Finance for Europe

**Association for Financial Markets in Europe**

# Response to EFRAG's consultation on the draft ESRS Implementation Guidance on the materiality assessment, value chain and ESRS datapoints

2 February 2024

The Association for Financial Markets in Europe (AFME)[1] welcomes the opportunity provide feedback on EFRAG's draft ESRS Implementation Guidance on the materiality assessment, value chain and ESRS datapoints.

We set out below our cross-cutting feedback to EFRAG on the draft ESRS Implementation Guidance (IG) including input relevant to the forthcoming sectoral standards for the financial services sector. This is followed by our specific feedback to each of the three draft ESRS IG which we have also submitted through the online survey.

AFME members welcome the opportunity to provide feedback to EFRAG on its three sets of draft ESRS implementation guidance and appreciate the work EFRAG has done in preparing these guides for the industry. In particular, we consider that EFRAG IG 3 will be a very useful checklist for firms in preparing their CSRD reports and have provided some suggestions on further enhancing the usability of the spreadsheet of CSRD datapoints drafted by EFRAG in our feedback to the relevant survey.

## 1. Cross-cutting comments

### Request for further guidance for the financial services sector in sector-specific ESRS

We have submitted our detailed feedback in the survey for each guidance document, and an overarching theme in our comments is a request for further guidance for the financial services sector to be provided as part of the sector-specific ESRS. In general, we note that both the materiality assessment implementation guidance and the value chain assessment guidance contain very few examples on how to apply these concepts to the financial services sector. We urge EFRAG to clarify the application of these terms to reporting undertakings which are regulated financial undertakings as part of the sector-specific ESRS. AFME is willing to engage with EFRAG in order to provide input into the sector-specific ESRS relevant to regulated financial undertakings.

### Transition period for sector-specific standards

We understand that the sector-specific standards are expected to be published in 2026 and would welcome EFRAG setting out an updated timeframe following the expected extension of the deadline for delivery of the sector-specific guidance to 30 June 2026.

If reporting undertakings will be required to apply the sector-specific standards in relation to their reports of 2027 (on FY 2026), this will impose a significant compliance burden on reporting undertakings. This would particularly be the case if the sector-specific standards mandate any additional metrics to be reported on, since reporting undertakings will need to gather this information during FY 2026 itself (and in most cases it

1

may not even be possible to collect this information in hindsight). We would therefore strongly urge EFRAG to clarify that all reporting undertakings will have a full financial year at the minimum (and ideally an 18–24-month implementation period) to apply and to implement the sector-specific standards as an implementation period and that reporting undertakings may apply the transitional provisions relating to entity-specific disclosures for the whole interim period during which the sector-specific standards have not yet become applicable.

In addition, AFME would like to take this opportunity to urge EFRAG to allow industry sufficient time to comment on the draft sector-specific guidance and to ensure that the sector-specific standards are as concise as possible, with minimal repetition. We finally request that EFRAG provides clarity on the anticipated timeline for the sector-specific standards, so that AFME's members can plan appropriately.

## Guidance on application of Article 48i transitional provision

In addition, neither the materiality guidance nor the value chain guidance contains any guidance relating to firms which choose to rely on the transitional provision set out in Article 48i of the Accounting Directive (which allows them to prepare a consolidated report for any in-scope EU subsidiaries that sit under a non-EU parent). Given firms can rely on this transitional provision from 2024 until 2030, AFME strongly urges EFRAG to clarify how the materiality and value chain concepts apply to undertakings reporting under Article 48i of the Accounting Directive.

## Application of materiality assessment at group or entity level

As a related point, in the future an increasing number of firms are likely to publish CSRD reports covering their whole group, instead of reports covering individual entities, as more entities become subject to CSRD. AFME strongly recommends that EFRAG confirms that firms may choose to adopt a group-level approach to conducting a materiality assessment currently (prior to those firms publishing group reports), which can then be utilised by each reporting subsidiary to assess their own business activities for their own reports. This would avoid the possibility of EU subsidiaries within one group utilising different methodologies for the materiality assessment, which would later have to be reconciled at the group level, and ensure that the materiality assessment is applied consistently for reporting entities within one group.

## 2. Response to EFRAG survey on draft ESRS IG1 on Materiality Assessment

### Summary

In paragraph 12, we believe there is a typographical error: "(also known as ISBB Standards)" should read "(also known as ISSB Standards)".

