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Ensuring alignment between the Disclosure Requirements of Investee Companies and the Sustainable Finance Obligations

The draft ESRS (European Sustainable Reporting Standard) Delegated Act published by the European Commission on 9th June 2023 presents several potential implications for investors and entails major inconsistencies across the Sustainable Finance legislative framework. In this paper, we will focus on the alignment of Environmental, Social, and Governance (ESG) reporting on two crucial areas: (1) the requirements of the Sustainable Finance Disclosure Regulation (SFDR), notably the Principal Adverse Impact indicators (PAIs), and (2) the Transition Plans and targets.

The Corporate Sustainability Reporting Directive (CSRD) has always been considered a crucial legislative piece as it provides the financial sector with better data on the sustainability risks faced by investee companies and their impact on people and the environment. **This data is vital for the financial sector to contribute significantly to the objectives of the European Green Deal and channel capital towards sustainability and transition finance.**

Disappointingly, **the proposed draft ESRS delegated act seems to be moving in the opposite direction.** The act would introduce materiality assessments by reporting entities for most of the disclosure requirements and data points, including those data points that Financial Market Participants (FMPs) need to fulfill their mandatory obligations under SFDR. These include PAI reporting, "sustainable investment" Do Not Significant Harm (DNSH) tests, and access to climate-related information such as scenario analysis, transition plans, targets, and forward-looking information for implementation of decarbonization strategies including relevant targets. Moreover, the act also delays the application of certain data points by investee companies, exacerbating the sequencing issues between CSRD and SFDR.

Therefore, **EFAMA has serious concerns about the decision to reduce the level of ESRS requirements, which creates a misalignment with SFDR. We advocate for the removal of materiality assessments on the set of indicators that ensure accurate and comprehensive sustainability reporting across the investment chain, from investee companies to financial market participants (FMPs) and from FMPs to end investors.** Beyond the necessary compliance with our regulatory obligations, we also believe that climate information such as greenhouse gas (GHG) emissions, transition plans and targets is always material for companies, regardless of their sector, and we support mandating all the related disclosure requirements and data points. This is not only to ensure coherence with EU Climate Law but also to guarantee that investors and asset owners have access to the most complete set of climate-related information possible.

RECOMMENDATIONS

#1 Addressing Materiality Assessment Challenges and Data Gaps for SFDR Obligations

Despite some confusion between Appendix B of ESRS 2 being full part of ESRS 2, and ESRS 1 §33, it appears that **almost all the disclosure requirements relating to the PAI indicators of SFDR are now subject to a materiality assessment** by the reporting entity under the draft ESRS delegated act. In addition, explanations by the reporting entity on the reason why certain topics are not considered material is optional.

This creates permanent data gaps between CSRD/ESRS and SFDR, posing significant challenges for Financial Market Participants (FMPs), as they will struggle to fulfill their regulatory requirements and hinder their ability to contribute to the objectives of the European Green Deal. Moreover, as highlighted in ESMA's "Progress Report on Greenwashing"¹, gaps and inconsistencies in the legislative framework contribute to the issue of greenwashing. **Therefore, we urge the Commission to eliminate any materiality assessments on ESRS disclosures/data points that are crucial for FMPs to meet their disclosure obligations under SFDR (table 1 in Annex I of SFDR DR). By doing so, we can bridge the data gap, enhance transparency, and ensure that FMPs have access to the necessary sustainability-related information to meet their own sustainability-related commitments/targets.**

In case this materiality assessment is maintained on all or on certain of the ESRS disclosures related to SFDR PAIs, we call on the Commission to cooperate with the European Supervisory Authorities (ESAs) and engage with key stakeholders on how PAI entity-level requirements for FMPs can be recalibrated. Our specific recommendations are the following:

- (i) It would largely be inconsistent if CSRD permits investee companies to disclose PAIs only when they are deemed material, while SFDR mandates FMPs to disclose all PAIs. To address this, FMPs should also be afforded some form for materiality assessment as part of PAI reporting. For example, the Commission could issue guidance that includes determining a "neutral non-detrimental" value for each PAI indicator (list 1,2,3) that would be deemed "non-material". It is of the **utmost importance that the Commission addresses implications for SFDR PAI reporting and for the assessment of Do Not Significant Harm (DNSH) for all FMPs**, especially considering that ESAs have just concluded their consultation on potentially increasing the number of mandatory and opt-in PAIs and potentially introducing quantitative thresholds as part of DNSH tests. Clear guidance should also provide for fair treatment by all FMPs having to integrate "non-material" data, without leaving room for interpretation.
- (ii) If the Commission and the ESAs decide not to take action to address this potential incoherence, we urge the Commission and the ESAs to provide clear guidance on how FMPs should handle missing data points that will be further exacerbated by the introduction of materiality assessments within ESRS delegated act.
- (iii) To enable investors to differentiate between missing disclosures or data points due to non-materiality and those that are optional or phased-in, **investee companies should be required to provide a list of disclosures deemed "non-material" in their reporting, accompanied by a clear explanation of the rationale.** This transparency will help investors understand the reasons behind missing information and ensure clarity in reporting.

