

Approach to the preparation of sector-specific draft ESRS

Background

- 1 The CSRD requires EFRAG to develop sector-specific draft ESRS.
- 2 In preparation, the EFRAG PTF ESRS developed an exposure draft that sets the ESRS sector classification (SEC 1 ED). This classification aggregates NACE codes into 41 different sectors.
- 3 On 26 August 2022, considering the activities necessary to develop 41 different draft ESRS including the public consultation, the SRB agreed to develop the sector specific standards in more than one year, giving priority to sectors assessed to have a high-impact and to include in the first year the five sectors already covered by a GRI standard. It was agreed to cover 10 sectors in Set 2 (consultation in 1H23, delivery to the EC in November 2023), assuming that proper resources would be available.
- 4 The EFRAG Secretariat has been running research activity since June 2022, including the organization of a series of workshops following a public call for input. The preparatory material that resulted from this activity constitutes the basis for the SR TEG and SRB imminent discussions to define the content of the Exposure Drafts of Sector-specific ESRS.

Objectives of this session

- 5 To discuss and approve the approach to the preparation of sector draft ESRS illustrated in this paper.

1. Sector classification

- 6 SEC 1 ED was not exposed for public comments as part of Set 1, as priority was given to the topical standards. The EFRAG Secretariat proposes to issue this document for consultation as ESRS Exposure Draft. The document is also provided as **Agenda Paper 01.02** for this session.
- 7 The sector classification approach in SEC 1 ED reflects a 'desktop approach', i.e. it has been prepared on a top-down basis, before a detailed investigation of the sustainability matters likely to be material for the specific sector and of the applicable disclosure requirements. The draft has also been prepared on the basis of a reconciliation table with the SASB classification system (table prepared by EFRAG Secretariat and not shared nor approved by the ISSB or ISSB staff). The preparatory work on the first ten sectors performed by the EFRAG Secretariat shows that the activity that leads to the definition of sustainability matters and disclosure requirements applicable at sector level constitutes a sort of 'on the field test' for the sector classification.
- 8 In particular, it emerged that for some of the sectors it would be more relevant to include, next to the production activities, also the sales and trading services. Consequently, the corresponding sub-sectors (grouping of NACE codes) related to the sales and trades of a given product could be re-allocated from the *Sales & Trade* sector of SEC 1 to the relevant production sector. This is considered as an example of possible selective re-allocations of sub-sectors to different ESRS sectors that can

emerge once the investigation of matters and disclosure requirements applicable to each and every sector progresses. As an illustration, ESRS mid to downstream oil and gas sector includes NACE codes for wholesale of petroleum products, as well as gas retailing. Consider a company belonging to this ESRS sector, that, next to selling petrol at the gas stations also sells candy bars. Selling candy bars is normally included in the Sales&Trade sector. The undertaking will have to identify its significant ESRS sectors as defined in ESRS 2, disclose its turnover by ESRS sectors under ESRS 2 – SBM 1 and report according to the sector specific draft ESRS corresponding to its significant sectors. Depending on its facts and circumstances, it may conclude that it has to apply both sector-specific standards (Oil and gas and Sales&Trade). The EFRAG Secretariat proposes to expose for comments SEC 1 ED in Set 2, with the caveat that selected re-allocation of sub-sectors across ESRS sectors are possible in a second stage, i.e. jointly with the consultation on a given sector specific ESRS ED. Each of the sector specific ESRS EDs would accordingly include the illustration of the NACE codes that, following SEC 1 ED, are allocated to the sector. Where applicable, this illustration could include the selected re-allocation of sub-sectors identified in the preparation of the ED. A specific question to confirm/validate the sector classification for the specific sector would be included in each sector specific ESRS ED. The sector specific draft ESRS to be exposed for comments in Set 3 and in subsequent sets would include an amendment to SEC 1, where appropriate, to reflect the selected re-allocations.

