Attn. of European Commission

The Hague, 7 July 2023

Ref: B23.13

Re: Comment letter on the draft Delegated Act regarding the ESRS – set 1

Dear Sir/Madam,

Eumedion, representing the interests of institutional investors with a long-term investment horizon and – collectively – with a more than € 7 trillion global investment portfolio, welcomes the opportunity to respond to the draft Delegated Act regarding the European Sustainability Reporting Standards (ESRS) - set 1 published for public consultation on June 9, 2023.

Sustainability information reported by investee companies in a consistent, comparable and reliable manner is key to understanding the long-term value creation capacity of these companies. As such, sustainability information is material to investors' decisions. Eumedion has welcomed the European Commission's efforts in this area and commends the tremendous preparatory work done by the EFRAG Sustainability Reporting Board (SRB) in developing this first of set of standards. In this letter, we would like to highlight a few areas that from a responsible investor's perspective require some further adjustment or improvement.

(1) Alignment with SFDR is crucial, but a re-evaluation of SFDR and CSRD/ESRS requirements is needed to increase the decision-usefulness of disclosures

Eumedion is a strong proponent of alignment between the various EU sustainable finance initiatives. Specifically with regard to the SFDR disclosure requirements, Eumedion has welcomed the mandatory inclusion of SFDR indicators in the first set of the ESRS. However, in its current state, this alignment does no longer always benefit the decision-usefulness of the CSRD *or* the SFDR disclosures. There are a few issues that contribute to this, such as:

- CSRD reporting is based on the outcome of a materiality assessment, meaning not all SFDR indicators will necessarily be reported on by companies. This means that (1) not all company data will be available for SFDR disclosures, and (2) even if it were, it could concern 'non-material' information in certain cases, thus diminishing the decision-usefulness of SFDR disclosures. This could be partially solved by making, at least for now, all SFDR-related indicators mandatory for companies in scope.
- The CSRD-required alignment with SFDR indicators has led to the inclusion of less relevant metrics in the proposed ESRS, at the expense of more relevant metrics. A case in point is the sole inclusion of the *unadjusted* pay gap disclosure requirement ESRS S1-16, introduced on the basis of SFDR alignment. In practice, we observe a

strong correlation between the unadjusted pay-gap and the gender diversity distribution throughout the various levels in a company (on which companies already tend to report extensively, including long-term actions plans to address any issues). However, an *adjusted* pay gap disclosure metric, which accounts for various factors affecting pay and as originally proposed by EFRAG, has a higher relevance for stakeholders, since it can showcase whether a company's equal pay policy is actually effective. Since this metric is currently not required by the SFDR, as a result both the CSRD/ESRS *and* the SFDR are inadequately serving stakeholder information needs.
- There is a general misalignment of developments between CSRD and SFDR as to what constitutes relevant information for stakeholders. For example, the ESRS does not include a disclosure requirement related to tax practices. The relevance of tax-related disclosures is only indirectly referred to in relation to the potential negative impact on affected community by aggressive strategies to minimise taxation (ESRS 2, AR 5), but not as a metric in itself. However, the ESAs are currently consulting the extension of tax-related indicators under the SFDR. While this is a welcome development, it also illustrates the need for a more coherent approach.

Taken together, these issues clearly underline the need for a coherent re-evaluation of the disclosure requirements in the broader EU sustainable finance framework, which should be primarily assessed from the perspective of decision-usefulness and materiality.

(2) Ensure maximum possible interoperability with the IFRS Sustainability Disclosure Standards

Interoperability with global standard-setting initiatives is crucial to enhance the level playing field for multinational companies and to stimulate standardised information for investors. We are pleased to see that the European Commission intends to reach a high level of interoperability between the IFRS and ESRS climate standards.

However, there is also a more holistic need for interoperability. Europe leads the world with its commitment to a sustainable future, but Europe cannot succeed alone as many key sustainability themes are by their very nature affected by how actors outside the EU operate. The interoperability process may need to be mirrored by many jurisdictions to come. We urge the EU and all those future jurisdictions to come to align as much as possible with what ultimately have to become globally accepted and applied standards set by the ISSB. Ideally, if the envisaged reporting resulting from certain requirements is not that different, there should be no reason to maintain unnecessary differences in the wording of such requirements between ISSB standards and regional/local standards. Interoperability therefore starts with avoiding any unnecessary deviations where possible.

Interoperability then continues with making life as easy as practically possible for preparers and users to handle remaining differences between global and regional/local standards. Unfortunately, in this second respect interoperability with international standard setting is not yet sufficiently visible in the draft ESRS. We urge Europe to continue seeking alignment with the ISSB and actively support the creation of tools for companies so they can easily identify which requirements are ESRS-specific, ISSB-specific, and which requirements are fully aligned. All stakeholders would benefit from tools that visualise the similarities and differences between ESRS and the IFRS sustainability disclosure standards of the ISSB.

