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## **Approach to the Development of European Sustainability Reporting Standards for Listed SMEs – Issues Paper**

### **Objective**

- 1 The objective of this paper is to propose a methodology and workplan for the development of simplified ESRS for listed SMEs<sup>1</sup> (listed SMEs ESRS) and seek approval of SR TEG on the proposed way forward.

### **Background**

- 2 The CSRD<sup>2</sup> introduces Sustainability Reporting Standards for listed SMEs (see detailed provisions in Appendix 1).
- 3 The CSRD introduces the following provisions concerning listed SMEs ESRS:
  - Recital 21: establishes concepts for listed SMEs disclosure such as investor protection, enhanced access to financial capital and investment portfolios, compliance with SFDR, cap of value chain, proportionality, delayed application and phase-in.
  - Art 19a (6) specifies the content of simplified sustainability reporting for i) listed SMEs, ii) small and non-complex financial institutions and iii) captive insurance and reinsurance undertakings. It establishes that those undertakings may report according to sustainability standards for SMEs as per Art 29 c. The content defined by art 19a (6) is :
    - (a) a brief description of the undertaking’s business model and strategy;
    - (b) a description of the undertaking’s policies in relation to sustainability matters;
    - (c) the principal actual or potential adverse impacts of the undertaking on sustainability matters, and any actions taken to identify, monitor, prevent, mitigate or remediate such actual or potential adverse impacts;
    - (d) the principal risks to the undertaking related to sustainability matters and how the undertaking manages those risks;
    - (e) key indicators necessary for the disclosures referred to in points (a) to (d).
  - Art. 29b (4): sets the SMEs cap in the value chain: “Standards shall not specify disclosures that would require undertakings to obtain information from SMEs in their value chain that exceeds the information to be disclosed according to the sustainability standards for SMEs referred to in art. 29C”.

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<sup>1</sup> SMEs whose securities are listed in regulated markets

<sup>2</sup> Adopted Text, P9\_TA(2022)0380, Corporate Sustainability Reporting Directive- European Parliament legislative resolution of 10 November 2022 on the proposal for a Directive of the European Parliament and of the Council amending Directive 2013/34/EU, Directive 2004/109/EC, Directive 2006/43/EC and Regulation (EU) No 537/2014, as regards corporate sustainability reporting (COM(2021)0189 – C9-0147/2021 – 2021/0104(COD))

- Article 29c on sustainability reporting standards for SMEs establishes that sustainability reporting standards shall be proportionate and relevant to the scale and complexity of the activities, and to the capacities and characteristics of small and medium-sized undertakings. In terms of content, it refers to art 19a (6) and to the criteria in Article 29b, paragraphs 2, 3,4 and 5. It requires the standards to specify, to the extent possible, the structure in which that information shall be reported. The Commission shall adopt those delegated acts at the latest by 30 June 2024
- 4 According to the CSRD definition, small and medium sized undertakings have between 10 to 250 employees (to be combined with turnover and balance sheet criteria). The number of such small and medium sized undertakings that are listed in Europe is estimated around 1.1 thousand which is a non-negligible proportion of the about 9 thousand listed companies in EU (or about 4 thousand if only domestic companies are considered).<sup>3</sup>
- 5 Besides art 29c on sustainability standard for listed SMEs that is legally binding, EFRAG has received feedback to develop guidelines for voluntary disclosures for all SMEs undertakings that are not in the scope of the CSRD. The potential users of the voluntary guidelines are therefore much broader compared to listed SMEs. The total number of SMEs in Europe is estimated to be around 1.5 million<sup>4</sup> (23 million if including micro). The former cluster 8 of EFRAG PTF has finalised a proposal on a voluntary reporting standard in July 2022 that was presented at SR TEG on 17 November 2022.
- 6 The focus of this paper and the paragraphs below is on the EFRAG's mandate related to the listed SMEs ESRS.

#### **Comparison between CSRD provisions for listed SMEs and the ones for large undertakings**

- 7 The following reflection points are based on Appendix 1 that analyses CSRD provisions for listed SMEs ESRS and compares them with the ones for large undertakings.
- ESRS for listed SMEs apply to i) listed SMEs, ii) small and non-complex financial institutions and iii) captive insurance and reinsurance undertakings [art 29c and art. 19a (6)]
- 8 - In terms of reporting areas the secretariat has compared the provisions of art. 19a (6) for listed SMEs ESRS and the ones of art. 19a (2) for large undertaking ESRS. The comparison is summarised in the table in Appendix 1 (par. 9). The table suggests that the overall reporting areas are the same, but many of the detailed reporting contents applicable to the large undertakings within those reporting areas are not explicitly required for listed SMEs. In particular, for the following detailed reporting contents that are not explicitly mentioned in the list of disclosures to be covered in listed SMEs ESRS, the technical question is to what extent they should or can still be included in the listed SMEs ESRS. Those areas are: i.: i) resilience, ii) opportunities, iii) transition plans in line with Paris agreement, climate law and exposure to coal and mining, iv) how the business model and strategy take account

