Deutsches Aktieninstitut

Public consultation on the first set of draft ESRS – Cover Note

Leaner and more practice-oriented sustainability standards necessary

Frankfurt/Brussels, 5 August 2022

Introduction

Deutsches Aktieninstitut, the German association of listed companies, welcomes the opportunity to comment on the first set of draft European Sustainability Reporting Standards (ESRS). We fully support the standardization of sustainability reporting in order to provide companies with the right set of tools for publishing accurate, verifiable, relevant and comparable sustainability information. However, the present exposure drafts are overly complex and extensive, and lack prioritization. Also, they are unclear with respect to various concepts and definitions, contain numerous inconsistencies as well as overlaps with existing regulation, and will lead to competitive disadvantages for companies. Unless radically simplified, the disclosure requirements will put the effectiveness of the future ESRS at stake.

The ESRS should also not create new legal requirements for preparers as this is not the purpose of sustainability reporting standards. It is essential that the final ESRS are aligned with the requirements in the final legal text of the CSRD – without any additional disclosure requirements that lack specification in the CSRD. The ESRS should also not go beyond current EU and national legislation.

In addition to our response to the online surveys, we would like to point out our key messages with this cover note.

Deutsches Aktieninstitut suggests:

1. Maximum alignment with ISSB standards necessary;
2. Delete the concept of rebuttable presumption;
3. Align impact materiality concept to GRI terminology;
4. Align financial materiality concept with ISSB approach;
5. Simplify reporting obligations;
6. Prioritize leaner disclosure requirements;
7. Retain option for integrated reporting;
8. Narrow the definition of value chain and establish safeguards;
9. Clarification and alignment with existing reporting frameworks;
10. Set realistic time frame for review of responses.

1. Maximum alignment with ISSB standards necessary

Maximum alignment and full interoperability/compatibility of the ESRS with the IFRS Sustainability Disclosure Standards is crucial in order to prevent a situation in which EU preparers are required to report under both (potentially even non-complementary) sets of standards in order to comply with EU law and respond to market expectations at the same time. Double reporting would result in unnecessary additional costs and reduced validity and comparability of data. Any inconsistencies not caused by mere extensions of the global baseline should be avoided. We strongly recommend establishing a regular and very close dialogue with the ISSB, especially at technical staff level, and the development of a collaboration model that enables global alignment and ensures a high level of synchronization of both sets of standards as soon as possible.

2. Delete the concept of rebuttable presumption

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 all or the vast majority of sectors. The rebuttable presumption, however, creates the impression that they are material, thereby entailing a significant risk in terms of an emerging "need for justification" to the public as well as significantly higher efforts for, e.g., documentation and stakeholder engagement. It is essential that the materiality assessment is fully performed by the management. As the materiality assessment will be subject to audit, there is no need to justify why certain sustainability topics are not material. The standard setter can define relevance, but not materiality.

The rebuttable presumption approach also differs significantly from the approaches taken by the ISSB and the GRI, and is inconsistent with current financial reporting in addition. This would not only significantly impede interoperability with the global baseline, but also connectivity between sustainability and financial information.

Moreover, there cannot be any disclosure requirements as regards immaterial information, neither in terms of a list of immaterial aspects nor in terms of immateriality evidence. Such information would per nature be immaterial itself and, thus, be of very limited value for stakeholders. The concept of materiality is key and should drive the reporting process. Otherwise, sustainability reporting will result in a massive information overload and thereby dilute the management report with immaterial content.

Finally, the rebuttable presumption would reverse the burden of proof for the company. Proving that a disclosure requirement is not material is hardly feasible for companies. Against this background, the rebuttable presumption will not

contribute to setting the right focus on reporting obligations. Therefore, we propose to delete the rebuttal presumption and leave the materiality assessment in the hands of preparers and their auditors.

3. Align impact materiality concept to GRI terminology

The definition of impact materiality seems to some extent aligned with the GRI's approach. However, we propose aligning this definition even more closely with the GRI terminology, which is clearer and more precise. The GRI Standards are the most widely used standards globally for impact materiality, and closer alignment will help reduce confusion and achieve consistency in reporting at global level.