2. List of sustainability matters covered in sector-specific draft ESRS

- 9 On 12 September, the SRB approved the methodology for determining material topics in sector-specific ESRS (the SR TEG approved the document on the 24 August 2022), subject to amendments to reflect the following SR TEG comments:
- (a) It was agreed to amend the paper, in order to give a less prominent role the existence of EU legislation as a determinant of the materiality of a topic. It is not the intent of the ESRS to require disclosure on the compliance with all the EU regulations. It should be clarified that EU legislation should play a role if it specifically mandates reporting by undertakings on sustainability matters, for example the SFDR and (potentially) the draft CSDDD; at the sector-specific level, such an example may be the Conflict Minerals Regulation. Furthermore, the existence of EU policies and legislation may indicate the existence of material impacts and risks, which should be analysed. Finally, the bulk of EU legislation is not applicable to undertakings in the value chain that are non-EU companies. It was also suggested to delete the reference to the Taxonomy regulation, as EFRAG has not received a mandate to develop the disclosure of the Taxonomy regulation.
 - (b) The language of the paper will be amended to more consistently follow the language of the final version of the CSRD regarding terms such as 'sustainability matters or factors' and 'sub-topic' or 'sub-sub-topics'.
 - (c) The paper proposes to conclude that a topic is material at sector specific level when it is material for the 'majority' of the companies in a given sector. The question was raised about alternatives to this rule and the need to examine such alternatives, if they exist.
 - (d) The paper implies that if a matter is material and it is already covered by the sector agnostic standards, the sector specific ESRS includes incremental Application Guidance. This should not be a general rule, but the paper should specify that this is the case only when the AG in the sector agnostic level is not sufficient.
- 10 The methodological document (still to be updated for the comments above) is provided for this meeting as **Agenda Paper 01.03**.
- 11 Following this methodology, the preparatory research conducted by the EFRAG Secretariat, a list of sustainability matters has been prepared, that will support the materiality assessment to be conducted by the undertaking for the respective

sectors. This list will be included as Application Requirements in the respective sector-specific draft ESRS.

3. Materiality approach sector-specific draft ESRS

- 12 ESRS 1 *General Requirements* sets the materiality approach to be followed when preparing ESRS sustainability statements. It combines a materiality approach with a list of disclosures that are always to be reported. Irrespective of the outcome of the materiality approach, the undertaking shall always include: the disclosures required by ESRS 2 *General Disclosures* and ESRS E1 *Climate Change*, the list of datapoints required by other EU regulations (Appendix C of ESRS 2) and, for undertakings with 250 or more employees, the Disclosure Requirements (DRs) ESRS S1-1 to S1-9 in draft ESRS S1 *Own workforce*. A materiality assessment process leads to the identification of the information to be reported for the sustainability matters other than climate change, supported by a list of topics and sub-topics (Appendix B of ESRS 1). When the undertaking concludes that a sustainability matter is material it shall: (a) report according to the DRs (including Application Requirements) related to that specific sustainability matter in the relevant ESRS; and (b) develop and report additional appropriate entity-specific disclosures when the material sustainability matter, is not covered by an ESRS or is covered with insufficient granularity.
- 13 According to ESRS 1 sector-specific ESRS/Disclosure Requirements are applicable to all undertakings within a sector. They address impacts, risks and opportunities not covered, or not sufficiently covered, by sector-agnostic Disclosure Requirements. The content of sector specific draft ESRS is incremental to the content of the topical standards in Set 1. This means that, when the undertaking concludes that a sustainability matter is material, it shall report according to the DRs of the topical standard in Set 1 and, in addition, according to the DRs of the sector specific ESRS.
- 14 As an illustration, if the sub-topic 'water use' is material for the undertaking, it has to:
 - (a) apply the DRs in ESRS E3 related to water use;
 - (b) apply the DRs related to water use in the sector standard (or standards) that is (are) applicable to the sector (or sectors) in which the undertaking operates.
 - (c) where applicable, develop entity-specific disclosures.
- 15 The EFRAG Secretariat acknowledges that different views may exist on the scope of the materiality assessment, as opposed to the scope of items to be always reported, on the basis of the discussions that SR TEG had on the approach in Set 1.
- 16 The EFRAG Secretariat proposes a general approach based on the materiality assessment, with some selected DRs deriving from EU Regulation that were not included in Set 1 due to their sector-specific nature. The undertaking would determine which sustainability matters are material to its specific facts and circumstances. The undertaking would run its materiality assessment considering in the same process both the levels (sector agnostic and sector specific). For this purpose, it would use the list in Appendix B of ESRS 1, integrated by the list provided under point 2 above per each sector specific draft ESRS.
- 17 Therefore, at sector specific level, a limited list of datapoint to be always reported would be included, to cover the indicators in SFDR, Benchmark Regulation and Pillar 3 not already covered in Set 1. Other regulations will also be considered, such as EMAS.

