiality.

Therefore, **E3G suggests reconsidering the declassification of the voluntary reporting standards**, **by switching to either 'always-to-be-disclosed' or at the very least making them subject to materiality assessment.**

3. Specific comments on Annex I

Standard	Paragraph or AR number or appendix	Comment
ESRS 1	*Paragraph 2*	Suggest removing the sentence "ESRS do not require undertaking to disclose any information on environmental, social and governance topics covered by ESRS that the undertaking has assessed as non-material". If this cannot be changed, then modify ESRS 1 pr.31 to mandate an explanation for why the specific sustainability matter has been deemed non-material.
ESRS 1	*Paragraph 29*	Revert to EFRAG's version: re-instate mandatory disclosure of all climate-related datapoints under ESRS E1, and for companies > 250 employees mandatory social datapoints in S1 (from S1-1 to S1-9).
ESRS 1	*Paragraph 31*	As suggested above, mandatory explanation of why an information has been deemed non-material is the minimum requirement. As 'comply or explain' practice has been re-instated in ESRS, the least to satisfy high transparency criteria is to require entities to disclose explanations for omitting datapoints.
ESRS 1	*Paragraph 133*	We suggest removing this paragraph. Applying ESRS 1 paragraphs 131 and 132 "irrespective of whether or not the relevant actor in the value chain is an SME" leaves too much room for interpretation for reporting entities. The underlying risk is that undertakings' value chain may exclude critical information of multinational or big companies.
ESRS 1	Appendix C	On the list of phased-in Disclosure Requirements • ESRS E1-6: Companies with >750 employees are allowed to omit information on Scope 3 and total GHG emissions for the first year of reporting. This provides big companies with the chance to postpone estimating their Scope 3 emissions in the short-term. • ESRS E1-9: Allowing undertakings to report only qualitative information on anticipated financial effects from material physical and transition risks for the first three years of reporting, allows undertakings to report less accurate data. We believe this phase-in period should be cancelled. • ESRS S1: remove additional phase-in of one year. • ESRS E4 / S2 / S3 / S4: remove the phase-in periods for these standards. Two additional years to omit all datapoints from these set of disclosure requirements would heavily undermine data availability at the time of

		entry into force of the Delegated Act. Furthermore, these phase-ins risk infringing the Level 1 legislation if minimum information regarding these sets of ESRS is not disclosed anyway in the first two years of reporting.
ESRS 2	Paragraph 17	The purpose of this paragraph is to meet the CSRD disclosure requirements in the case an entity is using the additional two-year phase-ins of ESRS E4 / S2 / S3 / S4. We consider this paragraph to be unnecessary if the additional phase-ins are deleted, which we highly suggest. We argue that, if an undertaking must report the information described under this paragraph, it means it has already set in place an analysis of material sustainability matters. Thus, we believe that if such a system is already in place, the undertaking would be reporting the information fully rather than partially.
ESRS 2	Paragraph 57	This mandatory disclosure requirement allows undertaking to decide whether to provide explanation for when they assess a sustainability matter as non-material. We suggest removing this paragraph, as it would allow companies to omit specific datapoints without providing a proper explanation for their decision.
ESRS E1-6	Paragraph 47	Significantly simplified the definition of GHG emissions from associates or joint ventures in the value chain, as now companies shall include GHG emissions only where it has operational control over entities. We suggest reframing back to the ESRS November version prepared by EFRAG on the current paragraph.
ESRS E1	Appendix A, AR41	Clarifies the definition and extension of operational control mentioned in the paragraph above. If paragraph above is re-phrased, then modify this appendix requirement too.

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About E3G

E3G is an independent climate change think tank with a global outlook. We work on the frontier of the climate landscape, tackling the barriers and advancing the solutions to a safe climate. Our goal is to translate climate politics, economics and policies into action.

E3G builds broad-based coalitions to deliver a safe climate, working closely with like-minded partners in government, politics, civil society, science, the media, public interest foundations and elsewhere to leverage change.

More information is available at **www.e3g.org**