Finnwatch response to the European Commission consultation on the revision of the European sustainability reporting standards

ESRS E1 (climate disclosures)

While we welcome that the E1 standard on climate-related disclosures has maintained sufficient coverage of climate related sustainability issues, we would like to point out few changes that should be reconsidered to ensure high quality and comparability of sustainability reporting under the CSRD.

E1-1 (transition plans)

Our own research on the first CSRD reports by the largest Finnish companies showed that companies eagerly reported having a climate transition plan, but were very vague on its compatibility with the 1.5°C target – and some of these plans clearly were not compatible. As companies are already widely reporting plans that may or may not be in line with 1.5. target, we support the change to allow companies to report transition plans that are not in line with the 1.5 degree target AND requiring them to disclose whether their strategy, business model and GHG emission reduction targets are science-based and compatible with limiting global warming to 1.5°C. This is a good way to ensure that the users of the reports won't make misguided assumptions that reporting some ambiguous plan under E1-1 is the same thing as having a 1.5°C compatible emissions reduction target and a plan.

E1-7 (energy)

While this has not been changed from the original set of ESRSs, we would like to point out that in the energy disclosures the classification is different when reporting energy consumption (three classes: fossil, nuclear and renewable) and when reporting produced energy (two classes: renewable and non-renewable). It would be more appropriate to use the former classification for both in order to make a distinction between the production of fossil-based energy and the production of nuclear energy.

E1-8 (emissions)

The disclosure requirement on GHG emissions problematically includes a proposal to remove the requirement to provide justification for any excluded scope 3 categories (the AR46(i) in the original ESRSs). This makes the DR incompatible with the GHG Protocol

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Scope 3 Standard that, on page 119, requires a "list of scope 3 categories or activities excluded from the inventory with justification of their exclusion". The ESRS requirements should be completely compatible with the requirements of the already widely used GHG Protocol and any exceptions should be based on the need to require more information.

This kind of an exception is the case with massive on-line ecommerce platforms as the GHG emissions reporting requirements in the ESRS (or in the GHG Protocol) do not include the emissions related to the third party sales on ecommerce platforms. This means that while companies such as Shein or Temu may fall under the requirements of the CSRD, a large proportion of the emissions related to their business operations may not. While the discussion on the regulation on such platforms is active in the EU and in many member states, without addressing this issue the CSRD may bring forward yet another piece of legislation that tilts the playing field in favour of third party ecommerce platforms at the expense of non-platform based (and often European) businesses.

While the requirements of the GHG Protocol are outside the Commission's jurisdiction, the forementioned issue could and should be addressed separately in the ESRSs. This could be done by adding a new paragraph to the section E1-8: "The undertaking shall disclose – if applicable – any significant emissions of the products that are being sold on the platform operated by the undertaking and not reported under the requirements stated in the paragraph 30". This could be further clarified with an additional application requirement: "These emissions must at minimum include the emissions related to the products that the third party seller reports (or would report) under the GHG Protocol Scopes 1 and 2 and in the Scope 3 categories 1 (Purchased goods and services), 4 (Upstream transportation and distribution), 5 (Waste generated in operations), 9 (Downstream transportation and distribution), 11 (Use of sold products) and 12 (End-of-life treatment of sold products)."

E1-9 (carbon credits)

The disclosure requirement on the use of carbon credits should require more information on the nature of the used credits. We propose that these additional requirements in the original ESRSs (listed in the AR62 for E1-7) are brought back: the share (percentage of volume) for each recognised quality standard, the share (percentage of volume) issued from projects in the EU and the share (percentage of volume) that qualifies as a corresponding adjustment under Article 6 of the Paris Agreement.

Cross-cutting standards

In regard to cross-cutting standards, we strongly welcome the added emphasis on fair presentation. According to EFRAG, the strengthening of the fair presentation framework is necessary to ensure quality of the reported information. We strongly agree with this.

