Financial Services Regulatory Insights

EC adopts new European Sustainability Reporting Standards

AT A GLANCE

August 2023

What's new?

- The European Commission (EC) has formally adopted the first set of European Sustainability Reporting Standards (ESRS), which sets out the detailed reporting firms need to undertake in line with the EU Corporate Sustainability Reporting Directive (CSRD).
- The adoption confirms key changes made to the draft standards that were published in June, including the use of materiality assessments to establish the relevant data points, the introduction of voluntary metrics, and additional 'phasing in' provisions.
- The CSRD is likely to bring a large number of UK firms into scope, including financial services firms.

What does this mean?

- The CSRD is a European directive that expands and standardises existing rules on sustainability reporting. The aim is to increase the availability and improve the quality of data. It will apply at both entity and group level.
- UK companies might be in scope if they have a large EU subsidiary or large EU sub-group, debt or equity listed on a EU-regulated market or significant turnover in the EU - see the next page for more details.
- The European Financial Reporting Advisory Group (EFRAG) were tasked with setting the detailed standards for reporting. The first standards were submitted by EFRAG in November 2022. The EC subsequently published amendments to them, alongside a draft act, in June 2023, for a 4 week consultation period.
- The EC formally adopted the standards on 31 July, and will submit them in August to the European Council and Parliament for scrutiny. This can last up to 4 months, and they cannot edit the standards.
- The key change to the final standards from the EFRAG proposals is the introduction of materiality assessments in relation to the majority of data points requirements. The only exception to this is the disclosure requirements set out in ESRS 2, which remain mandatory for all firms.
- The CSRD requires that materiality assessments consider 'double materiality' - taking into account the impact of the firm on people and the environment, and the risks and opportunities on the firm. This makes it more extensive than the ISSB standards.
- The final standards also make a number of the reporting requirements voluntary, and increase the phasing in of some requirements, mainly for firms in scope with fewer than 750 employees.

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- The final standards introduce a new requirement for firms that conclude climate is not a material topic, and therefore not reportable, to provide a detailed explanation of the conclusions of the materiality assessment in relation to climate change.
- For those data points that are intended to allow firms in scope of SFDR, the Benchmarks Regulations or the Capital Requirements Regulations to comply, where they are deemed not material, this must now be set out. Separately, those organisations must also publish a grid showing where data points can be found, or indicating that they are not material.
- The definition of financial materiality has been altered slightly to better align with the IFRS standards.
- It remains the case that all reporting will need to be of investment grade quality and be subject to external limited, and later reasonable, assurance.

What do firms need to do?

- It is essential that UK firms firstly fully understand the extent to which they are within the scope of the CSRD, and whether reporting needs to be at group level or individual entity level.
- Those in scope need to undertake a comprehensive materiality assessment to establish which disclosure requirements data points are material, and a gap analysis based on the CSRD and ESRS, and map out their value chains.
- Firms should prepare an implementation roadmap to prepare for reporting, taking into account plans to address any gaps and key ownerships.
- The application of the standards by financial services firms will require data from companies to whom they provide finance, which will be from a range of sectors.
- Firms should approach CSRD and ESRS implementation holistically, identifying synergies with other sustainability reporting regulations and ensuring an approach that is flexible enough to respond to further new regulations as they arise.

Next steps

The standards are expected to complete the adoption process by the end of 2023. There are four phased application dates for CSRD:

- Reporting in 2025 on financial year (FY) 2024 - companies already subject to NFRD and large issuers with more than 500 employees.
- Reporting in 2026 on FY 2025 - large EU companies or large EU sub-groups not currently subject to the NFRD.
- Reporting in 2027 on FY 2026 - listed SMEs (except micro undertakings), small and non-complex credit institutions and captive insurance undertakings.
- Reporting in 2029 on FY 2028 -third-country undertakings generating net turnover of more than €150 million in the EU, if they also have at least one EU subsidiary that is in scope of CSRD (e.g. large EU companies or those listed on an EU-regulated market), or a branch in the EU with turnover exceeding €40 million

EFRAG will released further guidance on materiality assessments and the value chain. The sector specific standards are on schedule to be adopted in 2024.

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