

PRI RESPONSE

EFRAG CONSULTATION ON DRAFT ESRS IMPLEMENTATION GUIDANCE DOCUMENTS

2 February 2024

The information contained in this response is provided for informational purposes only and should not be construed as legal advice on any subject matter. Except where expressly stated otherwise, the opinions, recommendations, findings, interpretations and conclusions expressed in this response are those of PRI Association, and do not necessarily represent the views of the contributors to the response or any signatories to the PRI (individually or as a whole).

PRI Association

Registered office: 25 Camperdown Street
London, UK, E1 8DZ Company no. 7207947
T: +44 (0) 20 3714 3220 W: www.unpri.org E: info@unpri.org



United Nations
Global Compact

ABOUT THE PRI

The United Nations-supported Principles for Responsible Investment (PRI) is the world's leading initiative on responsible investment. The PRI has over 5,300 signatories (pension funds, insurers, investment managers and service providers) globally with approximately US \$120 trillion in assets under management.¹

The 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. 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.

We welcome the opportunity to respond to EFRAG's [consultation](#) on ESRS implementation guidance.

ABOUT THIS CONSULTATION

The European Sustainability Reporting Standards ([ESRS](#)) contain reporting requirements under the EU Corporate Sustainability Reporting Directive ([CSRD](#)). The European Financial Reporting Advisory Group (EFRAG) provides technical advice to the European Commission in the form of draft ESRS.

In July 2023 the first set of ESRS were adopted by the European Commission. These contain sector-agnostic reporting requirements for large listed and unlisted companies within the scope of the CSRD.

On 22 December 2023 EFRAG released for consultation the following draft implementation guidance accompanying these standards, as stipulated under Directive 2013/34/EU (the Accounting Directive):

- [Draft EFRAG IG 1: Materiality assessment implementation guidance](#), which describes ESRS reporting requirements on the materiality assessment and illustrates possible steps of the process.
- [Draft EFRAG IG 2: Value chain implementation guidance](#), which describes ESRS reporting requirements on the value chain.
- [Draft EFRAG IG 3: Detailed ESRS datapoints implementation guidance](#), which presents all ESRS requirements in an Excel format.

This guidance is non-authoritative and has been developed for use by large listed and unlisted companies subject to the CSRD. It does not form part of the ESRS or introduce new provisions.

For more information, contact:

René van Merrienboer
Director, Sustainable Systems
rene.van-merrienboer@unpri.org

Benjamin Taylor
Senior Analyst, Driving Meaningful Data
benjamin.taylor@unpri.org

¹ See <https://www.unpri.org/signatories/signatory-resources/signatory-directory>

KEY RECOMMENDATIONS

The PRI's recommendations are on IG 1 and IG 2 – we do not have any comments on IG 3. Our key recommendations are for EFRAG to:

- **Include further guidance on how “decision-usefulness” of information should be assessed as part of the materiality assessment, including explicit recommendations to engage with investors to understand their data needs and consider investor reporting obligations** – so that reporting provides investors with information needed for decision-making and compliance.
- **Include further guidance on how undertakings can translate their reporting on the ESRS into reporting that would be in compliance with the ISSB Standards (or vice versa),** to improve interoperability with international standards.
- **Include practical examples on how companies could set thresholds to assess impact and financial materiality** – this will mitigate risks to consistent application of the materiality assessment, and by extension comparability of reporting for investors.
- **Clarify that financial institutions should focus their assessment of financial assets on those that are likely to give rise to material sustainability risks, opportunities and impacts,** to ensure proportionality and allow investors to undertake a more comprehensive assessment of these financial assets.
- **Include further guidance with respect to risks, opportunities and impacts arising from financial assets** – currently the guidance does not clearly address:
 - Whether (and if so in what terms) the financial market participants' type of involvement with an impact through their financial assets (direct linkage, causation or contribution to) should affect the materiality assessment and reporting.
 - The extent of reporting obligations related to financial assets, including the scope of information within each ESRS that would not need to be reported about financial assets.

PRI RESPONSE

IG 1: MATERIALITY ASSESSMENT IMPLEMENTATION GUIDANCE

DECISION-USEFULNESS

User engagement

The materiality assessment guidance specifies that the materiality of information is based on: (i) the significance of the information in relation to the matter it depicts; and/or (ii) whether the information is a relevant input for users of sustainability reporting in decision-making (“decision-usefulness”).

The PRI supports this clarification because responsible investors require decision-useful data to inform their investment process, client reporting and regulatory reporting. It is imperative that decision-usefulness is appropriately considered by portfolio companies in their materiality assessment and reflected in reporting to investors.

However, the guidance should be more prescriptive on the importance of engaging with reporting users, including investors, to determining decision-usefulness of information and meet investor needs.

While this is alluded to in paragraphs 91, 108 and 127, **it should be presented as a critical step of the materiality assessment.**

Materiality and investor reporting regulations

Investor reporting requirements can render certain information decision-useful to investors². For this reason, we welcome EFRAG's clarification on the relationship between taxonomy eligible activities and materiality – that when performing the materiality assessment undertakings should consider whether the activities are in compliance with criteria for “substantial contribution” and “do no significant harm” [cf. page 47]. This will help to strengthen the coherence of materiality assessments with Taxonomy reporting such that relevant risks, opportunities and impacts are not omitted by undertakings, **and should therefore be included more prominently within the guidance – for instance within the section on identification of actual and potential risks, opportunities and impacts related to sustainability matters.**

More generally, the guidance should clearly recognise the importance of investor reporting regulations in determining decision-usefulness, and by extension in shaping a company's materiality assessment. **This should be done by explicitly recommending that companies consider investor reporting requirements, particularly those under SFDR, as part of their materiality assessments.**

While investors would have benefited from mandatory company reporting of environmental and social indicators relevant to investor reporting regulations such as SFDR – as was called for in a [joint statement](#) endorsed by over 90 investors last year – such guidance would at least help to limit data gaps across the EU sustainable finance rules. Currently, these gaps are at risk of arising because the availability of the underlying information used by investors depends on the results of company-level materiality assessments, which may result in some decision-useful data not being reported.

