Kerstin Lopatta
Acting EFRAG SRB Chair

Commissioner Mairead McGuinness
Financial services, financial stability and Capital Markets Union

Brussels, 5th August 2022

BETTER FINANCE response to the European Financial Reporting Advisory Group (EFRAG) on its draft EU Sustainability Reporting Standards (ESRS)

Dear Ms Lopatta, Sustainable Reporting Board Chair, and dear Commissioner McGuinness,

I am writing to you in my capacity as Managing Director of BETTER FINANCE, the European Federation of Investors and Financial Services Users. We are the EU-level public interest non-governmental organisation dedicated to advocating for the interests and defending the rights of individual and small shareholders, fund investors, savers, pension fund participants, life insurance policy holders, borrowers, and other financial services users.

As an independent financial expertise centre to the direct benefit of European financial services users, BETTER FINANCE through its member organisations is the European level dedicated representative organization of the millions of individual investors in Europe and thereby a main potential beneficiary of the draft non-financial reporting Standards developed by EFRAG. Since sustainability reporting is one our core areas of interest, BETTER FINANCE welcomes the opportunity to comment on the draft EU Sustainability Reporting Standards (ESRS). **Please kindly note that this letter is co-signed by BETTER FINANCE, its member organizations and other supporters from outside of BETTER FINANCE's network**.

Size, Scope and feedback - BETTER FINANCE would like to stress that the scope of the public consultation is very large and its content very detailed. The questionnaire is extremely lengthy (about 1000 pages in total), very technical and only available in English, while at the same time the consultation period is short. All this makes it very difficult for individual non professional user representatives and impossible for end users themselves to reply to the whole set of questions, which could affect the conclusions. We were informed that even expert professional reporting organisations were struggling to answer all the questions. We are very concerned that very few nonprofessional individual users and their representatives will be able to provide detailed and somewhat comprehensive feedback to EFRAG on these however crucial standards. In that context, BETTER FINANCE is of the opinion that the methodology of the analysis of the answers to the public consultation should be disclosed and explained, in particular how EFRAG and/or third-party contractors will handle the answers and attribute weight to the different contributions.

Timetable - We are also concerned about the extremely challenging timetable planned for the finalisation and enforcement of the ESRS. In particular, we are concerned that EFRAG will not have the necessary time to really review not only the boxes ticked but also the comments made by the stakeholders. Please note that international financial reporting standards took decades to complete and enforce, although their scope was by far not as large.

<u>**Executive summary**</u>

In light of the proposals put forward by EFRAG, BETTER FINANCE would like to draw your attention to the overarching themes that will ensure investors receive understandable, comparable, and reliable information which will enable them to make informed opinions and decisions about the impact and risks on current and potential investments.

- **Clarity & Intelligibility**. First, BETTER FINANCE wishes to remind that EU Law rightly requires information provided to "individual" investors to be **CLEAR**, i.e. "*presented in a way that is **likely to be understood** by, the average member of the group to whom it is directed, or by whom it is likely to be received*"[1]. Thus, EFRAG should consider reviewing the wording of the draft standards to this aim or at least add 'plain language' summaries making these standards actually accessible for EU citizens as end users.

- **Consistency, comparability and coordination with other disclosure standards and initiatives** such as the International Sustainability Standards Board (ISSB)[2], the Sustainability Accounting Standards Board (SASB)[3] , the Global Reporting Initiative (GRI)[4], and the Task Force on Climate-Related Financial Disclosures (TCFD)[5] can ensure a set of internationally accepted high-quality sustainability reporting standards, which provide comparable and consistent information for "individual" investors. We encourage EFRAG to work closely with the ISSB, SASB and other international initiatives in order to provide a consistent non-financial reporting landscape for investors and other stakeholders alike. In particular, US-domiciled listed equities account for about 60% of the World's total equity markets, and EU citizens as pension savers and investors are therefore largely directly or indirectly exposed to those.