### Chapter 1: Introduction

With respect to the disclaimer outlining the non-authoritative nature of this guidance, we would welcome further clarification on what exactly this means. In particular, we understand this to mean that the guidance is not binding on undertakings obliged to publish CSRD reports and only provides examples of how undertakings could carry out their materiality assessments, so we would welcome EFRAG's confirmation on this point.

In paragraph 22, we note that the hyperlinks to the delegated acts are broken.

### Chapter 2: the ESRS approach to materiality

<u>Paragraph 25</u>

In paragraph 25, we believe there is a typographical error and "the" should be deleted: "…as well as in its the upstream and downstream value chain".

<u>Paragraph 30</u>

Paragraph 30 states, "the MA process (including criteria and thresholds applied and conclusions) should be consistent with internal and other external reporting". In relation to internal reporting, we believe that it is extremely important that EFRAG clarify their guidance regarding which parts of the materiality assessment need to be provided to the board of the relevant reporting undertaking. Given the materiality assessment may involve applying different thresholds for each of the different sustainability matters/topics, we request that EFRAG clarifies the extent to which KPIs relating to the materiality assessment need to be reported to the board. We recommend that the board should not be required to review the particular thresholds used for the materiality assessment of each sustainability matter.

In addition, in relation to external reporting, AFME members would welcome EFRAG's clarification on its expectations in this regard and confirmation that this does not go beyond the requirements set out in the ESRS regarding the disclosures which undertakings must include in their CSRD reports regarding how they have carried out their materiality assessment.

<u>Figure 1.b</u>

We would welcome figure 1.b being re-worked in order to clarify the following points:

- the legend contains a single line dotted arrow, however this does not appear in the figure at all; and
- it is not clear if the bold arrows (indicating, "Materiality assessment outcome in terms of sustainability reporting") should be included in the top half of the diagram (relating to the IRO universe), or if these

should be a different colour from the bold arrows included in the bottom half of the diagram (relating to IRO assessment and reporting).

Section 2.2: Understanding key concepts for the materiality assessment

We note that paragraph 8, ESRS 1 states that the sustainability topics, sub-topics and sub-sub-topics should collectively be considered "sustainability matters", as reflected by figure 2. We also note that paragraph 45 of IG 1 states, "The undertaking needs to identify whether a topic, sub-topic or sub-sub-topic is material from any of the two perspectives…".

AFME members would welcome EFRAG's confirmation that if an undertaking concludes a topic (e.g., "biodiversity and ecosystems") is immaterial following their materiality assessment, then the undertaking is not also required to conduct the materiality assessment at the sub-topic or sub-sub-topic level. We believe this is consistent with appendix E of ESRS 1, in which, if an undertaking answers that a topic covered by a topical standard is not material, the undertaking can omit the disclosure requirements of the topical standard, and only has to consider if particular metrics or disclosure requirements contained in the topic are material if the topic is material. We therefore request EFRAG to clarify this point in this section of the guidance.

Moreover, paragraph 48 of IG 1 states, "once a given matter is assessed to be material, the information to be disclosed is identified at matter level, following the datapoints of the relevant DR in the topical standards." The ESRS are clear that reporting undertakings should also apply the materiality assessment at the level of each individual Disclosure Requirement and Data Point (appendix E, ESRS 1). However, IG 1 does not provide any examples of how particular Data Points can be assessed for materiality. We request that EFRAG provides examples of criteria which reporting undertakings can apply in order to determine the materiality of single Data Points, in order to guarantee greater homogeneity and objectivity in the approaches adopted by reporting undertakings and therefore comparability between disclosures, especially between companies belonging to the same sector. This is particularly important considering that sector standards are not yet available and are unlikely to be available until 2026.

## Chapter 3: How is the materiality assessment performed?

We note that EFRAG lists a large number of steps which undertakings may carry out as part of "Step A: Understanding the context". We believe that reporting undertakings need only to gather this information to the point they are sufficiently comfortable they can conduct the materiality assessment and identify its IROs. We therefore request that EFRAG confirms this in the guidance.

In chapter 3.5, EFRAG sets out the role and approach to stakeholders in the materiality assessment process and states that, "Dialogue with affected stakeholders may assist during various steps of the materiality assessment." In relation to financial institutions specifically, engaging with stakeholders is not practical (and often impossible) given the extremely high number of potential stakeholders and the nature of those relationships. We request that EFRAG clarifies in the guidance that in certain cases (particularly including in relation to large financial institutions), engagement with stakeholders is not always necessary, depending on the type of reporting undertaking, the nature of its services and relationships. For example, engaging with stakeholders may not be necessary where suitable public information is available in respect of that stakeholder, where the reporting undertaking already has sufficient information to carry out the materiality assessment in relation to certain stakeholders or where the reporting undertaking has engaged with representatives of stakeholders (such as the WWF in relation to climate and nature issues).