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<sup>3</sup> Source : [FESE, Capital market Fact Sheet, Q1 2022](#), figures on number of listed SMEs and number of listed companies in EU and [COMMISSION STAFF WORKING DOCUMENT EXECUTIVE SUMMARY OF THE IMPACT ASSESSMENT](#) Accompanying the document Proposal for a Directive of the European Parliament and of the Council amending Directive 2013/34/EU, Directive 2004/109/EC, Directive 2006/43/EC and Regulation (EU) No 537/2014, as regards corporate sustainability reporting

<sup>4</sup> Source: [Eurostat, Key figures on European business with a special feature on SMEs](#) , 2021 (p.11)

of the interests of the undertaking's stakeholders, v) implementation of the strategy, vi) own operations and value chain, including its products and services, its business relationships and its supply chain in adverse impact, , vii) dependencies. Among these particular attention shall be given to "value chain" as described in Appendix 1. Specific questions are raised to SR TEG on whether E2-5 (substances of concern and substances of very high concern), E5-4 (resource inflow) and (E5-5 resource outflow) and E4-5 (39) (land-use based on a Life Cycle Assessment) the inclusion of the value chain could be covered in the sector-specific layer of listed SMEs ESRS. Questions are also raised for SR TEG on the course of actions to take regarding "opportunities" and "interest of stakeholders" as elaborated in Appendix 1.

- 9 The secretariat has also identified reporting areas that are not explicitly included in the list of reporting areas to be covered by listed SMEs. Among those particular attention shall be drawn to i) description of due diligence process and ii) role of administrative, management and supervisory bodies in sustainability matters, iii) targets and progresses, iv) financial plans and resources (as described in detail in Appendix 1). The latter could be implicitly covered by a requirement to disclose a general statement on policies, targets and action plans, limited to matters that are material in the materiality assessment. The undertaking would comply with a statement that it has not adopted targets and may report a timeline for adoption where appropriate. Proposals on due diligence and role of governance bodies are detailed in Appendix 1.
- 10 The question to SR TEG is if the approach illustrated above and in Appendix 1 could be supported.
- 11 Listed SMEs ESRS shall also consider art 29b (par 2 to 5) that means:
  - i) it should cover the environmental, social and governance sustainability matters as in ESRS for large undertaking [art. 29b (2)],
  - ii) it should present forward-looking, retrospective, qualitative and quantitative information as appropriate like for ESRS large undertakings [art 29b (3)];
  - (iii) it should take into account the cap on the value chain provisions [art. 29b (4)]
  - iv) it should take into account the international initiatives and EU regulation listed in art 29b (5) like the ESRS for large undertakings. However, taking into account the principles of simplifications and proportionality, the secretariat asks SR TEG if a limited subset of EU legislations shall be considered (i.e. disclosure requirements related to Pillar 3 ESG risks or Benchmark Regulation).
- 12 Listed SMEs ESRS shall include the information related to SFDR PAI and art 8 Taxonomy Regulation [ Recital 17 and 21]. Hence the secretariat's proposal refers to those two legislations for a discretion criterion to define the sustainability matters topics and sub-topics in listed SMEs ESRS. It also proposed to add the Benchmark Regulation (tentative table in par. 21 in Appendix 1). To note that while the list of topics would result the same as for main ESRS (set 1), the list of sub-topics would change. Questions to SR TEG is if this approach could be supported or if alternatives shall be considered.
- 13 Finally, an important element of the ESRS for listed SMEs is the implication it has in terms of setting the cap for the value chain for the ESRS for large undertakings. This will result in an amendment to Set 1.

### **Methodology for listed SMEs ESRS**

- 14 The below proposal for methodology concerns art 29c sustainability standards for listed SMEs (point 2 above). The proposal has been informed by the provisions of the CSRD for listed SMES ESRS outlined in Appendix 1 and the reflection points contained in the sections above.

15 Scope. Given the diversity of target groups within the scope of art 29c listed SMEs ESRS that includes; i) listed SMEs, ii) smaller banks and iii) captive insurers or iv) reinsurers – and to limit the complexity under time constraints - the proposed approach is:

- ✓ To take a sector agnostic approach for the listed SMEs ESRS in first phase and move the simplified requirements for smaller banks and captive insurance and reinsurances to the sector-specific layer of the standards.
- ✓ The sector specific layer of listed SMEs ESRS would take shape of an Annex. It will be drafted after EFRAG has finalised the sector-specific layer of ESRS.