- **Integrating sustainability and financial reporting is key for investors** as is access to appropriate data. A single - integrated - management report would ensure that all information

[1] Commission Delegated REGULATION 2017(565) *Article 44,* Fair, clear and not misleading information requirements (Article 24(3) of Directive 2014/65/EU), 2. (d**)**

[2] The International Sustainability Standards Board (ISSB) was created following COP26 in 2021 with the aim of developing a comprehensive global baseline of high-quality sustainability disclosure standards to meet investors' information needs.

[3] The Sustainability Accounting Standards Board (SASB) – the US standard provider - focus on ESG issues expected to have a financially material impact on the company, aimed at serving the needs of most investors and other providers of financial capital, About Us – SASB https://www.sasb.org/about/

[4] The Global Reporting Initiative (GRI) created by representatives from the UN, investor agencies, corporations, practitioners, and civil society groups, provides the world's most widely used standards for sustainability reporting, GRI - Home (globalreporting.org)

[5] The Task Force on Climate-Related Financial Disclosures (TCFD) was created in 2015 by the Financial Stability Board (FSB) to develop consistent climate-related financial risk disclosures for use by companies, banks, and investors in providing information to stakeholders, Task Force on Climate-Related Financial Disclosures | TCFD) (fsb-tcfd.org). Its membership does not include any organization representing "retail" investors.

is based on the same requirements with respect to precision, quality and comparability and thus improve decision-making processes of "individual" investors. The consistency should also apply to accounting and financial reporting standards as well as audit standards, assurance and independence of external statutory auditors.

- **Double materiality concept requires a clear and standardised methodology**. The guidance in the ESRS is rather high-level and directional, leaving undertakings with a lot of margins on deciding on the materiality of their positive and negative impacts on society or the environment. Ensuring that the materiality concept is uniformly understood amongst users and preparer, BETTER FINANCE proposes to provide clear and detailed guidance on how to perform the materiality assessments. This will provide greater clarity around the concept and how to apply it in practice. Without clear process guidance, it will be difficult for undertakings to comply with the ESRS, may lead to inconsistent application and subsequently impact the quality of information for investors.

- **Adequate environmental, social and governance standards are essential tenets of sustainable development for investors** as well as undertakings. The ESRS should include clear requirements for the disclosure of climate transition plans (both with regard to mid- and long-term targets) to provide clarity and support the avoidance of greenwashing. Despite the fact that there is not yet a Social Taxonomy in place on which ESRS could build on, the social standards cover a wide range of topics. We consider that further guidance is needed to ensure high quality reporting for investors. Equally, understanding the governance of a company is crucial for investors and other stakeholders as undertakings cannot be sustainable without good corporate governance. It also provides the basis upon which sustainability activities are built and evaluated. Strong corporate governance indicates strong corporate culture, which in turn signals robust long-term resilience. The ESRS should provide further guidance to enhance transparency and participation in decision-making processes. In particular, the compliance of undertakings (especially listed ones) with the exercise of shareholders rights and engagement should be part of the ESRS. **In that context, we are concerned that the G1 standard may be subject to revisions, because of amendments to the final version of Article 29b (2) (c) (i) CSRD.**

1. Clarity and intelligibility for "retail" investors" and end users

Citizens as individual non-professional investors are often referred to by the financial industry and by policy makers as "retail" investors. EFRAG should consider how disclosed information can be more accessible for digital consumption, enabling broader spectrum of investors to understand the impacts of their current and future investment decisions.

Several sustainability frameworks such as SASB, GRI, and TCFD already enable digital consumption of sustainability-related financial information and have machine-readable versions or taxonomies, which enable easier extraction and comparison of information. However - as noted above - investors and other stakeholders, will benefit from greater accessibility of reporting disclosures through other media including smartphones. "Individual" investors have different levels of knowledge and expertise, and the digital disclosures should serve in their interests and be accessible and inviting for a broad spectrum of investors.