- 18 This approach is a natural complement to the granularity resulting from the sector classification in SEC 1 (e.g. 41 sectors as opposed to 77 SASB industries or more). It allows the undertaking to adopt a two-fold approach:
- (a) in accordance with ESRS 1 - SBM 1 the undertaking selects the significant sectors out of the 41; and
 - (b) for each sector, in accordance with its materiality assessment, it may exclude information required by DR/datapoints that are not material, as they pertain to activities that are covered by an ESRS sector but are not material to the undertaking on the basis of its specific activities.
- 19 Possible adjustments to the approach in ESRS 1 in relation to omissions of DR/datapoint and transparency on the omitted items, will be discussed at a later stage (when looking at the actual drafts).

4. Process for the definition of the contents of sector-specific draft ESRS

- 20 Consistent with the requirement in the CSRD to align the content of ESRS with the existing frameworks and standards, the sector-specific draft ESRS will leverage to the maximum extent possible on existing material. The main sources are:
- (a) SASB indicators (investor focused financial materiality framework available for 77 industries and maintained in the US by a global non-profit, which has been integrated in August 2022 in the IFRS Foundation);
 - (b) GRI (impact-based materiality standards available five sectors: Energy Production & Utilities, Textiles/Accessories/Jewellery/Footwear, Motor Vehicles, Road Transport, Food & Beverages).
- 21 Other sector guidelines and European legislations are also to be included, when they exist.
- 22 Starting from June 2022, the EFRG Secretariat has been collecting research material, benefiting from the preparatory work done by the EFRAG PTF ESRS in 2020 and 2021. The work of the EFRAG PTF ESRS focused in particular on the SASB indicators.
- 23 From July 2022, the EFRAG Secretariat has run a series of workshops and collected a number of additional references, including sector guidelines, and has prepared, per each sector, a list of applicable legislations (mostly European but with some international legislation also included).
- 24 Next to these sources, the sector specific draft ESRS will have to consider, where relevant, the following DRs of ESRS EDs that have been deleted in the finalization of the sector-agnostic ESRS, as they were more relevant for specific sectors:
- (a) ESRS E1 *Climate change ED*: energy and GHG-intensive sectors: E1-1 *Transition plan: quantitative locked-in emissions*; E1-5 *Energy consumption and mix: breakdown of non-renewable energy*; E1-14 *Avoided GHG emissions*;
 - (b) ESRS E3 *Water and marine resources ED*: DR E3-6 *Marine resources related performance*: the DR was deleted because the disclosure on performance metrics was not considered mature enough to be required at sector-agnostic level.
 - (c) ESRS E4 *Biodiversity and ecosystems ED*: DR 4-8 *Biodiversity-friendly consumption and production metrics*: The DR was removed due to the difficulty of defining what biodiversity-friendly consumption and production really is. The DR may be added to a future Governance standard on responsible production and consumption. In sector-specific standards specific types of certificates may be referred to.
 - (d) ESRS S1 *Own workforce ED*: DR S1-12 – *Working hours* (moved to sector specific).