¹ ESMA – "Progress report on Greenwashing" p. 29

#2 Avoid different phasing-in times in SFDR and CSRD

After reviewing the draft ESRS delegated act, we have observed that certain ESRS disclosures and data points required by Financial Market Participants (FMPs) under SFDR may be introduced one or two years after the reporting's application date. This implies that the collection of such data, which FMPs expected to occur in 2027, would be delayed until 2028 or 2029, especially for listed SMEs. While we understand that phasing-in provisions were included in ESRS to allow entities sufficient time to transition towards disclosing the relevant information, **this unintentionally exacerbates the potential data gap caused by the introduction of materiality assessments for SFDR-required data points**.

Therefore, **we urge the Commission to eliminate any additional phasing-in periods for the disclosures and data points that FMPs need to meet their own disclosure obligations under SFDR**. FMPs already face challenges in acquiring the necessary data and implementing phasing-in would further worsen the current situation, making it increasingly difficult to fulfill regulatory obligations on a best-effort basis. If the Commission chooses to maintain the phasing-in for SFDR-related data points, we recommend addressing this issue promptly. For instance, the determination of coverage thresholds under which a Principle Adverse Impact (PAI) could be disregarded and not disclosed in SFDR should be considered, particularly if it poses a risk of providing misleading information. Temporarily suspending the opt-in PAIs from the SFDR list (2 & 3) could also be explored as an option. Additionally, clear guidance must be provided on how FMPs should handle these extended phasing-in periods if they are maintained in the final delegated acts as currently proposed, as mentioned above in #1 regarding missing data.

#3 Guarantee maximum interoperability of the ESRS with ISSB and GRI reporting standards

We appreciate the EC's efforts to ensure consistency with the ISSB and GRI reporting standards, we seize the opportunity of this paper to encourage continuous efforts to guarantee maximum interoperability of standards worldwide. We strongly support the EU's double materiality approach and we would welcome any further alignment, if possible, regarding the financial materiality element of the double materiality assessment. While the ISSB standards focus on investors' information needs, the ESRS focuses on a broad range of stakeholders, which may cause confusion for investee companies. Policymakers should also prioritize enabling FMPs to access and utilize data from third-country jurisdictions, thereby fostering a fair competitive environment for EU-based market participants.

#4 Specific considerations should be done in relation to the Transition Plan

Reporting entities' transition plans play a vital role in enabling FMPs to allocate capital toward supporting the transition to a more sustainable economy. Therefore, in line with our earlier comments on PAI indicators, we call on the Commission to:

- (i) Remove any materiality assessment on climate disclosures and data points including transition plans and targets, especially for financial products with implementing decarbonization strategies including targets. This is particularly true if transition plans will be required as part of the Corporate Sustainability Due Diligence Directive.
- (ii) Reconsider the fully optional nature of biodiversity transition plans, particularly for "high-risk sectors" according to TNFD and instances when biodiversity has been considered as a material topic.

In conclusion, the introduction of materiality assessments and phasing-in for SFDR data points, as well as transition plan disclosures—especially for climate-related aspects—not only present significant challenges to effective sustainability reporting and investor confidence but also undermine the broader European sustainable finance agenda. By eliminating materiality assessments, we can ensure accurate, comparable, and transparent reporting across firms, reduce dependence on ESG data providers, and guarantee the success of the European Single Access Point (ESAP). We urge policymakers, the European Commission, and all relevant stakeholders to address these concerns, align the CSRD/ESRS with the SFDR, and prioritize the coherence between various EU sustainable finance initiatives.



ABOUT EFAMA

EFAMA is the voice of the European investment management industry, which manages EUR 28.5 trillion of assets on behalf of its clients in Europe and around the world. We advocate for a regulatory environment that supports our industry's crucial role in steering capital towards investments for a sustainable future and providing long-term value for investors.

Besides fostering a Capital Markets Union, consumer empowerment and sustainable finance in Europe, we also support open and well-functioning global capital markets and engage with international standard setters and relevant third-country authorities. EFAMA is a primary source of industry statistical data and issues regular publications, including Market Insights and the EFAMA Fact Book. More information is available at www.efama.org

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