CONSULTATION RESPONSE: KEY RECOMMENDATIONS

PUBLIC CONSULTATION ON THE FIRST SET OF DRAFT EUROPEAN SUSTAINABILITY REPORTING STANDARDS (ESRS)

August 2022

To inform this response, the following investor groups have been consulted: PRI Corporate Reporting Reference Group and PRI Global Policy Reference Group. This consultation is not an endorsement or acknowledgement of the views expressed in this response.

Please note that this document contains PRI's key recommendations in response to Sections 1, 3A and 3B of EFRAG's public consultation on the first set of Draft European Sustainability Reporting Standards (ESRS).

Our full responses to the consultation are available here.

INTRODUCTION

The Principles for Responsible Investment (PRI) works with its international network of signatories to put the six Principles for Responsible Investment into practice. Its goals are to understand the investment implications of environmental, social and governance (ESG) issues and to support signatories in integrating these issues into investment and ownership decisions. The PRI acts in the long-term interests of its signatories, of the financial markets and economies in which they operate and ultimately of the environment and society as a whole.

The six Principles for Responsible Investment are a voluntary and aspirational set of investment principles that offer a range of possible actions for incorporating ESG issues into investment practice. The Principles were developed by investors, for investors. In implementing them, signatories contribute to developing a more sustainable global financial system.

The PRI's Driving Meaningful Data programme is a key PRI Blueprint target and works on the types of data, sources and reporting frameworks needed to support responsible investors. This work includes ensuring consistent data across all the various units and entities, as well as addressing gaps identified in the Driving Meaningful Data Framework. This requires collaboration with others across the financial and corporate sectors as well as standard setters, policy makers and regulators. The PRI has an important role in working with our signatories to provide a clear signal on their data needs, how they aid decision-making and understanding their contribution towards sustainability objectives.

The PRI develops analysis and recommendations based on signatory views and evidence-based research. The PRI welcomes the opportunity to respond to the European Financial Reporting Advisory Group (EFRAG) public consultation on the first set of Draft European Sustainability Reporting Standards (ESRS).

ABOUT THIS CONSULTATION

On 29 April 2022 EFRAG launched a first set of sector-agnostic Exposure Draft European Sustainability Reporting Standards (ED ESRS) prepared by its Project Task Force on European sustainability reporting standards (PTF-ESRS), for consultation until 8 August 2022. Final standards will be adopted through Delegated Acts by the European Commission next year and constitute reporting requirements under the Corporate Sustainability Reporting Directive (CSRD).

This first set of ED ESRS includes:

- Two **cross-cutting standards** applicable to reporting on all sustainability issues
  - ESRS 1 General principles
  - ESRS 2 General, strategy, governance and materiality assessment disclosure requirements
- Eleven **issue-specific standards** with additional disclosures on their respective sustainability issues
  - E: ESRS E1 Climate change, ESRS E2 Pollution, ESRS E3 Water and marine resources, ESRS E4 Biodiversity and ecosystems and ESRS E5 Resource use and circular economy
  - S: ESRS S1 Own workforce, ESRS S2 Workers in the value chain, ESRS S3 Affected communities and ESRS S4 Consumers and end-users
  - G: ESRS G1 Governance, risk management and internal control and ESRS G2 Business conduct

We expect the second set of ED ESRS, which will include sector-specific standards, to be consulted on in 2023 and adopted through Delegated Acts by the European Commission by June 2024.

This consultation aims to gather feedback on whether the structure and content of ED ESRS are fit for purpose, and on the potential phase-in of certain draft standards after the initial reporting period.

ABOUT OUR RESPONSE

The recommendations set out in our consultation response were shared with and reflect input of PRI signatories, including members of the PRI Investor Corporate Reporting Reference Group and PRI Global Policy Reference Group. The PRI has previously provided views and recommendations on European sustainability reporting standard setting through consultation responses and public statements on the proposed CSRD.

Our response focuses on cross-issue requirements (ED ESRS 1 and 2), climate reporting requirements (ED ESRS E1), social requirements (ED ESRS S1-4) and business conduct (ED ESRS G2). To shorten our overall response, recommendations on social and business conduct requirements are fully captured within our Section 1 response document (cf. Questions 45-50), and we have not responded to Sections 3c and 3d on Social and Governance standards.