SR TEG to approve or propose alternative options.

16 Reporting Principles. Considering the CSRD provisions (point 3 above and Appendix 1), it is proposed that the standard will elaborate on the following principles:

- ESRS 1 General Requirements would be applicable. This would be justified by the fact that, at least for financial materiality, the users are the same as the users of the reporting of larger undertakings in scope of the SMEs.
- Subject to satisfying the need of the users, proportionality shall be an additional principle (to the content of ESRS 1). Proportionality can be defined as the relation between the sustainability report's scope and complexity compared to the undertaking's resources and know-how. This principle is connected to accessibility and processing of data to be reflected in the other general principles listed below. The following could be considered when reflecting the proportionality principle:
  - Simplify the materiality assessment process and due diligence for SMEs.
  - Simplification of disclosure requirements. (e.g. qualitative versus quantitative).
  - Simplified application guidelines and digital questionnaires to facilitate implementation.
  - The listed SMEs ESRS shall build as much as possible on existing international or national initiatives.

17 Characteristics of information. Reference to be made to Appendix C of ESRS 1.

18 Architecture and format. Considering the CSRD provisions (point 3 to 13 above and Appendix 1), listed SMEs ESRS shall be connected and mapped to the general ESRS in order to meet all legally binding requirements. The listed SMEs ESRS will consist of one standard combining cross-sector and topical disclosures across five parts. The following architecture is proposed:

- I. Listed SMEs ESRS General Requirements. This section shall include SMEs specifications to ESRS 1 that is incorporated by reference. Those specification include for example the proportionality principle, simplified materiality assessment (double materiality), approach to due diligence and value chain, guidance in presentation of information. See Appendix 1 for details.
- II. Listed SMEs ESRS General Disclosure. This section shall include the description of sustainability matters in business model and strategy; governance; policies; principal actual or potential adverse impacts and actions; principal risks (art 19 5 (a) to (d).) This section would correspond to existing ESRS 2 to be simplified and merged as proposed in Appendix 1 in details.

- III. Listed SMEs ESRS Environmental Disclosures. This section shall include reporting on topical environmental matters and impacts. This section would correspond to ESRS E 1 to 5 simplified and merged. It is proposed to reduce the number of DRs that shall be limited to : i) green taxonomy alignment DRs and ii) mandatory and optional SFDR PAI <sup>7</sup> DRs and iii) Benchmark Regulation related DRs (key metrics, art. 19b 6 (e). Question is raised on whether to also include under the E Disclosure the requirements deriving from EBA Pillar 3 ESG framework<sup>5</sup> as it is under ESRS. This may lead to additional complexity but would be in line with CSRD provision to consider in listed SMEs ESRS art 29b (5). ). See Appendix 1 for details.
- IV. Listed SMEs ESRS Social Disclosures. This section shall include reporting on topical social matters and impact. This section would correspond to ESRS S1 – 4 simplified and merged. It is proposed to reduce the number of DRs that shall be limited to the mandatory and optional SFDR PAI indicators and Benchmark Regulation 7. ). See Appendix 1 for details.
- V. Listed SMEs ESRS Governance Disclosures. This section shall include reporting on topical governance matters and impact. This section would correspond to ESRS Gov 1 simplified and merged. It is proposed to reduce the number of DRs that shall be limited to the mandatory and optional SFDR PAI indicators and Benchmark Regulation. See Appendix 1 for details.
- VI. Application Guidelines with enhanced simplification and digital questionnaire. SR TEG to approve or propose alternative options.

### **Involvement of stakeholders**

- 19 Given the specificities of SMEs and in particular the need to develop requirements that are proportionate to their organisation and resources, user-tests and outreaches are particularly important in the development of this proposal.
- 20 The following stakeholders' or expert groups are identified as relevant in the development of the Listed SMES ESRS to cover both the users and preparers perspectives:
  - Existing EFRAG Expert Group SMEs
  - Listed SMEs representatives
  - Large and smaller banks representatives (incl. EIB, ERBD)
  - Captive insurance and reinsurance representatives
  - Large companies' representatives as SME's customers
  - DG FISMA, DG Grow (SME's unit), DG Justice, ESMA, EBA, EP SMEs intergroup
- 21 To facilitate the reach-out and onboarding, it is proposed that EFRAG collects inputs and performs user tests on its proposals in two ways:
  - ✓ Internally: setting-up a testing/ sounding board within EFRAG members in TEG and SRB
  - ✓ Externally: enlarging the existing expert group (se point 14 above) and organizing outreaches, questionnaires, and informal exchanges outside EFRAG membership

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<sup>5</sup> [EBA Final draft implementing technical standards on prudential disclosures on ESG risks in accordance with Article 449a CRR](#)

SR TEG is requested to approve or suggest other alternative options.

