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Investor Groups Raise Concerns Over European Sustainability Reporting Standards

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On July 31, 2023, the European Commission adopted the long-anticipated European Sustainability Reporting Standards ("ESRS") for use by all companies subject to the Corporate Sustainability Reporting Directive ("CSRD"). The version of the ESRS published by the Commission in June 2023 made a number of significant changes to the first draft prepared by EFRAG in November 2022.

The European Sustainable Investment Forum ("Eurosif"), the Principles for Responsible Investment ("PRI"), the Institutional Investors Group on Climate Change ("IIGCC"), the European Fund and Asset Management Association ("EFAMA"), the United Nations Environment Programme Finance Initiative ("UNEP FI"), as well as 92 investors and other financial market participants expressed concerns about these changes in a joint statement published on July 7, 2023, in which they urged the Commission to reflect the integrity and ambition of the first set of ESRS as set out in EFRAG's final proposals of November 2022. Despite this, the final ESRS do not reflect the recommendations of various investor groups and remains largely unchanged from June 2023.

The Commission has emphasized that the standards adopted seek to address the regulatory burden on reporting companies while enabling companies to demonstrate their ESG credentials and access sustainable finance. The ISSB has also highlighted that collaboration between the Commission, EFRAG and the ISSB has resulted in a high degree of alignment among standards, which reduces complexity and duplication for reporting companies. Further assistance will be provided to companies through the publication of non-binding technical guidance by EFRAG.

The joint statement's signatories, however, point out that making disclosure requirements subject to a materiality assessment (as opposed to outright mandating disclosure in certain areas) has led to a misalignment between what companies are obligated to report under ESRS and the reporting obligations of market participants and investors under EU sustainability reporting frameworks. This threatens to adversely affect the ability of investors to access comparable data and information and therefore inform decisions and ultimately mobilize sustainable capital and investment. In addition, according to the joint statement, it is also likely to affect their ability to accurately comply with sustainability-related reporting and disclosure requirements, including under EU's Sustainable Finance Disclosure Regulation and Basel Pillar 3, potentially increasing greenwashing risk: "In light of the EU's climate objectives and investors' own climate commitments, reporting on GHG emissions, transition plans and climate targets should always be considered material and hence mandatory. This would ensure that investors can access information from their holdings to support the alignment of their portfolios with net-zero and the Paris Agreement targets." Other market participants have also criticized the decision to make some biodiversity and social indicators voluntary.

The ESRS are subject to a two-month scrutiny period (extendable by a further two months) and are intended to apply from January 1, 2024 (for fiscal years beginning on or after that date).

Final Thoughts

We have frequently emphasized the importance of aligning reporting and disclosure frameworks to enable investors to compare sustainability credentials and make fully informed investment decisions. Greater collaboration among international standard setters also enhances interoperability and avoids duplication, as we have discussed here, here, and here.

(This article originally appeared in Cadwalader Climate, a twice-weekly newsletter on the ESG market.)