2. Consistency and comparability with international standards and initiatives

BETTER FINANCE welcomes that the EFRAG and ISSB Standards make an effort to align with the TCFD Standards which is a good basis for more harmonization. It is also encouraging that for climate reporting aspects of the EU's Corporate Sustainability Reporting Directive (CSRD) for example, ESRS has been closely aligned with the ISSB technical work and the two standards are overall well aligned – with the important exception of EFRAG's inclusion of the Taxonomy related disclosures. Further cooperation between the ISSB and EFRAG is necessary to ensure comparability of the standards to the largest extent and subsequent usability for "individual" investors. To that end, diverging or – even worse - competing standards would have negative and significant consequences for investors and companies while a collaborative approach would create an effective regulatory model to support existing and future national, international, and inter-governmental policies, such as the Paris Agreement.

Appropriate convergence is also key to avoid "duplicative reporting" for EU undertakings operating globally, with ESRS inside the EU and non-EU local regimes inspired from the ISSB's global baseline standards outside the EU. In this regard, it is especially key to ensure that definitions are aligned as much as possible and BETTER FINANCE recommends that EFRAG and ISSB collaborate closely in that regard to ensure maximum harmonization of definitions and metrics.

One of the main differences between the EFRAG and ISSB approaches is the concept of materiality. **BETTER FINANCE welcomes the approach of EFRAG, following the preconditions of the CSRD on double materiality. To enhance standardised, comparable, neutral and accurate information, a mandatory double materiality approach is welcomed from an investor perspective. This is especially important as the market of ESG financial products is growing significantly,[6] and consequently, investors and analysts need to understand both the risks and the opportunities of any investment.** This is difficult to achieve when the information required to distinguish and assess various investment products is diffuse, disaggregated, and hard to interpret. Research suggests that information asymmetry of this kind impedes ESG labels from carrying substantive information to investors leading to situations where mainstream and sustainability indices contain to a large extent the same companies.[7] While EFRAG is not responsible for the definitions and application of materiality for the ISSB, we would encourage both standard setters to collaborate regarding the materiality concept and scope to ensure consistency and interoperability between EU and non-EU regimes and ultimately support "individual" investors' understanding and usability of the respective standards

[6] Global Sustainable Investment Review GSIR-20201.pdf (gsi-alliance.org) and ESG funds provided better returns for investors in 2020 (europa.eu)

[7] D. Brakman Reiser, A. Tucker (2020), „Buyer Beware: Variation and Opacity in ESG and ESG Index Funds", https://readingroom.law.gsu.edu/cgi/viewcontent.cgi?article=4011&context=faculty_pub

3. **Integrating sustainability and financial reporting**

Non-financial and financial reporting as a common part of the management report (integrated reporting)

BETTER FINANCE as the leading European association of "individual" investors shares a common interest in comparable, consistent, and reliable sustainability related information on investment and stewardship decisions. From the investors' point of view the objective is to link the sustainability reporting with the financial reporting to publish an integrated management report. **Consistency between financial and non-financial statements is key for investors. This can only be achieved if the sustainability-related data complies with the financial data.** In order for this to be achieved, requiring the same level of audit assurance as for financial statements would ensure that sustainability- and climate-related reporting gains the same importance as financial reporting - also with respect to auditing.

BETTER FINANCE therefore strongly prefers a fully-fledged integrated reporting requirement by the ESRS. Given the restrictive CSRD framework, though, we welcome that the current standards aim at ensuring a high level of connectivity. However, while in principle the incorporation of information in the sustainability section by reference to other parts of the management report does support cohesiveness, it is necessary to point out that that lack of standardization would affect the way investors can access information and therefore impact the usefulness of sustainability data. A single format, machine-readable approach would enhance investor useability and enable them to make better informed decisions.