### Chapter 4: How to leverage other sources?

No comments.

### Chapter 5.1: FAQs on Impact Materiality

No comments.

### Chapter 5.2: FAQs on Financial Materiality

Paragraph 156(c) of the guidance states, "future events may trigger anticipated sustainability-related risks and opportunities while financial statements typically account for risks based on past events". Given the time horizons differ between financial and sustainability reporting, we request that EFRAG clarifies the recommended time horizons to be used for CSRD reporting, including a time limit for the long-term time horizon (keeping in mind a realistic time limit of how far into the future an undertaking can estimate its future sustainability risks and opportunities).

### Chapter 5:3: FAQs on the materiality assessment process

No comments.

### Chapter 5:4: FAQs on stakeholder engagement

No comments.

Chapter 5.5: FAQs on aggregation/disaggregation

No comments.

### Chapter 5.6: FAQs on reporting

No comments.

### Chapter 5.7: FAQs on art. 8 EU taxonomy

No comments.

## 3. Response to EFRAG survey on draft ESRS IG2 on Value Chain

### The summary of the VCIG

We note that EFRAG has stated that the undertaking's sustainability statement shall include information about all material IROs which arise in its upstream or downstream value chain. In relation to GHG emissions, it is clear how financial undertakings should measure this in their value chain (i.e., through GHG emissions). However, in relation to the other sustainability matters covered by the ESRS, we believe that the extension of sustainability financial materiality to business relationships throughout the value chain risks double-counting of risks (particularly in relation to the metrics which do require value chain information). For example, without a specified "financed biodiversity" or "financed pollution" metric, different reporting undertakings could report on the same value chain entity and therefore the impact of that value chain entity would be double-counted. We urge EFRAG to clarify how financial institutions can avoid double-counting of risks and opportunities in such scenarios and to ensure this is taken into account as part of the sector-specific standards.

As set out in our comments below, we would also welcome confirmation on which CSRD metrics require inclusion of value chain metrics – as the position is not very clear in the ESRS or draft EFRAG IG2.

### Chapter 1: Introduction

No comment.

### Chapter 2: Navigating Value Chain under CSRD and ESRS

Paragraphs 18 and 26

We note that the hyperlinks to the delegated acts in paragraphs 18 and 26 are broken.

Paragraph 28

Our members are generally supportive of EFRAG's guidance set out in paragraph 28, that the ESRS do not require information on every actor in the value chain but only the inclusion of material value chain information. However, this paragraph also states that the value chain includes both direct and indirect relationships. We note that elsewhere, the guidance states that "the relevant impacts are not ringfenced by…contractual relationship" (see paragraph 71). We are extremely concerned by this guidance, given firms operating in the financial sector generally have an extremely large number of relationships and therefore this definition of value chain relationships is unlikely to be practical for them and would cause a significant burden. Therefore we strongly recommend that EFRAG clarifies that for firms in the financial sector, it would be reasonable to limit value chain relationships to contractual relationships.

In the event that EFRAG does not clarify this, we request that EFRAG provides greater clarity and examples of what is meant by "indirect business relationships".

Paragraphs from 40 to 47

IG 2 appears to include all joint operations in the scope of sustainability reporting and introduces the concept of "operational control" over the entity. We ask for better clarification of the definition of "operational control".

Paragraphs 49 and 52

It is unclear whether the "*investments*" row in the table in paragraph 52 could be applied broadly in relation to all investments made by regulated financial undertakings, or whether it is only relevant to associates and joint venture style arrangements which are to be treated as investments (as suggested by paragraph 49).

We would welcome EFRAG's confirmation that the "investments" row could be applied to investments made by financial services undertakings (e.g. Treasury investments or asset management investments) and confirmation that there are no specific requirements relating to the metrics required to be disclosed in relation to investments of financial undertakings (other than scope 3 GHG emissions).

For example, can brokers that hold less than 20% in a company for short term gain, exclude those short terms investments from a materiality perspective? Similarly, can asset managers investing less than 20% in a company (for longer term purposes) descope them on the basis of materiality? If EFRAG does not take that view (because firms are expected to set their own materiality thresholds) then is it the case (as the table suggests) that only scope 3 GHG emissions of such investments need to be reported?

Paragraph 53

We request that EFRAG clarifies in this decision tree the difference between "customer" and "investment", particularly in relation to financial services and how they can categorise their customers (in whom they may also invest).