We are concerned about the Commission's proposal to introduce an exemption for companies that manage investments on behalf of their clients without retaining risks or rewards of ownership. Following this exemption, which was not included in the EFRAG's technical advice, such companies would not need to provide data on those investments. The text does not provide a clear list of the types of investors to be exempted. In our view, when the management of investments involves any decisions on what to invest on, such exemption should not apply.

We are also concerned about the impact of some new reliefs that are being proposed, such as the requirement to use reasonable and supportable information that is available to the undertaking at the reporting date without undue cost or effort, to e.g. identify material impacts and when extending the information to cover the value chain. Whereas it is important to ensure that sustainability reporting is feasible for companies to do, too much flexibility may undermine the quality of disclosed information. To counter such negative impacts on quality, as a bare minimum, the requirement to disclose significant limitations affecting the reported information under the undue cost or effort provision for specific datapoints should be maintained, and the use of the undue cost or effort provision should be timebound i.e. limited to e.g. 2 years at most.

In the proposal, the disclosure requirements on value chains have been simplified, among other things, by removal of the requirement to disclose "a description of the main business actors (such as key suppliers, customers, distribution channel and end-users)". In our view, this would be regrettable. Value chain transparency enables stakeholders, including affected stakeholders to bring impacts into the attention of companies, and maintaining more detailed disclosure requirements on value chains would be an important means to drive such transparency. More detailed reporting on the value chain also lends credibility to the companies' materiality assessment and thus their entire reporting. This removal of the more detailed information was proposed already by EFRAG, but we recommend the Commission reinstates it when adopting the revised delegated act.

The proposed changes to the disclosure requirement on statement on sustainability due diligence in our experience largely reflect the current practice. In their first sustainability statements, many companies reported only information which enabled the understanding of where in their statements the main steps of their due diligence process were reflected rather than information that facilitated the understanding of their due diligence process. Although reporting on due diligence is a key component of sustainability reporting, we think that the proposed change is unlikely to lead to less informative and transparent reporting on due diligence and therefore, it can be supported.

In our experience, companies' disclosures on the identification and assessment of their adverse impacts, a key step of both the due diligence process and the double materiality assessment, has been the least transparent and meaningful of their reporting on their sustainability due diligence so far. Some of the proposed changes, such as emphasis on

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how companies assess and prioritise impacts based on severity and likelihood (instead of whether and how they do so), and clear requirement to disclose whether the materiality assessment is informed by the company's due diligence process may bring about some improvements in this regard. In connection with this, we also welcome the proposal to make a distinction between qualitative considerations and quantitative thresholds to determine materiality (instead of qualitative and quantitative thresholds). For social impacts in particular, the requirement to apply thresholds to determine materiality, in our experience, leads companies using quantitative thresholds which in turn leads to meaningless reporting on materiality conclusions.

ESRS S2 and S3 (social disclosures)

In regard to social standards, at least the S2 and S3 which we are focussing on in our work, we generally welcome the proposed changes as they genuinely simplify the disclosure requirements without foreseeably compromising the integrity of the reported information.

However, we regret the proposal by the Commission, contrary to EFRAG's technical advice, to replace "direct linkage" with "other connection" in each of the social standards in the following sentence in the application requirements: "*The actions taken by the undertaking differ depending on its connection to the impact (causation, contribution, direct linkage) and how it has identified the actions as appropriate for addressing material impacts*." Cause, contribute and directly linked to, or the involvement framework as they are collectively known, are established concepts in the international business and human rights standards and in the CSDDD. Therefore, replacing 'direct linkage' with 'other connection' does not add clarity or simplification but rather introduces a wholly new concept that is subject to interpretation and adds confusion. We recommend that the Commission reverts back to the EFRAG's technical advice in this regard.

We also think it unadvisable to combine datapoints on actions taken to manage potential impacts and actions to remediate actual impacts. In our experience, companies reporting on concrete actions to remediate an impact is often completely lacking even when the company has classified their material adverse impacts as actual impacts. Combining the datapoints may lead to even less reporting on concrete actions undertaken to remediate actual impacts. We also note that managing impacts and remediating are two distinct duties in the CSDDD. This supports keeping the related disclosure requirements separate, too.

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