

This paper provides the technical advice from EFRAG SR TEG to the EFRAG SRB, following EFRAG SR TEG's public discussion. The paper does not represent the official views of EFRAG or any individual member of the EFRAG SRB. This paper is made available to enable the public to follow the EFRAG's due process. Tentative decisions are reported in EFRAG Update. EFRAG positions as approved by the EFRAG SRB are published as comment letters, discussion or position papers or in any other form considered appropriate in the circumstances.

Sector Classification (SEC 1) Exposure Draft

Cover Note

Objective

- 1 The objective of this session is to consider the SR TEG advice and obtain an approval on Sector Classification SEC¹ Exposure Draft (excluding the classification of activities in bioenergy and financial institutions).
- 2 For two areas the approval request is postponed (indicated in grey in the Exposure Draft). These relate to:
 - (a) the sector definitions of the financial sectors: Credit Institutions, Insurance and Capital Markets; and
 - (b) The decision to include – or not – a separate sector on Bioenergy.
- 3 For Credit Institutions, Insurance and Capital Markets the Financial Reporting Panels will provide an advice on sector definition to SR TEG members within the next two months.
- 4 For Bioenergy the SR TEG members will have to complete the technical discussion at a future meeting.
- 5 SR TEG members discussed the creation of a sector Bioenergy in their meeting of 25 April 2024. They suggested to reword the paper in a more neutral way, noting that the introduction of a separate sector may be perceived as a form of support for the role that biofuel may have in the climate transition which should be avoided.
- 6 Technically, they found equally valid the option to split the topic in several different sectors. Several SR TEG members proposed to leave the different activities in the separate sectors they relate to.
- 7 One SR TEG member questioned whether commonality of IROs could be found in the different production processes of bioenergy. The EFRAG Secretariat noted the commonality was found in how the residuals of energy were treated.
- 8 In SEC 1 ED presented for this meeting, the content related to these two aspects is highlighted in grey.

Background and last SRB SEC 1 discussions

- 9 EFRAG SRB discussed intensively until mid-March 2023 the SEC 1 ED and provided detailed input to the EFRAG Secretariat that has been reflected in the draft submitted for approval today.
- 10 The EFRAG SRB was updated in its meeting on 24 January 2024 on the ongoing activities of the EFRAG Secretariat and TEG to enhance SEC 1. In this session, SRB members generally agreed not to align to the EU Taxonomy activities. Some SRB members fear that the co-existence of different reporting requirements (ESRS, EU Taxonomy, financial reporting) with each different aggregation levels ((sub)sectors, Taxonomy activities, operating segments) may stand in the way of a clear communication from undertakings on their activities. It was suggested to discuss possible ways forward to limit this risk with the EU Platform on Sustainable Finance. Also it was noted that EFRAG was not the cause of inconsistent EU regulations.

Outcome of the SR TEG discussion

- 11 On 8 May 2024 EFRAG SR TEG approved the SEC 1 ED (except biofuel and financial institutions). Integrating input obtained in written by members that did not participate to the vote, the outcome is as follows (quorum 17 members):
- 1 Abstention justified by not having had time to consult with stakeholders: Luc Hendrickx will express a view when finalizing the standard.
 - 5 Abstentions: Belen Varela Nieto, Giulia Genuardi, Eric Duvaud, Anne-Claire Ducrocq consider the sustainability matters per each sector ESRS should be developed at the same time and be available when the classification is established. Carlota de Paula Coelho abstained – in writing after the meeting – as she does not consider the approach followed as a real principle or methodology to support the classification.
 - 5 Abstentions of new TEG members: Elena Philipova, Julia Kölzer, Robert Adamczyk, Vanya Rusinova, Olivier Scherer. Abstention is justified by the too short period since they started as SR TEG members. These members will form an opinion during the consultation and take a position in the final vote when the standard will be issued.
 - 13 members approved: Chiara Del Prete, Jose M Moneva, Beiersdorf Kati, Sigurt Vitols, Per Tornqvist, Philippe Diaz, Sandra Adler, Luis Piacenza, Piotr Biernaki, Pier Mario Barzaghi, Jean-François Coppenolle, Fiona Watson and Antonino Vaccaro – in written after the meeting - conditioned their approval to the incorporation in the version for consultation in January 2025 of the list of sustainability matters that will be available at that time, expected to cover 7 sectors (OG, MQC, Textile, Road Transport, Banks, Insurers, Capital Markets) – this is compatible with the current workplan.
 - One SR TEG member (Signe Andreasen Lysgaard) noted in writing that, despite her approval for SEC 1, she had sympathy for the views of fellow SR TEG members re the SEC 1 process. She found it challenging to provide technical input re sector classifications discussed in abstract with little consideration of the sustainability matters of relevance. She took note of the point in the minutes around the need for pragmatism and considering potential future changes where needed, cognizant of the desire to keep them to a minimum.

