Financial institutions
ESRS Sector process

Background

1 During the finalization of the sector agnostic ESRS (Set 1) the EFRAG SR TEG discussed the need to provide guidance on how to implement the boundaries of value chain for financial institutions, given the peculiarities of their business relationships with clients (lending ,investing or insurance activities). Due to the complexity of the issue and the need to consult on the possible approach, the EFRAG SR TEG did not developed such guidance, acknowledging that it would be incompatible with the time available.

2 During the deliberations on Set 1 in November 2022 the EFRAG SRB considered the possible inclusion of a phase-in provision that would allow financial market participants (banks, insurers, asset managers) to postpone the inclusion of downstream value chain until the effective date of the future ESRS draft sector standards, pending the establishment of a clear methodology. Considering the complexity of the topic and the need to have a public consultation on the approach to the value chain for financial market participants, the EFRAG SRB finally decided not to include this phase-in provision. However, the EFRAG SRB considered this as an area of priorities for research and public consultation in the next months/next sets of standards.

3 The proposal for the Corporate Sustainability Due Diligence Directive (CSDDD) as of 23 February 2022 includes a proposal for defining the value chain for Financial institutions. However, the CSDDD is still subject to trilogue and is subject to changes until the legislative process ids finalised. The CSDDD definition will be a relevant point of reference for the sector-specific guidance for financial institutions and appropriate consideration in the timeline and approach should be given on how to ensure compatibility. The timing for adoption of the CSDDD is likely to be delayed to beginning of 2024. The approach to due diligence in Set 1 has been inspired by the international guiding principles and not pre-empting the content of the CSDDD.

Objective

1 The objective of this session is to discuss the process to develop ESRS sector specific guidance for financial institutions, including the timing for issuance of the sector ESRS for the relevant sectors and how to address requests from stakeholders to have guidance on the concept of value chain in the early stages of application of Set 1.

2 This paper provides background content to support the SRB discussion.

Timeline-related considerations

4 EBA/ESMA in their recent opinions on Set 1 ESRS suggest issuing the ESRS sector standards for financial institutions in 2024 (Delegated act in June 2025, effective from reporting on 2026). ECB recommends these standards to be adopted before the first reporting cycle of the CSRD (2024 reports issued in 2025). EIOPA recommends sector guidance on insurers to be part of Set 2.

5 More in detail, the views of these authorities are the following:

a) European Banking Authority (EBA): As *regards the specific-sector standards for credit institutions and other entities operating in the financial sector, the EBA would encourage the Commission to follow a timetable where these standards would be finalised still in 2024, having in view the respective adoption in 2025. This would allow, on the one hand, to still gain experience from institutions' Pillar 3 disclosures that start to apply as of 31 December 2022 first reference date and, on the other hand, to provide earlier clarifications specifically applicable to credit institutions' disclosures on topics like the one reflected in this paragraph.*[1]

b) European Securities and Markets Authority (ESMA): "*ESMA stresses the importance of prioritising the sector-specific standards for the financial sector. In light of the central role that financial institutions play in the transition towards a more sustainable financial system as investors and intermediaries, it is important to accelerate the development of these standards ideally for adoption by the Commission already in 2025"*[2].

c) European Insurance and Occupational Pensions Authority (EIOPA): "*sector-specific standards for the financial sector should ideally be for adoption by the Commission already in 2025 to support first reporting by the financial industry*"[3]

d) European Central Bank (ECB) has also called for anticipating the timeline for financial institutions sector-specific standards : "*ECB staff are of the view that the standard for financial institutions, including credit institutions, should be prioritised and ideally adopted before the first reporting cycle foreseen in the CSRD. Such prioritisation is justified by the key role of financial intermediaries in the transition to a sustainable economy, but also pragmatically by the need to bring clarity to the financial industry on what and how to report, ensuring coherence across the multiple reporting obligations under EU sustainable finance legislation, including the interactions with prudential disclosure requirements*[4]*.*