At this time the PRI is not able to offer detailed views on the content of ED ESRS for pollution (E2), water and marine resources (E3), biodiversity and ecosystems (E4), resource use and circular economy (E5) or governance, risk management and internal control (G1). **However, we want to stress that these issues are highly important for investors and welcome EFRAG's work in this area.**

KEY RECOMMENDATIONS

The PRI is broadly supportive of the ED ESRS and views them as a significant step towards providing responsible investors with the corporate sustainability data needed to effectively consider sustainability-related risks, opportunities and impacts in their decision-making.

The PRI recognises that proposed cross-issue and issue-specific disclosures would:

- cover the cross-issue information required by Articles 19(a) and 29(a-b) of the provisionally agreed CSRD text;
- lead to relevant reporting on all issues covered by the CSRD;
- allow for needed issue-specific adjustments by undertakings;
- produce reporting that meets the required characteristics of information quality; and
- support investors in meeting their own reporting obligations, such as those under the Sustainable Financed Disclosure Regulation (SFDR).

SECTION 1: OVERALL ESRS EXPOSURE DRAFTS' RELEVANCE

This section covers our recommendations on ED ESRS 1, which include:

- the architecture of ED ESRS – interoperability with international standards, alignment with EU policies and legislation, coverage of sustainability topics and presentation requirements; and
- implementation of the CSRD principles – materiality, reporting boundaries and value chain, time horizons and disclosure principles on policies, targets, action plans or resources.

Our Section 1 response also summarises recommendations on cross-issue and climate ED ESRS at the standard level and includes our recommendations on social and business conduct ED ESRS (S1-4 and G2).

To better meet investor data needs, the PRI's key recommendations within Section 1 are:

- Include a fourth presentation option which allows for disclosure under the TCFD recommendations' core elements (governance, strategy, risk management and metrics & targets), to improve alignment between reporting under ESRS and the International Sustainability Standards Board Exposure Drafts (ISSB EDs) – cf. Question 9.
- Include additional guidance and disclosure requirements on: (i) considering interlinkages between risks, opportunities and impacts arising from all sources, such as management decisions; and (ii) aggregating risks, opportunities and impacts to measure total financial consequences and impacts on people, planet and the environment (cf. Question 10). This would help to ensure that information on various sustainability issues are not reported in silos.
- Include additional guidance on assessing materiality, including on how to evaluate sustainability risks, opportunities and impacts against the parameters provided within ED ESRS 1 (scale, scope and remediability for sustainability impacts and the magnitude of financial effects for risks/opportunities), to ensure consistency across undertakings (cf. Questions 19, 21 and 23).
- Recommend that undertakings consider the following aspects when assessing materiality, such that relevant information is provided to users of reporting:
    - actual and potential adverse environmental and human rights impacts under the proposed Corporate Sustainability Due Diligence (CSDD) Directive (cf. Question 5); and
    - sustainability matters arising from subsidiaries (cf. Question 21).
- Require disclosure on policies to monitor compliance with the UN Guiding Principles on Business and Human Rights (UNGPs), since the UNGPs are the global authoritative standard on how companies manage impacts on people (cf. Questions 47-48).
- Require disclosures on changes to social issues-related targets during the reporting period and the rationale for these, which reflect the dynamic relationships between undertakings and their affected stakeholders (cf. Questions 45-48).
- Include guidance on how to undertake the materiality assessment for political engagement, lobbying or advocacy activities.

Finally, while investors would benefit from corporate reporting in line with the detailed requirements in the ED ESRS, we recognise that a lack of corporate readiness may impact the quality and comparability of disclosures. Therefore, EFRAG should consider the maturity of industry practice, as well as current and forthcoming issue-specific standards and frameworks (such as the ISSB EDs) as it further develops the ESRS. It should also seek to prioritise information needed by investors to meet their own reporting obligations, such as mandatory Principal Adverse Impact indicators under the SFDR and reporting under the Taxonomy Regulation, considering the content and timing of these data needs.

SECTION 3A: ADEQUACY OF CROSS-CUTTING DISCLOSURE REQUIREMENTS

This section covers our response on ED ESRS 2, which contains reporting requirements applicable to all sustainability issues on general information, strategy, governance and the materiality assessment.

To better meet investor data needs, the PRI's key recommendations within Section 3a are:

- Require disclosure of additional information that investors would need to understand the context of an undertaking's business and operations, including: (i) an additional disclosure requirement to define the undertaking's value chain; and (ii) additional disclosure requirements on the geographic location of the overall undertaking and (where possible) of individual plants/factories (cf. Question 3).