- 4 Not present/vote not provided in written: Luca Bonaccorsi, Klaus Hufschlag, Christoph Toepfer, Fiona Watson.
- 12 The EFRAG SR TEG Chair noted that the development of the sector classification is a typical "chicken or egg first" situation. One can only describe all sectors in full detail (and freeze the list of NACE codes) once all of the sectors have been analysed (in the next 4 years), but undertakings need guidance earlier than that, in order to identify to which sector(s) they belong to. In addition, for the standard setting exercise in each sector you need to have the boundary of the sector as a starting point. Finally, SEC 1 is needed as a delegated act, to allow the implementation of SBM 1 (breakdown of revenues by ESRS sectors/ list of significant ERSR sectors where the company is active). The decision to develop SEC1 before the sector standards was taken by the SRB in 2023 and even before, this was the recommendation of the ESRS PTF. Also, SR TEG had approved SEC 1 already in March 2023.
- 13 In addition, SEC 1 was subject to an intense scrutiny at the beginning of 2024 through the workshops with the communities.
- 14 In the previous discussions, the conclusion was that a certain pragmatism is needed, so that the future changes are kept to the minimum level and future amendments to the standard are made if necessary. The EFRAG Secretariat notes that, to further mitigate the concerns of the members that abstained, the at the date of issuance of the final draft in November 2025, the lists of additional sustainability matters will be available for the other high impact sectors, so that the content of SEC 1 will be corroborated for 11 sectors (high impact and financial institutions). Additional sectors will progress by the time that SEC 1 Delegated Act is issued (June 2026).
- 15 SR TEG members suggested the following editorial changes: clarify paragraph 5b of paper 04-02, indicating that the analysis pertains to EFRAG not to the company.
- 16 Other aspects discussed included:
- (a) One SR TEG member queried if mapping one ESRS sector with multiple SASB standards could affect interoperability. The EFRAG Secretariat replied that in most cases the SASB industries were identified as subsectors within an ESRS sector.
 - (b) One SR TEG member asked to add in paragraph 13 of paper 04-02¹ the necessity for analysis of the value chain. The EFRAG Secretariat notes that this paragraph needs to stay aligned with ESRS 2 para. AR 13. The value chain dimension should be covered in each sector "vertically" (e.g. in the oil and gas sector the undertaking will already find the DRs to cover its own value chain without having to apply the standards for the sectors of its value chain). What matters when deciding the significant sectors of a company are only the own operations.
 - (c) One SR TEG member was worried about the trickle-down effect for SMEs by the sector standards, leading to double reporting for these undertakings in their value chain. The EFRAG Secretariat noted that EFRAG cannot question the role of sector standards as this is in the level 1 regulation.
 - (d) One SR TEG member expressed doubts about the rationale behind merging some sectors and splitting others, furthermore she asked if the analysis, in terms of

¹ This number refers to the SR TEG papers.

alignment, took into consideration TNFD guidance. The EFRAG secretariat clarified that the analysis had not (yet) incorporated TNFD guidance. The issuance of the ED will be accompanied also by a mapping with TNFD.