6 EFRAG SRB (following a SR TEG recommendation) discussed in July/September 2022 how to prioritise sectors and agreed not to include financial institutions in the list of 10 sectors to be covered in 2023. In particular, the EFRAG SR TEG and EFRAG SRB rejected the Secretariat's proposal to have financial institutions in the first batch of sector-standards, as they considered that priority should be established on the basis of impact materiality (list of the ten sectors assessed by EFRAG SR TEG as connected to high impacts in Appendix 1) and also acknowledged the high

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[1] Par. 38 Opinion of the EBA on the draft European Sustainability Reporting Standards (ESRS)

[2] Par. 106 OPINION OF THE EUROPEAN SECURITIES AND MARKETS AUTHORITY of 26 January 2023 on the technical advice by the European Financial Reporting Advisory Group on European Sustainability Reporting Standards (Set 1)

[3] Par. 4.6 EIOPA's Opinion to the European Commission on EFRAG's technical advice on ESRS

[4] https://www.ecb.europa.eu/pub/pdf/other/ecb.staffopinion_europeansustainabilityreportingstandards202302~fc42a81b30.en.pdf

level of regulation existing on financial institutions, including on sustainability reporting (e.g. SFDR PAI, Art. 8 Taxonomy or Pillar III for banks). The EFRAG SRB did not take a decision on which of the sectors should be covered with priority after the ten highest-impact sectors.

7 On the 15 December 2022 the EFRAG SRB agreed to limit the number of sectors to be covered to five in 2023, reflecting EFRAG resourcing constraints. The current workplan foresees to cover Coal and Mining, Oil and Gas, Road Transport and Agriculture (next to LSME standard) in 2023, and in addition to consult on a draft VSME standard.

8 The EFRAG Secretariat notes that under the current staff availabilities the earliest some guidance (or the entire standards) can be enacted is June 2025 (Set 3, which would be effective in 2026). The inclusion of them in Set 2 (Delegated Act in June 2024, effective in 2025) is not possible at this stage as it would require approval by March/April 2023 and the efforts of the Secretariat have been focused, after the issuance of Set 1, on the finalisation of the working papers for sectors to be covered in 2023 according to the current workplan. Similarly, effective date in 2024 (to be applied jointly with the first reporting in 2024) is not possible, as it would have required to finalise them in Set 1.

9 As regards the ESAs and ECB suggestions to anticipate the work on financial institutions - that include draft ESRS banks, insurers and capital markets – it may imply under the current staff availabilities to deprioritise one or several priority sectors foreseen currently in Set 3 (textile accessories footwear and jewellery, car vehicles, food and beverage, energy production and utilities).

Guidance on value chain

10 The European authorities and the ECB have indicated in their opinions on the EFRAG ESRS set 1 that guidelines on the boundaries of value chain shall be developed to help financial institutions, ideally before the effective date of Set 1. Their views are as follows:

(a) EBA: *EBA believes that further clarifications are necessary to understand how the definition of the value chain applies to credit institutions. While the concept of value chain is clearer now, in the specific case of credit institutions it continues to seem operationally challenging to implement. This is the reason why additional sector-specific guidance would be needed in order to achieve an adequate quality level in the data to be disclosed.*

(b) EIOPA: *considering the potential broad implications of the implementation of the ESRS throughout the value chain of insurance companies and pension funds, a timely adoption of sector-specific European sustainability standards for the insurance industry should clarify the boundaries of the value chain and affected stakeholders for financial institutions. EIOPA is of the opinion that further clarity on the boundaries of the value chain is needed to enable financial market participants to report on relevant material sustainability impacts across the value chain in a proportionate and risk-based manner. Such guidance should ideally be available the latest as part of the second set of ESRS.*

(c) ECB: *ECB staff highlight the urgent need to develop specific guidance for the definition of the value chain of financial institutions. While general principles on the definition of value chains are provided in Chapter 5 of ESRS 1, the specific nature of financial institutions and the peculiar characteristics of their business relationships requires additional guidance for a clear delineation of the reporting boundaries well before financial institutions begin using the first set of ESRS.*