- (e) ESRS G2 *Business conduct* ED: G2-4 – *Anti-competitive behaviour prevention and detection* and G2-7 – *Anti-competitive behaviour events* have been eliminated from the sector agnostic standards to be included in sector standards where appropriate.
- 25 For ESRS E5 *Circular economy* ED, the DRs E5-7 – *Resource use optimisation* and E5-8 – *Circularity support* have been significantly simplified. To be verified whether there are sector standards that would benefit from the inclusion of specifications related to them.
- 26 In addition, ESRS S2 *Workers in the value chain*, ESRS S3 *Affected communities* and ESRS S4 *Consumers and end-users* do not include DRs related to metrics, as they are considered relevant at sector level. Accordingly, the sector specific draft ESRS will consider metrics to cover the sustainability matters in those standards.
- 27 Taking inspiration from the decision tree adopted in the finalisation of the sector agnostic ESRS after the public consultation, the EFRAG Secretariat recommends to systematically factor into the decision making that will lead to the EDs to be put in consultation the cost/benefit considerations. This means that, per each datapoint available in the sources described above, the relevance of the resulting information would be considered jointly with the costs to produce it. On the basis of these considerations and depending on its nature, the result could be: (a) include as additional datapoint in a DR, (b) include as ‘shall consider’ guidance to be applied in implementing an existing datapoint in a DR (either a sector agnostic DR or a sector specific DR), (c) include as a voluntary recommendation to encourage good practices (‘may’ disclose).
- 28 Determining the appropriate number of datapoints to be added to the sustainability statements on a sector-specific basis requires judgement. In order to allow a transparent illustration of how this judgement has been exercised and allow for a more efficient consultation process, the EFRAG Secretariat proposes to include in the EDs one appendix per each source (SASB, GRI, etc.) that illustrates which of the datapoints in the source are included in the ED and which are not included. A specific question in the ED would support the validation of this process per each standard and per each source, with a reasonably limited number of questions (one per each source).
- 29 The Basis for Conclusions will reflect the different sources considered and the rationale for the final content.

5. Architecture of sector-specific draft ESRS

- 30 The secretariat proposes to have one standard per each ESRS sector, following SEC 1 classification. The content of the sector-specific draft ESRS will mirror the architecture of the sector-agnostic ESRS. In particular, the sector standards will include:
- (a) Sector specifications to DRs of ESRS 2. Following the same approach adopted in the topical standard, where contents in the main body or in the Application Requirements have been added to reflect topical specifications of DRs in ESRS 2, sector specifications to DRs in ESRS 2 will be added in the sector standards, where appropriate. An updated version of Appendix D of ESRS 2 will support the navigation of the contents.
- (b) Sector specifications to support the implementation of DRs that are included in the topical standards (an appendix in each topical standard could be added to support the navigation of the contents at sector agnostic and sector-specific level – alternatively this appendix could be located in the sector standard);
- (c) New DRs, including their Application Requirements.

6. Presentation of the sector disclosure

- 31 Draft ESRS 1 sets requirements on the presentation of disclosures in sustainability statements. It is worth here mentioning paragraphs 116 to 118 and noting in particular paragraph 117:
- 32 *116. The undertaking shall structure its sustainability statements in four parts: general information, environmental information, social information and governance information in the order prescribed in Appendix E Structure of ESRS sustainability statements of this [draft] Standard. Respecting the provision in section 3.6 Material impacts or risks arising from actions to address sustainability matters of this [draft] Standard, when information provided in one part is also covering information to be reported in another part, the undertaking may refer in one part to information presented in another part, avoiding duplications. The undertaking may apply the detailed structure illustrated in Appendix G of this [draft] Standard.*
- 33 *117. The disclosures required by sector-specific ESRS shall be grouped by cross-cutting reporting area and, where applicable, by sustainability topic. They shall be presented alongside the disclosures required by the corresponding sector-agnostic ESRS.*
- 34 *118. Where the undertaking develops material entity-specific disclosures in accordance with section 1.4 Entity-specific disclosures, it shall report those disclosures alongside the most relevant sector-agnostic and sector-specific disclosures.*

Agenda Papers

- 35 **Agenda Paper 01.02:** SEC 1 Exposure Draft
- 36 **Agenda Paper 01.03:** Methodology to identify material matters for sector specific draft ESRS

Questions to SR TEG/SRB members and observers

- 37 Do you agree with the approach proposed in this paper? Do you have any specific suggestion on how to improve the proposed approach?
- 38 Do you agree to consult on SEC 1 ED as part of Set 2?
- 39 Do you agree with the approach proposed in section 1 above for the consultation on SEC 1 ED and possible subsequent adjustments to it?
- 40 Do you agree on the materiality approach described section 3?
- 41 Do you agree on the process described in section 4?
- 42 Do you agree on the architecture described in section 5?