- (e) One SR TEG member brought up an editorial issue concerning the descriptions of sub-sectors (paper 04-04)¹, suggesting that in some cases, further clarification might be necessary regarding different levels of sub-sector granularity. They proposed the possibility of labelling them as sub-sub-sectors for clarity. The EFRAG Secretariat notes that until a full articulation of the disclosure requirements for each sector ESRS is available, it would be premature to attempt a full aggregation of NACE codes in sub-sectors. It is also not essential for the correct functioning of the classification system.
- (f) Another SR TEG member suggested to revise the text of Appendix B, where economic activities are described. In particular, the description as much as possible make reference to the language in the NACE nomenclature. The EFRAG secretariat acknowledged this would be done, noting it does require an important overhaul of the sector definitions. One SR TEG member asked to clarify the terminology of internal activities in paragraph 14 of paper 04-02¹.

Next steps

- 17 Complete the discussion on Biofuel with EFRAG SR TEG.
- 18 Develop reconciliation with TNFD and include in Basis for Conclusions.
- 19 Validate the list of NACE codes/activities aggregated in the sectors Banks, Insurers, Capital Markets.
- 20 Get approval of FI and biofuel classification from EFRAG SR TEG and SRB.
- 21 Develop Basis for Conclusions and consult in written with SR TEG and SRB Update and finalize questionnaire for consultation (the EFRAG SRB had already pre-approved the questionnaire in March 2023).

Changes occurring since the last discussion

- 22 The updated sector classification now counts 35 sectors (instead of 39) and 15 sector groups (instead of 14). This is caused by the following changes:
 - (a) Tobacco sector is incorporated into “Agriculture, Farming and Fishing” and “Food and Beverages”;
 - (b) “Gaming” sector is incorporated into “Recreation and Leisure”;
 - (c) “Marketing” sector is incorporated into “Professional services”;
 - (d) “Paper and Wood products” sector is merged with “Forestry” to become “Forestry and Wood products”;
 - (e) “Sports equipment” and “Construction and Furnishings” are merged into “Household durables n.e.c.”. To build this sector additional economic activities from other sectors have been brought into this sector. Even so, some other household durables remain part of other sectors (e.g. cars or jewellery), hence the

denomination “n.e.c.”. This new sector has also been assigned to a new sector group “Durable goods”.

- 23 Specialised sales activities have been assigned to the underlying manufacturing sectors they relate to, in contrast non-specialised sales activities remain grouped in the “Sales and Trade” sector.
- 24 Operational leasing activities have been assigned to the underlying manufacturing sectors they relate to. Financial leasing operations are incorporated into the “Credit Institutions” sector. Leasing of intellectual property and other tangible goods and non-financial assets – categories that can affect all sectors – remain in the “Sales and Trade” sector.
- 25 Comments from workshops discussed during the SR TEG meetings of 19 and 25 March have been incorporated in the classification. This made it necessary to include some structural changes in dealing with the NACE codes:
 - (a) Dual or multiple use of several NACE Classes. The Basis for Conclusions contains a list of all NACE Classes that are used more than once and if so, in which sectors;
 - (b) Description of activities at a more granular level than NACE Classes (4-digit level) to separate activities that do not belong in the same sector.

Questions for EFRAG SRB

- 26 Do EFRAG SRB members agree to include in the public consultation a question on whether a subset of disclosure requirements need to be always mandatory and to ask constituents to identify which are these DRs?
- 27 Do EFRAG SRB members approve the proposed sector classification SEC 1 ED?

Agenda Papers

- 28 In addition to this cover note, agenda papers for this session are:
 - (a) Agenda paper 04-02 – Sector Classification SEC 1 ; and
 - (b) Agenda paper 04-03 – Sector Classification SEC 1 – compared.