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## Consultation Response

### First set of European sustainability reporting standards

7 July 2023

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The Association for Financial Markets in Europe (AFME) welcomes this opportunity to comment on the European Commission's consultation on the first set of European sustainability reporting standards (ESRS).<sup>1</sup>

Financial institutions have highlighted the urgency of effective implementation of the CSRD and its standards, which have the potential to reduce gaps in sustainability-related information made available by companies and mitigate the sequencing issues and legal uncertainty that have created obstacles to the usability of the broader EU sustainable finance framework.<sup>2</sup>

Streamlining reporting obligations can enhance proportionality and reduce the overall burden for companies, but it should strike a balance with the overall objectives to strengthen disclosures, counter greenwashing, and enable financial institutions' own disclosures as well as investment decisions and risk management.<sup>3</sup> Simplification must go hand in hand with the continued effectiveness of the regulation.

Financial institutions are subject to legal disclosure requirements including Pillar 3 ESG disclosure templates and the Principal Adverse Impact indicators (PAIs) disclosed under the Sustainable Finance Disclosures Regulation (SFDR). In order to be able to effectively meet these obligations, financial institutions require the relevant information from companies that they finance.

Under the revised draft ESRS, an undertaking can decide to omit such datapoints if it assesses the information to not be material. When omitted, such information is implicitly reported as "not material for the undertaking" and there is no obligation for the undertakings to explain why a topic was considered not material.<sup>4</sup>

These datapoints, however, are mandatory for financial institutions' own disclosures and must be included in Pillar 3 and SFDR reporting even if the companies they finance deemed this information not material. Financial institutions' disclosures should be made on a quantitative basis and, for companies not reporting this information under the CSRD, financial institutions may have to resort to a complementary assessment which may involve the use of estimates and proxies.

Existing regulatory expectations do not set out clearly that financial institutions can report zero/nil values for such quantitative disclosures without an additional assessment, even if underlying companies omitted the necessary datapoints having deemed them not to be material. The use of proxies or estimates is not an effective solution for bridging this gap and exposes companies to liability risks.

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<sup>1</sup> AFME's feedback to the EFRAG draft European sustainability reporting standards is available [here](#).

<sup>2</sup> A recent Commission's [staff working document](#) notes the difficulties reported by shareholders with the application of "disclosure requirements under the wider sustainable finance framework due to usability and sequencing issues [...] explained by the pace at which the framework was developed"

<sup>3</sup> The Commission's communication on [a sustainable finance framework that works on the ground](#) notes that: "Sustainability disclosures are a critical source of information for financial institutions to help them direct capital to transition investments and create financial products with sustainability objectives. The CSRD is an important milestone in providing transparency on sustainability risks, impacts and opportunities for undertakings. It is also the basis for companies to provide reliable, accurate and comparable high-quality sustainability information to financial market participants and other stakeholders."

<sup>4</sup> Par. 29 of ESRS 1 General Requirements states that undertakings shall always disclose the information required by ESRS 2 General Disclosures. Appendix B, containing the list of datapoints in cross-cutting and topical standards that are required by EU law, is considered to be an integral part of the ESRS 2.

However, Par. 33 states that an undertaking may also omit the information prescribed by a datapoint of a Disclosure Requirement, including datapoints that derive from other EU legislation listed in Appendix B of ESRS 2, if it assesses such information to be not material and concludes that such information is not needed to meet the objective of the Disclosure Requirement. Par. 36 adds that, when omitted, such information is considered to be implicitly reported as "not material for the undertaking" and Par. 31 states that a company may briefly explain the conclusions of its materiality assessment for that topic.

It is therefore essential that the European Commission provides a timely and effective solution to the treatment of datapoints omitted through the application of a materiality assessment, to ensure that financial institutions can satisfy their disclosure obligations under SFDR and Pillar 3 in an effective manner.

**We thus recommend that the Commission and ESAs provide a solution to enable financial institutions to report effectively where relevant metrics have been omitted by their counterparties due to not being assessed as material.**

It is important that financial institutions are able to reliably report accurate information based on disclosures made in accordance with the ESRS directly by the companies they finance or invest in.