We also recommend that the key audit matters identified by the external auditors would also apply to sustainability reporting. Interestingly, **the independence of the external statutory auditor is not tackled at all in the ESRS. Thus, it would be strongly advisable that EFRAG adds a respective reporting requirement to help investors understand and verify if the statutory auditor can be considered being independent.**

4. **Double materiality and standardization of methodologies**

BETTER FINANCE considers that more guidance on the definitions of double materiality and financial materiality needs to be provided to avoid a different understanding of financial materiality for sustainability information on the one side, and of financial materiality for financial information on the other. In addition, it should be noted that aspects like the assessment of double materiality and the way topical standards relate to one another is open for interpretation and more concrete guidance in that respect will benefit investors and all other stakeholders.

Moreover, to ensure understandability and comparability of information, guidance on specific methodologies should be provided for investors and other stakeholders. While not directly linked to the EFRAG consultation, the methodology behind ESG ratings is also very relevant to investors. Ensuring consistent and comparable metrics and methodologies among ESG rating providers are being used against the methodology of the ESRS will ultimately support all stakeholders with precise data.

5. **Adequate environmental, social and governance standards**

Environment

Requirements regarding disclosure of transition plans and carbon offsetting need to be comparable across ESRS standards and others to enhance clarity and understanding for "individual" investors. Given the key role of transition plans in fighting climate change and helping investors navigate and understand their investment landscape, uncertainties around the content of transition plans will cause further divergence among entities and stakeholders. **EFRAG should collaborate closely with the ISSB on developing reporting requirements in the absence of transition plans as well as mid/long-term target dates, mid/long term reviews, GHG emissions in absolute terms and carbon/GHG offset alignment. The lack of appropriate guidance and level of detail under the requirements, could compromise the integrity of the information reported and thus increase greenwashing.** In particular, BETTER FINANCE considers GHG targets should be required to be science-based, in line with 1.5 C and disclosed in absolute and relative values for Scope 1-3.

Social

The Exposure Drafts on social aspects cover a broad range of social responsibility and human rights issues including equality and non-discrimination, forced and child labour, collective bargaining and freedom of association, or grievance mechanisms for workers. The level of detail required in reporting will be granular, including, for example, information about non-employees/workers in the value chain. We expect that many undertakings will have to establish new internal data collection and verification processes, and work closely with social audit firms, to ensure complete and accurate reporting on these issues as relevant facts for these disclosures may often lie outside of the EU and across companies' global operations. BETTER FINANCE would like to reiterate that since there is not yet a Social Taxonomy in place on which ESRS could build upon, sufficient guidance is vital in ensuring that undertakings' quality of reporting remains high and comprehensive and represented in a fair way to investors.

Governance

Good governance is an essential pillar of sustainability. It promotes accountability, transparency, efficiency and rule of law at all levels and allows efficient management of human, natural, economic and financial resources for equitable and sustainable development, guaranteeing civil society participation in decision-making processes. The transformation of the economy needs to be encompassed by a robust governance of undertakings. BETTER FINANCE therefore **strongly recommends consolidating all governance-related DR[8] in ESRS 2 because governance-related issues are genuinely cross-cutting and material for all undertakings**. **We therefore urge EFRAG to give the highest priority to ESRS E1 and ESRS G1**. **In that context, we are concerned that the G1 standard may be subject to revisions, because of amendments to the final version of Article 29b (2) I (i) CSRD. Deleting parts of the G1 standards completely would be a huge step backwards in corporate governance reporting.** Furthermore, in its current form, ESRS would require undertakings to report

[8] DR refers to the Disclosure Requirements within the proposals of ESRS.

on governance topics in the management report only. Such a consolidated reporting is needed, as a respective EU-wide requirement does currently not exist.

Please find more detailed comments under our responses to the surveys. It should be noted that all of our detailed **responses should be considered to a great extent, given they represent millions of individual investors in Europe** and thereby the addresses of the draft Standards developed by EFRAG.

We remain available for answering any questions concerning our analyses and recommendations you may have.

Yours sincerely,

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