Paragraph 57

We note that the link to paragraph 130 does not work.

Paragraph 61

Paragraph 61 refers to the transitional provisions relating to value chain information. We request that EFRAG clarifies its expectations regarding the reasonable efforts which firms should apply in order to gather the relevant data for CSRD reporting purposes on their value chain. In particular, if information is not publicly available, we recommend EFRAG clarifies if reporting undertakings will be expected to use third-party data vendors in order to gather information on their value chain.

Elsewhere, EFRAG notes that CSRD limits the value chain information that the ESRS shall require undertakings in scope of the CSRD to obtain from SMEs (paragraph 67). We suggest that EFRAG confirms that following the end of the transitional period of the value chain provisions, reporting undertakings will still be held to this limit and will not be required to gather information beyond the LSME cap from SMEs in their value chain.

Paragraph 67

We recommend that EFRAG confirms that reporting undertakings will not be required to demand information from SMEs in their value chain which goes beyond their own public CSRD disclosures.

## Chapter 3: FAQ 1

No comment.

## Chapter 3: FAQ 2

AFME members welcome the particular example relating to financial services, and we urge EFRAG to provide further details in the sector-specific ESRS regarding the reporting of financial services firms on their financial counterparties. In particular, the example given relates to lending activity, however we recommend that in the sector-specific ESRS, EFRAG also clarifies its expectations with regard to other types of activities carried out by financial undertakings, including underwriting, brokerage activities, providing clients with investment advice and off-balance sheet investing (such as by asset managers).

## Chapter 3: FAQ 3

No comment.

## Chapter 3: FAQ 4

No comment.

## Chapter 3: FAQ 5

No comment.

## Chapter 3: FAQ 6

We welcome EFRAG's confirmation that most DRs relating to metrics cover only own operations (except for entity-specific disclosures). We request that EFRAG additionally notes in this FAQ that the transitional provisions relating to value chain apply in relation to entity-specific disclosures. This means that, where an undertaking concludes that a particular IRO in its value chain is material and is not covered by a topical standard, the undertaking will still not be required to include upstream and downstream value chain information in its CSRD report for the first three years of reporting, except for datapoints derived from other EU legislation (see paragraph 133(b), ESRS 1).

We also welcome EFRAG's list of metrics which do require disclosures of value chain information and we expect this will be extremely helpful for AFME members in determining the metrics which need to be gathered from their value chain. We strongly suggest that EFRAG confirms that this list is exhaustive of the metrics which require value chain information, so that reporting undertakings can rely on the list. This would be extremely helpful in allowing undertakings to ensure they have gathered all necessary information from their value chain. Alternatively, if the list is not intended to be exhaustive, we would strongly urge EFRAG to identify which other metrics require disclosure of value chain information, because this is not otherwise clear from the rules or guidance (please also see our comments below on Chapter 4, VC Map).

## Chapter 3: FAQ 7

No comment.

## Chapter 3: FAQ 8

We welcome the response to FAQ 8, which explains that reporting undertakings can estimate missing information using estimates, sector-average data and other proxies. However, noting that this reporting may be included in financial statements, we are conscious that sustainability reporting incurs significant liability risk for firms using estimates, assumptions and general data in their reporting. We would be grateful if EFRAG would consider clarifying how firms should effectively manage this liability risk.

### Chapter 3: FAQ 9

No comment.

### Chapter 3: FAQ 10

No comment.

### Chapter 4: VC map

Our members welcome the VC coverage map however we believe the map could benefit from greater clarity regarding rows 10 and 11. Row 10 states that in relation to the SFDR indicators, "VC to be covered to the extent that foreseen in the relevant technical standards", however the SFDR RTS do not foresee any value chain metrics to be included in disclosures by SFDR in-scope entities (nor do the SFDR RTS envisage whether CSRD should refer to certain SFDR metrics in relation to value chain). Instead, we believe row 10 should be deleted and subsumed as part of row 11, so that SFDR is treated in the same manner as other EU law.

We also note that the VC coverage map is accompanied by notes, including a reference to E5-6 "Waste treatment may sometimes require information from supplier who treats waste", however there is no reference to E5-6 on the VC coverage map.

The VC coverage map includes in row 7 (on "Disclosure of procured materials") references to E2-5 and E5-5. However, there is no specific definition of the VC coverage of this disclosure on the coverage map.