(3) A brief explanation of the conclusions of the materiality assessment should be mandatory

Eumedion welcomes the double materiality assessment as the basis for (most) ESRS-disclosures, as both the impacts of the company on society and, vice versa, the impacts of society on the company may well be material to our decisions to buy, sell, vote on financial instruments of a company, and to our decisions to engage with the company. We do recognise that, at least in the short to medium term, the proper application of the materiality assessment and of, in fact, the ESRS in general, will be subject to a learning curve and most likely to various practical and/or interpretation issues in its initial phases of application. This learning curve applies to both companies and external auditors, but will also involve and affect the companies' stakeholders, not the least the users of sustainability reporting. As the foundation for the sustainability statements, this means that it is of key importance that stakeholders understand what criteria and reasoning was used to construct the materiality assessment and, thus, how conclusions were reached. In our long-standing experience with company engagement, such is in many cases not self-evident when viewed from the outside stakeholder perspective. The mere fact that the materiality assessment will be subject to an external auditor's review, will in itself not make this any different. Therefore, the ESRS need to additionally require that a company *shall briefly explain the conclusions of its materiality assessment*.[1] We want to emphasise that in the absence of a requirement to disclose such information, stakeholders will certainly in most cases not be able to deduce these key pieces of information from the more general description of the materiality assessment process or from the mere absence of a topic from the sustainability statements. This will hinder a stakeholder's assessment of company sustainability performance and of the completeness of the reported information, and will require increased company engagement efforts that could easily have been avoided.

[1] As per the EFRAG SRB November 2022 (draft) ESRS 1, General requirements, paragraph 38.

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(4) Make climate-related reporting mandatory and reconsider the optional nature of certain other key disclosures

Given the societal urgency and relevance of certain topics, Eumedion is of the opinion that exemptions to the materiality assessment criteria are fully warranted. To avoid any unwanted loopholes, we strongly recommend that the European Commission follow the November 2022 EFRAG SRB advice and to make sure that at least the key climate-related disclosures are mandatory. Similarly, Eumedion would prefer that also the ESRS S1 (Own workforce) disclosure requirements are mandatory. This should not pose an excessive burden on companies, as in our experience it is very unlikely that this topic is immaterial for any (large) company.

Additionally, the proposed ESRS might hinder comparability and create unnecessary confusion by inserting optional disclosure requirements *within* topical standards. This optionality is introduced by the phrase ‘companies *may* disclose’, as opposed to ‘companies *shall* disclose’. Within the CSRD disclosure framework, that is built around the principle of materiality, we fail to see how such optionality contributes to comparable and relevant disclosures. This is, for example, very obvious where it regards the optionality of biodiversity-related transition plans: if the topic of biodiversity is assessed to be material, the societal urgency to address impacts and risks associated with biodiversity loss and the protection of ecosystems should *at least* trigger a requirement for a company to disclose if it has a transition plan in place. From a sustainability perspective, there is no valid reason why the status of the disclosure requirement regarding biodiversity-related transition plans should be different as compared to climate.

(5) Inadequate coverage of governance-factors needs to be addressed

As Eumedion has pointed out before, the coverage of governance factors within the ESRS is absolutely inadequate. In our view, the ESRS in their current state cannot be considered to cover the basic spectrum of E, S *and* G, even though this is required by the CSRD. There are ample examples where poor governance characteristics of a company come at the detriment of long-term value creation for all stakeholders. It is also our direct experience as an investor platform for governance and sustainability that governance serves as an important pre-condition to sustainable long-term value creation by companies. Therefore, we consider it essential that governance be treated on a more equal footing with the E and S categories. This will allow responsible investors to also more adequately screen and engage companies based on their performance in the area of governance, and where necessary foster positive change at companies. This key element of ‘ESG’ cannot simply be covered only by information specifically related to the *governance of sustainability* (ESRS 2) or by information related to business conduct (ESRS G1). The European Commission should explore more in-depth coverage of governance topics related to e.g. minimum shareholder rights, the structure and quantum of executive remuneration, and the number of independent and diverse nonexecutive directors. Where necessary and relevant, certain governance-related information can in practice be reported in the sustainability statement 'by reference' – but the disclosure requirements should still be included in the ESRS. Furthermore, we point out that this issue – the inadequate coverage of governance factors – needs to be better addressed in the EU sustainable finance framework as a whole, not just in the ESRS. Above, we already referred to another example, namely the proposed inclusion of tax-related indicators in the SFDR framework and the present absence of such indicators in the ESRS.

We hope that you will consider our feedback. Should you have any questions, please do not hesitate to contact us. Our contact person is Ron Gruijters (ron.gruijters@eumedion.nl).

Kind regards,

Rients Abma
Executive Director

Eumedion
Zuid Hollandlaan 7
2596 AL THE HAGUE
THE NETHERLANDS