MATERIALITY ASSESSMENT PROCESS

Clarifications included within the draft guidance on how companies should undertake the materiality assessment process [c.f. pages 18-29] will help to strengthen the ESRS. For example, while the ESRS are light in detail on how companies should factor stakeholder engagement and contextual information within the assessment, the guidance covers these topics in greater detail.

Further, the guidance contains practical explanations on how the financial and impact materiality perspectives are interrelated [cf. pages 13-14], and commentary on interoperability of ESRS with ISSB and GRI Standards [cf. pages 29-31]. These are valuable steps towards ensuring a comprehensive assessment of sustainability risks, opportunities, impacts and dependencies by companies, accounting for relevant interdependencies between these. **However, further guidance is needed on how undertakings can translate their reporting on the ESRS into reporting that would be in compliance with the ISSB Standards (or vice versa).** This would help to improve interoperability with international sustainability reporting standards.

Finally, the clarification on how companies could set thresholds to determine financial and impact materiality [cf. pages 25-29] will help to ensure a consistent approach across undertakings, leading to

² The PRI defines decision-useful data as data that is available, of sufficient quality and relevant to either the investment decision-making process (i.e., material) or to investor reporting obligations, or to both.

more comparable reporting. **However, worked examples for setting such thresholds are needed to illustrate how this guidance can be put into practice by companies.**

IG 2: VALUE CHAIN IMPLEMENTATION GUIDANCE

This guidance provides useful clarifications on matters including but not limited to:

- Value chain definition and process for obtaining information from actors in the value chain.
- How the value chain should shape the materiality assessment and reporting on policies, actions, targets and metrics.

The guidance reflects existing ESRS requirements with respect to value chain, which are largely in line with the GRI Standards and UN Guiding Principles on Business and Human Rights (UNGPs). It will help to promote consistent disclosure across undertakings, and ensure that undertakings appropriately reflect all material risks, opportunities and impacts in reporting.

Our only recommendations here relate to the treatment of financial assets, including equity and debt investments. EFRAG specifies these would be considered business relationships under the ESRS [cf. page 18] – which is not explicitly stated in the standards.

The PRI agrees that financial assets should be considered business relationships, in line with authoritative global corporate responsibility instruments.³ However, investors often have many investee companies in their portfolios. Since EFRAG's draft guidance implies that business relationships through financial assets would need to be considered in the materiality assessment – and that associated material risks, opportunities and impacts would need to be reported on – **it should clarify that financial institutions should focus their assessment of financial assets on those that are likely to give rise to material sustainability risks, opportunities and impacts.**

For investors, this would help to ensure proportionality and allow for a more in-depth assessment of these financial assets. EFRAG's implementation guidance should emphasise that due diligence processes such as the one outlined in the OECD Guidelines⁴ can be a useful tool to guide this process.

In addition, further clarification or guidance on the below topics is needed to provide financial market participants with an appropriate level of clarity to inform their reporting on sustainability risks, opportunities and impacts associated with financial assets.

- Whether (and if so in what terms) the financial market participants' type of involvement with an impact through their financial assets (direct linkage, causation or contribution to) should affect the materiality assessment and reporting.

³ The [OECD Guidelines for Institutional investors](#), for example, state that "a relationship between an investor and investee company including a minority shareholding can be considered a "business relationship " under the OECD Guidelines" (p. 13).

⁴ The OECD Guidelines state that investors are "encouraged to identify general areas where the risk of adverse impacts is most significant and, based on this risk assessment, prioritise [parts of their value chain] for due diligence". This is commonly referred to as a risk-based approach: first, investors try to understand the scope of issues they may be directly linked to, and second, they prioritise and respond to them as appropriate. These steps should be carried out both pre-investment and at regular times throughout the investment's life, or when a change in the situation makes it necessary.

See OECD (2017), [Responsible business conduct for institutional investors: Key considerations for due diligence under the OECD Guidelines for Multinational Enterprises](#), section 1.3, pg. 18.

- The extent of reporting obligations related to financial assets. For example, the scope of information within each ESRS that would not need to be reported about financial assets should be clarified within the forthcoming financial sector ESRS.
 - There appears to be a contradiction between paragraph 77 – which states that “for equity investments there is currently only disclosures under Category 15 of GHG emissions where significant under ESRS E1” – and the ESRS requirement that companies must report information about all material impacts, risks and opportunities including those that arise or may arise in the context of their business relationships in the upstream and downstream value chain [c.f. paragraph 1]. As with non-financial companies reporting on the value chain, reporting on financial assets should include material information across all relevant sustainability issues, including but not limited to climate change.

Where possible, these additional clarifications should be included within the value chain guidance – to provide financial market participants with answers to the above questions as they begin to implement the ESRS – and should be subsequently formalised within the forthcoming financial sector ESRS.

The PRI has experience of contributing to public policy on sustainable finance and responsible investment across multiple markets and stands ready to support the work of EFRAG on ESRS.

Please send any questions or comments to DMD@unpri.org.

More information on www.unpri.org