4. Align financial materiality concept with ISSB approach

When it comes to financial materiality, we strongly recommend fully aligning the definition with the approach of the ISSB, which focuses on 'enterprise value', rather than on 'value creation' and 'capitals'. A different approach would significantly impede interoperability with the global baseline and connectivity between sustainability and financial information, while not resulting in any benefits, also given the lack of market practice and field-testing of such a new, less elaborated concept for financial materiality.

5. Simplify reporting obligations

The proposed ESRS foresee 137 disclosure requirements, including numerous sub-requirements. The application guidance adds even more requirements, translating into far over 800 data points and disclosures in total. The application guidance should, however, not add further reporting burdens on companies, but (only) provide guidance on how to implement the disclosure requirements.

Also, the proposed ESRS are too granular and too extensive. The exposure drafts for example foresee disclosure on action plans, where numerous information would have to be provided at action-level. Companies should not be obliged to disclose separate information for (most likely in most cases highly interlinked) individual actions. Instead, such disclosures should be provided on a more aggregated level. Also, overly granular requirements will lead to competitive disadvantages vis à vis companies that do not fall in the scope of the CSRD. (e.g. as regards resources for action plans). Such disadvantages can be avoided by significantly reducing granularity. Finally, the overly granular data to be published by companies will make it very difficult if not impossible for stakeholders to assess which of the disclosed information is indeed material.

Some data may be company/competitor-sensitive and accordingly the ESRS should allow for exceptions where needed, for example as regards the following disclosure requirements: descriptions of investment plans or information on the cost of raw materials and respective turnover as well as granular CapEx plans and plans to enter new markets are confidential and will commonly contain information that is commercially-sensitive.

Moreover, the information to be disclosed by companies under the ESRS will inevitably lead to double reporting due to many overlaps of disclosure requirements with other EU legislation, which need to be significantly streamlined by EFRAG before submission to the EU Commission.

The level of information that has to be disclosed by companies will result in massive implementation efforts and costs. Therefore, every disclosure requirement has to be scrutinized by the EFRAG/EU Commission on the basis of its harness and a cost-benefit analysis. In the end: less is more!

6. Prioritize leaner disclosure requirements

Certain standards should not be as detailed as foreseen in the exposure drafts. It should be sufficient that companies disclose a few important features on each ESRS, at least in a first step. This applies especially where measurements, metrics and data collection have not yet reached the same maturity as in other areas as well as for ESRS which are not of sector-agnostic relevance. We believe that it is necessary to develop and agree on the right metrics and measurements before companies will be obliged to report on the respective (sub-)topics, e.g., on biodiversity and pollution. The data published by companies under the respective ESRS will otherwise fall short not only of the objective of comparability but also of the ability of assuring the data.

A reasonable prioritization approach is indispensable, taking into account proportionality in general as well as the high number of companies that will be required to disclose sustainability information in a systematic way for the first time. In a first step, i.e. upon initial implementation, the focus should lie on

- Alignment with the SFDR (as foreseen by the CSRD);
- Actual needs of (key) users;
- Covering climate adequately; and
- Own operations and the consolidation scope (to ensure feasibility by all companies in scope of the CSRD).

Some of the disclosure requirements in the ESRS that are included in the sector-agnostic standards should be transferred to the sector-specific standards. This, for example, applies to the ESRS on pollution and water, which contain numerous disclosure requirements that are not relevant for non-manufacturing companies.

7. Retain option for integrated reporting

The final text of the CSRD states that the sustainability information has to be disclosed in a dedicated section of the management report. Nevertheless, we would like to reiterate that integrated reporting should remain an option. We are of the opinion that an integrated sustainability reporting approach stands for a connection between and the equal importance of financial and sustainability reporting as well as for integration of sustainability matters throughout the organization and down to the operational level of the entity. Companies and stakeholders alike acknowledge the better understanding of the entity's strengths, weaknesses, opportunities, and threats through integrated reporting.

