

## THE CHAIRPERSON

Ms Kerstin Lopatta  
Acting Chair  
Sustainability Reporting Board  
European Financial Reporting Advisory Group (EFRAG)  
35 Square de Meeûs  
1000 Brussels  
Belgium

28 July 2022

**Subject: EBA comments to the EFRAG consultation on European sustainability reporting standards – Exposure drafts ESRS 1, ESRS 2, ESRS E1**

Dear Ms Lopatta,

The European Banking Authority (EBA) welcomes the opportunity to comment on the EFRAG's Exposure Drafts (EDs) published for a public consultation in April 2022.

Following our own role and policy mandates on financial institutions prudential disclosures, including disclosures on Environmental, Social or Governance (ESG) risks, the EBA has a strong interest in promoting transparency and enhanced public disclosures on this topic. Our objective is to reinforce the market discipline, encourage financial institutions to strengthen their management of these risks and promote awareness of the financial institutions' key role in the transition to a green economy.

Please note that the EBA has recently published (and submitted to the European Commission for the final adoption) the draft Implementing Technical Standards (ITS) specifying uniform disclosure formats, and associated instructions on Pillar 3 disclosures, which large financial institutions with securities traded on a regulated market of any EU Member State shall follow for disclosing their exposure to ESG risks. The first application date of the disclosure is 31 December 2022.

Considering the work of the EBA on ESG risks disclosures and the scope of the EFRAG consultation, the EBA provides its comments to a limited number of EDs focusing on ESRS 1 'General principles', ESRS 2 'General, strategy, governance and materiality assessment' and ESRS E1 'Climate change'.

The EBA provides its comments and responses to the questions using the online tool considering the requirements set out in its draft ITS on Pillar 3 ESG risks and from the perspective of a prudential banking regulator. The focus is on those aspects which may be relevant regarding the Pillar 3 ESG disclosures and financial institutions' information needs.



Floor 24-27, Tour Europlaza  
20 Avenue André Prothin  
92400 Courbevoie, France

T: +33 186 526 831  
E: [JoseManuel.Campa@eba.europa.eu](mailto:JoseManuel.Campa@eba.europa.eu)  
<https://eba.europa.eu>

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In general, the EBA agrees with the objective and the content of the EDs. In addition to the responses to the public consultation question, the EBA feels important to summarize the key messages below.

EDs ESRS 1 *'General principles'* and ESRS 2 *'General, strategy, governance and materiality assessment'*

*Architecture of the cross-cutting standards and consistency with the ISSB's initiative on sustainability-related disclosure requirements*

The EBA acknowledges that the EFRAG's proposal is consistent, to a large extent, with the ISSB's ED IFRS S1. In particular, the two initiatives include similar disclosure requirements on many aspects, including changes in preparation and presentation, prior period errors, interactions of risks and opportunities with the undertaking's strategy and business model.

However, the EBA would like to suggest a further alignment between the two initiatives in order to ensure greater comparability between entities using the European Sustainability Reporting Standards and undertakings using the International Sustainability Reporting Standards.

Regarding the architecture of the cross-cutting standards, the EBA observes that the TCFD structure has been reflected in the IFRS Sustainability Standards, as well as being used as a starting point for the ESRS, although in this case the TCFD structure has been altered by the EFRAG into a more complex architecture. The EBA reckons that this adaptation might potentially hinder the comparison between the provisions of the European Sustainability Standards and the International Sustainability Standards. Therefore, the EBA encourages the EFRAG to consider how to minimise the differences in architecture, while being aware of the fact that the TCFD structure was devised for financially material information and therefore might not be entirely suitable to the European context of the sustainable standards

The EBA also notes that there are some overlapping and repetitions between the ESRS 1 and ESRS 2 when it comes to the structure of the cross-cutting standards. In this regard, the EBA invites the EFRAG to explore other possible different structures, including a merger of the two EDs into a single cross-cutting standard, like the ISSB's ED IFRS S1, or a clearer split between the principles contained in ESRS 1 and the general disclosure requirements of ESRS 2, which would avoid any overlapping or repetition.

Furthermore, a closer alignment in terms of the terminology used in EFRAG and ISSB's proposals would be advisable when they refer to equivalent concepts. Moreover, in order to foster comparability and improve the usability of disclosures, quantitative information should be consistently preferred over qualitative one.

Because of these reasons, the EBA encourages the EFRAG to seek a closer cooperation with the ISSB during the finalization of their Standards.

### *Double materiality approach and rebuttable presumption*

The EBA welcomes the proposed double materiality approach in the context of sustainability-related financial information. The EBA also supports the disclosure requirements on the processes followed to identify material sustainability impacts, risks and opportunities and the outcome of the materiality assessment. This will ensure consistency, comparability and verifiability of the information across institutions and over time.

However, the EBA notes that the application of double materiality approach may raise some practical concerns when undertakings are asked to disclose how the prioritization of the negative impacts on the environment and people reflects their severity and likelihood (paragraph 74b(iii)). In this regard, further guidance should be provided.