- Require that where undertakings choose to include reporting additional to ESRS disclosures within their sustainability statements, such as reporting under pronouncements / guidance of other standard-setting bodies (cf. Question 9):
  - this reporting meets the required characteristics of information quality (relevance, faithful representation, comparability, verifiability and understandability); and
  - undertakings specify which standards and technical guidance have been followed, such that reporting users are able to verify the completeness of this disclosure.
- Require disclosure on overlaps and differences between sustainability-related governance arrangements (covered in ED ESRS 2) and general governance arrangements (covered in ED ESRS G1), such that differences are clear to investors (cf. Questions 15-16).
- Require further reporting on the rationale, method and challenges presented by the incorporation of sustainability-related metrics in executive pay (cf. Question 18).
- Require additional disclosures on assessing the materiality of sustainability risks/opportunities to ensure consistency of disclosures with equivalent reporting on sustainability impacts. Currently there are more granular disclosure requirements on assessing impacts in ED ESRS 2 (cf. Question 20).
- Require that undertakings identify relevant stakeholders to engage as part of the materiality assessment, engage these stakeholders and specify which stakeholders have informed the process of determining material topics as well as how they have informed this process – in line with GRI 3: Material Topics 2021 (cf. Question 20).
- Include additional guidance on calculating and disclosing current and potential financial effects of sustainability-related risks and opportunities, to improve the consistency of this information across undertakings (cf. Question 21).

SECTION 3B: ADEQUACY OF ENVIRONMENTAL DISCLOSURE REQUIREMENTS

This section covers our response on ED ESRS E1, which contains climate-related reporting requirements along cross-issue themes and climate-specific performance metrics.

Sector-agnostic recommendations

To better meet investor data needs, the PRI's key recommendations regarding the content of ED ESRS E1 are:

- Include additional metrics capturing how undertakings are exposed to physical risks, including asset location data of an undertaking's main facilities, operations and leading suppliers located in an area at risk of extreme weather events, how physical risk is assessed and considered in companies' business interruption plans, current and predicted financial losses from extreme weather events and anticipated future financial impacts based on the results of physical risk-focused scenario analysis (cf. Question 37).
- Require undertakings to disclose the temperature probability of the base scenario used to assess 1.5°C-alignment of emissions reduction targets, where such alignment is reported. This would help to ensure that reporting on alignment constitutes a faithful representation and enhance the comparability and verifiability of such reporting (cf. Question 25).
- Include further guidance on calculating and reporting locked-in emissions, given the novelty of this disclosure area (cf. Question 23).
- Require undertakings to explain how metrics on energy consumption and potentially stranded assets were calculated – including information on methodologies, assumptions and limitations – to improve the verifiability of this reporting (cf. Questions 27 and 38).

- Require undertakings to use the [Greenhouse Gas Protocol Corporate Standard] to calculate and report Scope 1, Scope 2 and Scope 3 greenhouse gas emissions, in order to improve comparability of reporting at the EU and international level (cf. Questions 29-32).
- Require that disclosures on the potential market size of 'green products' accessible to undertakings be put into perspective against planned future EU Taxonomy-aligned turnover – this would indicate an undertaking's willingness to pursue such opportunities and the alignment of this strategy with environmental objectives (cf. Question 39).

Sector-specific recommendations

We note that the second set of ED ESRS, which will include sector-specific standards, is set to be consulted on in 2023 and adopted through Delegated Acts by the European Commission by June 2024. We are therefore including the following recommendations on sector-specific metrics, for consideration as sector-specific ED ESRS are elaborated.

Sector targets are the most relevant means for financial institutions of achieving real world emissions reductions, incentivising and providing capital support to companies which are the best carbon performers within their sector, and financing the global economy's transition to net zero. Therefore, the PRI recommends that when sector-specific ED ESRS are elaborated, EFRAG proposes to require the disclosure of industry metrics for the 12 most energy-intensive sectors listed in Annex 1 of our Section 3b response. These should include Scope 1, Scope 2 and where material Scope 3 emissions, capturing historical data as well as data on a forward-looking basis (at 5-year and 10-year intervals).

In addition, sector-specific ED ESRS should contain requirements on methane, a major greenhouse gas that is significant in a number of key industries such as oil and gas, the utility sector and agriculture. The PRI recommends that methane emissions are reported separately and not as aggregated CO_2e. Further, there should be a measure of methane volume disclosure per metric ton, and a measure of methane intensity within the oil and gas, utility and agricultural sectors.

Finally, EFRAG's approach towards sector-specific standards should be driven by an ambition to close transparency gaps, not duplicate existing sector-specific reporting requirements (such as extending SFDR requirements to financial companies at consolidated level). Otherwise, sector-specific standards will be unable to enhance transparency and comparability of corporate climate reporting.

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