Being able to report “zero” in SFDR and Pillar 3 reporting if financed or investee companies deem this information immaterial may be a solution which would also in turn ensure more proportionate, material and less burdensome disclosures for financial institutions.

A solution must be in place as a matter of urgency, ahead of the ESRS taking effect, to ensure that financial institutions can effectively comply with their reporting requirements.

Similarly, the further flexibility and phase-ins introduced by the Commission for certain provisions should be balanced with the regulatory expectations and disclosure requirements levied on financial institutions.

Notably, the ESRS allow undertakings to omit metrics on their value chains for a period of three years while they obtain this data. Further, for SMEs, CSRD reporting will apply from 2029 (on financial year 2028) and the information will be reported in accordance with simplified standards. Until then, financial institutions are again expected to obtain such information with complementary assessments, estimates and proxies.

Flexibility, in this case, can exacerbate the significant challenges that financial institutions will face with reporting on their downstream business relationships – made up of counterparties which will benefit from the phasing-in of reporting on relevant metrics, as well as SMEs.

**We thus recommend that the ESRS clarify value chain reporting requirements for financial institutions, extending by 2 further years the current 3-year phase-in period related to information on an undertaking’s value chain, thus improving the sequencing for the application of the requirements.**

We welcome the work to improve the interoperability of the ESRS and the ISSB disclosure standards - essential for global companies to claim compliance with ISSB standards when adhering to the ESRS. However, we note that the materiality assessment process will also have an impact on the interoperability between the ESRS and the global baseline developed by the International Sustainability Standards Board.

Due to being intended for a different range of stakeholders, the financial materiality assessment carried out under the ESRS will be broader than the financial materiality assessment carried out under IFRS S1 and S2. We encourage the European Commission to continue to work with the ISSB to maximise interoperability of the respective standards and avoid companies having to carry out separate financial materiality assessments under the EU and ISSB standards, leading to duplicative reporting. Moreover, well calibrated requirements and appropriate guidance would assist companies when applying both sets of standards.

**We thus recommend that the Commission continues to strengthen its engagement with the ISSB to enhance interoperability, including in relation to the financial materiality assessment.**

**We also recommend that the Commission develops comprehensive tools to map and help companies navigate the differences between European and global standards.**

Interoperability would also benefit from clarity as to whether global financial institutions can assume that the datapoints required by both ESRS and ISSB standards can be used interchangeably. This clarification may result in enabling financial institutions not only to build on extensive voluntary sustainability reporting, but also centralize and consolidate their sustainability reporting efforts across various jurisdictions where they operate, potentially benefiting from the exemption from reporting for their subsidiaries.

Finally, it is important that the standards acknowledge that certain non-EU issuers may be within the scope of reporting under these standards, further to the amendments made by CSRD to the annual reporting requirements in the Transparency Directive.

At present, the draft standards possibly contemplate the application of requirements under other EU legislation such as the EU Taxonomy Regulation, CRR, SFDR or the Benchmark Regulation and/or include statements which do not reflect the correct application of other EU legislation to non-EU financial institutions (e.g., the requirement to disclose information under the Taxonomy Regulation).

However, such non-EU financial institutions may not be subject to the relevant EU legislation referenced in the ESRS. Some members headquartered outside the EU therefore consider that it should be clarified in the ESRS that such requirements are not mandatory for non-EU issuers and it should be acknowledged in the final standards, that the ESRS do not extend the scope of any EU legislation.

We hope that due consideration is given to these points in ahead of the Commission's adoption of the standards as well as with further guidance, and would be very happy to discuss these points further.

## **Contacts**

Oliver Moullin, Managing Director, Sustainable Finance and General Counsel

[Oliver.Moullin@afme.eu](mailto:Oliver.Moullin@afme.eu)

Giorgio Botta, Manager, Sustainable Finance

[Giorgio.Botta@afme.eu](mailto:Giorgio.Botta@afme.eu)

Carolina Cazzarolli, Manager, Advocacy

[Carolina.Cazzarolli@afme.eu](mailto:Carolina.Cazzarolli@afme.eu)

## **About AFME**

AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society.<sup>5</sup>

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<sup>5</sup> AFME is the European member of the Global Financial Markets Association (GFMA) a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association (ASIFMA) in Asia. AFME is registered on the EU Transparency Register, registration number 65110063986-76.