Consistently with the previous point, the EBA also encourages the EFRAG to closely cooperate with the ISSB in order to align their definitions and application of materiality, with particular consideration to the concept of financial materiality.

Regarding the proposed rebuttable presumption, the EBA believes that its introduction may undermine a proper materiality assessment. In particular, undertakings could be encouraged to prioritize its application over the materiality concept and to select which disclosure requirements apply or not in order to reduce the regulatory burden. This not only goes against a proper materiality assessment, but also it does not reflect the spirit and the letter of the CSRD. Furthermore, it creates an asymmetry with the financial reporting standards, where the concept of materiality is the sole guidance available to companies to decide whether disclosure is needed. The proposed rebuttable presumption departs from this simple principle as it provides an alternative route for entities to avoid disclosing potentially material information. Therefore, the EBA recommends that the EFRAG revises the rebuttable presumption and avoids combining the materiality assessment with any proportionality considerations which should be dealt with by other means, such as a phasing-in of specific disclosure requirements or a postponement of some disclosure requirements to the forthcoming industry-specific standards.

### *Location and presentation of information*

The EFRAG proposes that the information of the sustainability statement is incorporated in the undertaking's management report. Cross-references to other parts of the management report are allowed in order to avoid any repetition. In addition, within the management report, three different options of presentation are provided.

The EBA agrees with the proposed location of the information in the management report. Regarding the three options of presentation, the EBA believes that the option of presenting the sustainability-related information into a single separately identifiable section of the management report is the

clearest one and it invites the EFRAG to consider the benefits of presenting a single option in terms of comparability.

In addition, the EBA believes that the ED should clearly state that financial institutions can provide the risk-related information in their Pillar 3 report and make cross-references to Pillar 3 disclosures, where the specific information required under the two frameworks is equivalent, in order to avoid any double reporting with the risk of inconsistencies.

#### *Collection and verifiability of information along the value chain*

In the EBA's view, it may be difficult to collect and verify the information on stages, entities, resources, and relationships along the value chain for several reasons, for example the information could be available at a different point of time from the entity's reporting date; some entities along the value chain could be not obliged to produce any sustainability information; numerous suppliers and clients along the value chain can be involved. All of this could impair the quality of the data provided.

In this regard, the EBA believes that the EFRAG should provide more guidance and practical examples on the application of the definition of the value chain, also considering the wide range of different business models of the entities, including financial institutions' ones.

#### *ESRS E1 'Climate change'*

##### *Scope 1, 2, 3 emissions calculations*

The EBA observes that different greenhouse gases (GHGs) can have different effects on the Earth's warming and that the translation of each gas to its CO<sub>2</sub> equivalent requires assessing its Global Warming Potential (GWP) factor, by following the methodology indicated in the Application Guidance<sup>43-54</sup>. Given the evolving landscape in methodologies, the EBA fully supports that the standards reference to the PCAF in the disclosure of GHG emissions. A clear application guidance is of paramount importance at this stage to enhance and support the newly developed standards.

Considering the banks' information needs on their counterparties to produce the metrics requested in the EBA draft ITS on Pillar 3 ESG risks, the EBA recommends that undertakings are required to provide a breakdown of all seven-greenhouse gases, the volume of GHG emissions for each gas and the GWP factor used for the translation into CO<sub>2</sub> equivalent. On a similar note, the EBA greatly appreciates the ESRS E1 proposal to disclose offset separately from the gross emission. This choice increases the transparency of the information provided and it ultimately benefits the users of the disclosures.

### *Physical risks disclosures*

The EBA supports that when disclosing the impact of physical risks, undertakings should make a distinction between acute and chronic climate change events, as specified in the AG 17 of the ED ESRS E1.

However, the EBA believes that it would also be useful to require the disclosure of exposures sensitive to physical risks broken-down by geographical location of the activities of the counterparty. This information is included in the EBA draft ITS on Pillar 3 ESG risks for banks.

### *GHG intensity metric for transition plan*

The EBA highlights that the draft ESRS E1 only requires undertakings to disclose emissions intensity metrics in terms of net turnover. The EBA believes that this approach is sufficient for a cross-industry standard since it has the advantage of simplicity and comparability, but different options or a multitude of granular metrics should be envisaged in a sector specific standard. Specifically, the EBA encourages the EFRAG to consider a more granular information by referring to the EBA draft Pillar 3 ITS on ESG risks in the forthcoming banking sector standard. For instance, it would be useful if the sector specific standard for banks would include GHG intensity per unit of production. This metric is used as a basis in the EBA ITS and as it is also aligned with the units of production available in the International Energy Agency Net Zero Emission by 2050 Scenario (IEA NZE2050) NZE2050.

Moreover, the EBA highlights that the draft ESRS E1 only requires the disclosure of reduction targets in terms of 5-years rolling periods. The EBA suggests that the disclosure of reduction targets should be foreseen for 3 years after the reference period.

In addition to these general remarks, the EBA provided detailed responses to the EFRAG consultation survey and uploaded them via the online tool.

We stand ready to discuss with you any of the topics raised should you have any questions regarding our comments.

Yours sincerely,

[signed]

José Manuel Campa