Also, a reasonable degree of flexibility is clearly necessary for each company to be able to choose the most appropriate way of communicating with its stakeholders, taking into account its idiosyncratic context. However, this also requires flexibility in terms of storyline, order of disclosure and integration of (at least) sustainability information (across ESRS and respective disclosure requirements) and (at best) sustainability information and financial information.

Finally, EFRAG should allow for extensive cross-referencing within the sustainability statements, throughout the management report and to other documents such as the financial statements and the corporate governance statement. In order to make information easier to find, a location table might be useful.

8. Narrow the definition of value chain and establish safeguards

The definition of the value chain in the ESRS is too broad. 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 direct suppliers and direct customers ("Tier 1" contractors) have to be addressed.

The definition of the value chain also leads to legal issues. It is very difficult if not impossible for companies to obtain information from suppliers that do not fall in the scope of the CSRD. Some ESRS foresee the data collection for data which cannot be obtained in a legal manner by companies. This, for example, applies to ESRS S1 Own workforce which stipulates that companies have to disclose information on persons with disabilities.

Full value chain-reporting may not be possible during the first years of application. Hence, safeguards must be established, that should also apply for forward-looking information.

9. Clarification and alignment with existing reporting frameworks

The issue of unclear definitions is common for all ESRS. Examples are “biodiversity friendly consumption and production” (ESRS E4 Biodiversity and ecosystems), “prevention, minimization and avoidance” (ESRS E2 Pollution) and the unclear cross-cutting definition of workers, non-employee workers, workforce and employers in the social ESRS. The requirements stem from other frameworks, but different terminology has been used.

As definitions are unclear or even missing in the ESRS, this leads to legal uncertainties for companies and ultimately to the disclosure of non-comparable data. We urge EFRAG to use equal definitions and metrics as the ones from the IFRS regarding financial reporting, IFRS S1 and IFRS S2 and GRI, wherever possible. Uniform definitions are of paramount importance to achieve comparable sustainability information. Against this background, the present inconsistencies between the use of terms and definitions within and between ESRS (examples: “turnover” vs. “revenue”, “sustainability report” vs. “sustainability statement”, definition of “circular economy” varies in E5, “significant employment” within S1) should be resolved.

10. Set realistic time frame for review of responses

We understand the ambitious timeline set by the CSRD for submitting the first set of ESRS to the European Commission by November 2022. However, a 100-day instead of 120-day consultation period makes it very difficult if not unrealistic for stakeholders to respond comprehensively to the consultation. Approximately 400 pages of ESRS and approximately 200 pages of survey cannot be adequately reviewed and completed in this short period. Especially questions whether the disclosures are “sufficiently consistent with relevant EU policies and other legislation” or “aligned (…) to international sustainability standards given the CSRD requirements” require significant effort and in-depth assessments. The summer holiday season made it even more challenging to respond to the consultation effectively.

Also, it is unclear to us how the expected more than 1,000 responses to the consultation can be reviewed in depth by EFRAG and implemented into the final technical advice for ESRS in due time. In order to achieve practice-oriented high-quality ESRS, it is of paramount importance that the responses to the consultation are thoroughly reviewed.

The very tight review period also makes it difficult to achieve alignment and full interoperability with the ISSB's global baseline, which is, however, a key success factor for the EU sustainability reporting framework.

Contact

Dr. Uta-Bettina von Altenbockum
Head of Communications
Phone +49 69 92915-47
altenbockum@dai.de

Jessica Göres
Policy Advisor Sustainability
Phone +49 69 92915-39
goeres@dai.de

Jan Bremer
Head of EU Liaison Office
Phone +32 2 7894101
bremer@dai.de

Frankfurt Office:
Deutsches Aktieninstitut e.V.
Senckenberganlage 28
60325 Frankfurt am Main

EU Liaison Office:
Deutsches Aktieninstitut e.V.
Rue Marie de Bourgogne 58
1000 Brussels

Berlin Office:
Deutsches Aktieninstitut e.V.
Alte Potsdamer Straße 5, Haus Huth
10785 Berlin

Lobbying Register German Bundestag: R000613
Transparency Register: 38064081304-25
www.dai.de

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