**Work program for listed SMEs ESRS**

22 The following tentative workplan is proposed:

- Beginning December 2022: SR TEG and Board decision on proposed methodology, scope, workplan and other elements addressed in this paper.
- Mid-December 2022: collecting stakeholders' specific input on basis of questions or one-to-one Informal meetings. Parallel drafting of SMEs ESRS
- Mid-December - Beginning January 2022: Draft 1 – Listed SMEs ESRS-discussion at SR TEG and SRB
- End January – beginning February 2023: Draft 2 – Listed SMEs ESRS-workshop outreach + SR TEG and SRB
- Beginning March 2023: Final Draft – approval of SR TEG and Board.
- End March 2023: Final Exposure drafts listed SMEs ESRS and launch of public consultation with 3 months period
- March 2023 - June 2023: Cost-benefit analysis
- April 2023: Basis for Conclusions

**Questions to SR TEG members and observers**

- 1 With regards to the scope of the listed SMEs ESRS: do you agree with the proposal to take a sector agnostic approach for the listed SMEs ESRS and add the SMEs sector specific layer as annex? In particular do you agree that the simplified requirements for smaller banks and captive insurance and reinsurances foreseen in art. 29c and 19a(6) will be moved to the sector-specific layer of the listed SMEs ESRS?
- 2 With regards to sustainability reporting areas and the gaps emerging between CSRD provisions for listed SMEs and for large companies, do you agree with the approach presented in par. 8 and 9 above and the sustainability areas identified in the table at par. 9 of Appendix 1? In particular the questions concern the approach to i) value chain (including specific approach to E 2-5, E5-4, E5-5 and E 4-5 in ESRS), to ii) opportunities and to iii) interest of stakeholders. Further questions are raised on: i) due diligence, ii) role of the administrative, management and supervisory bodies, iii) targets and financial plans. Do you agree with the proposed approach?
- 3 With regards to sustainability topics and subtopics (tentative table in par.21 of Appendix 1) to be covered in listed SMEs ESRS, do you agree that the discretion criterion to apply could be the prioritization of Taxonomy Regulation and SFDR PAI as indicated in Recital 21 and 17 of CSRD, plus the Benchmark Regulation related disclosures? To note the gap between sub-topics as a result of this approach, between ESRS and listed SMEs ESRS. Do you agree with it?
- 4 With regards to the methodology and reporting principles, do you agree to confirm the applicability of ESRS 1 and to add the principle on proportionality? Do you agree that this principle of proportionality should result in simplified materiality assessment, simplified DRs, and guidance in presentation of information (qualitative versus quantitative)? Do you agree on proposed adjustment to other principles where necessary (specific approach to due diligence, value chain, materiality and stakeholders interest according to listed SMEs provisions in CSRD)? Do you have other proposals?
- 5 With regards to the topical standards: do you agree with the proposed approach that policies, targets and actions would be covered by a centralised disclosure covering material matters to the extent that the undertaking has implemented policies, targets and actions (see paragraph on Architecture in Appendix 1. This would allow to simplify the chapters dedicated to each topic and in particular, the only additional content required would be the datapoints in Appendix C ESRS 2 (mandatory for EU regulation).
- 6 With regards to quality of information do you agree that reference shall be made to Appendix C of ESRS1?
- 7 With regards to the architecture and format proposed for the listed SMEs ESRS. Do you agree on a simplified approach to general ESRS? Do you agree with the five parts as suggested at par. 18 above ? Do you agree with the detailed approach to the format and architecture for each of the five parts provided in Appendix 1 par. 22?
- 8 Do you agree that the topical disclosures on Environmental, Social and Governance matters shall be limited to the mandatory and optional SFDR PAI, taxonomy DRs and Benchmark DRs? Should the EBA Pillar ESG risk requirements be also added? Or would this be in contrast with simplification and proportionality?

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| 9  | With regards of involvement of stakeholders, do you agree that given the specificities of SMEs user-test and outreach is particularly important in the development of this proposal? Do you agree with the identified stakeholders' groups at par. 19 and 21 above? Do you agree with the two processes/ sounding board? Internal and external at par. 21? |
| 10 | With regards to the workplan and timeline: do you agree with the proposal in par 22 above?   |
| 11 | Do have any other comments on EFRAG approach to listed SMES ESRS?  |