ESRS S1 relates to disclosures on own workforce and we would expect it to be classified as relating to the reporting undertaking's own operations and not its value chain. However, the VC coverage map refers to S1-1 to S1-5 in row 4, indicating that these disclosure requirements require information on the value chain to be reported. S1-1 to S1-17 is also referred to in row 6, indicating that there is no requirement for value chain coverage in relation to these disclosure requirements. AFME requests that AFME clarifies whether or not the S1 topical standard requires value chain information.

## 4. Response to EFRAG survey on draft ESRS IG3 on Detailed ESRS datapoints

### The explanatory note itself

AFME members welcome the list of ESRS datapoints and explanatory notes, given this will be a helpful resource for reporting undertakings to rely on when compiling their CSRD reports.

Our members would also be grateful for standard format tables, divided by the type of datapoint, to ensure consistency and automated readability.

We note that EFRAG has stated that it will launch the public consultation on the draft ESRS-XBRL taxonomy at the beginning of 2024 (paragraph 11). We believe that firms would likely need at least six months to schedule and implement electronic reporting for CSRD. In the first instance, reporting providers will need to update their packages to the new XBRL requirements, and only then would firms be able to implement to conform to these reporting requirements. We therefore suggest that EFRAG takes this into account in their timelines and any transitional periods which it sets for reporting undertakings.

The explanatory note states that each topical standard referencing the MDR has a dedicated hyperlink (paragraph 16). We request that EFRAG corrects these hyperlinks, which appear to be broken once the file is downloaded.

Paragraph 17 (column G) refers to "the data reported under the Appendix C-ESRS 2 [SFDR, Benchmark and Pillar 3]", however we believe that this should instead refer to Appendix B.

### 'Index' sheet

As previously stated, our members welcome this useful spreadsheet however we believe that our recommendations below could improve the usability of the spreadsheet, with its key purpose in mind to enable reporting undertakings to manage and to track the implementation of processes required to prepare its disclosure.

- We recommend that EFRAG incorporates explanatory notes and a legend for cells colours into the spreadsheet at the appropriate points. This would help alert the user to the content and purpose of the information in the spreadsheet. It would improve usability by ensuring that each page can be understood on a standalone basis, without the need for a back and forth between the spreadsheet and the standards themselves. For example, Column F is supposed to indicate the XBRL data type rather than describing what the nature of the disclosure point is/ what data needs to be collected. In the majority of cases, these two things match up but there are examples where it may cause confusion e.g. ESRS E4-1 point AR 1(e).
- In addition, we recommend that EFRAG clarifies in the excel which data points are mandatory, which subject to Materiality Assessment, and which are voluntary. Where a phase-in option allows a reporting entity: (i) to make the full disclosure; (ii) to omit disclosure in full in year 1; or (iii) to provide qualitative disclosure in year 1; EFRAG appears to have reflected that in the spreadsheet by marking quantitative data points (and related qualitative disclosure points that are linked to the quantitative

disclosure points) as subject to phase in, but the qualitative disclosures as not subject to phase in. We assume that this is highlight the points which would need to be disclosed against if you were making a qualitative disclosure but, because there is no phase in marked, it appears as though the point is mandatory. See e.g. ESRS E1-9 para AR 69a.

- Further to our comments above, we would also request the excel identifies the metrics that require disclosure of value chain information. We would find it extremely helpful if a new column is introduced in the datapoints spreadsheet to identify whether the datapoint relates to the reporting undertaking's own operations or to their value chain, and we believe that this would also promote consistency across CSRD reports.
- We suggested that EFRAG ensures that all text in the excel is consistent with the text in the underlying ESRS. For example, the excel refers to GHG "reversals", which is referred to as "removals" in the ESRS.
- The number of voluntary datapoints mapped out in the spreadsheet also does not reconcile with those listed in the explanatory pdf, so we recommend reconciling this.
- We have observed deviations between the excel datatypes that identify disclosures as narrative, semi-narrative etc. and the requirements set out in the ESRS. Please confirm alignment between the ESRS requirements and the datatypes in the final publication of the EFRAG guidance.

### ESRS E1 sheet

It is not clear to us which disclosure requirements are being referenced in rows 114-123. If these rows are intended to refer to the table of AR 48, we recommend that EFRAG specifies this, for example by stating: *"The undertaking shall disclose its total GHG emission: Gross Scope 3 greenhouse gas emissions based on the GHG protocol categories, Accounting and Reporting Standard or EN ISO 14064-1:2018 Annex H.3.2 in line with table categories 1-15 specified under Application Requirement 48".*

## 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.

AFME is registered on the EU Transparency Register, registration number 65110063986-76.

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