IFRS guidance on Scope 3 GHG

11 The issue of financed and facilitated emissions for commercial banks, investment banking, asset management and insurance, was also developed by IFRS in September 2022 as part of the Exposure Draft S2 Climate Related disclosures. The IFRS staff paper focuses on Scope 3 emissions and proposes definitions for each of the four industries on how to include financed and facilitated emissions in the calculations. The IFRS staff paper can be found here:

https://www.ifrs.org/content/dam/ifrs/meetings/2022/september/issb/ap4d-climate-related-disclosures-financed-and-facilitated-emissions.pdf

12 The ISSB Board decided at the meeting on 15 December 2022 to introduce disclosure requirements for financed emissions for three industries-Asset Management & Custody Activities, Commercial Banks and Insurance- as part of Scope 3 GHG emissions disclosures. They also decided to remove facilitated emissions for Investment Banking & Brokerage industry:

https://www.ifrs.org/news-and-events/updates/issb/2022/issb-update-december-2022/#2

Possible approaches to the workplan

Coordination between different regulators needed

13 A relevant coordination effort is needed, actively involving other relevant actors, next to EFRAG SR TEG and SRB, in the development of the standards. The financial institution sectors have seen the development of several different initiatives and regulation with a degree of overlap between them[5]. Contents are piling up, leading to a variety of data produced, and do not spontaneously provide for coherence and efficient compliance, thus also creating a risk of reducing the potential effectiveness of the regulations in contributing to sustainable growth. Decentralised policymaking in key areas of the sustainable finance agenda, relying on several parallel processes and fora (e.g. Technical Expert Group, EFRAG, EBA, ESMA, EIOPA, and Platform on Sustainable finance) may generate potential overlaps, inconsistencies, coordination challenges in filling in the existing gaps.

Involvement of the experts

14 The EFRAG Secretariat considers that the most efficient project structure would be to create three dedicated working groups (one for banks, one for insurers and one for asset managers) that, with appropriate cross-group coordination, would develop proposals and work as an advisor to EFRAG SR TEG (and therefore to EFRAG SRB), involving stakeholders from different categories and the relevant authorities, i.e. EBA, ESMA, EIOPA and ECB.

15 EFRAG can leverage on the existing working group (created contextually with the EFRAG PTF-ESRS) and community (created in June 2022) as a starting point whilst ensuring a balanced representation of the various chapters and use the material developed by Cluster 7 of EFRAG PTF-ESRS. A public call for candidates will support the creation of a larger group of experts. Appropriate balance needs also to be considered to cover the different sectors (asset management, banking, insurances, etc) and to acknowledge the different maturity on sustainability reporting in the various financial services sectors due to regulation, market practice ..etc.

[5] See the final report of Cluster 7 of the EFRAG PTF NFRS, March 2021. https://www.efrag.org/Assets/Download?assetUrl=%2Fsites%2Fwebpublishing%2FSiteAssets%2FEFRAG%2520PTF-NFRS_A5_FINAL.pdf

Priorities and steps

16 The EFRAG Secretariat considers that there are two possible approaches:

a. Prioritise the issuance of value chain guidance, with the purpose of delivering a specific EFRAG technical advice in 2024;

b. Develop the sector standards and the value chain guidance at the same time (as part of them).

17 The first approach would allow to set a less ambitious target for the 2024 working plan. The work could be started as soon as resources are available following the issuance of the Exposure Drafts in March/April 2023. The impact on the overall workplan would be manageable, with the postponement of only one sector standard from those currently planned for 2024.

18 The second approach would require a more substantial mobilisation and could impact significantly, under the current staff availabilities, the overall workplan (in terms of sectors to be covered in 2024). Resources in 2023 would be available to the extent allowed by the finalisation of Set 2, while more substantial resources would be available from November 2023, when Set 2 will be finalised.

19 The second approach would ensure that all the relevant aspects of value chain are appropriately considered, as the approach to value chain would be defined jointly with the definition of the relevant disclosures for sector standards. On the contrary the first approach would require defining the key concepts underpinning the value chain in the first document, and to develop the disclosures following that concept in the second step.

20 Since the question of staff availability is critical and a parameter likely to evolve in the coming months, the two approaches above should be put in perspective and not considered as mutually exclusive. It seems possible to (i) create and leverage the working groups immediately, (ii) to prioritise the value chain guidance issue (approach a) for clarification as soon as possible and (iii) to consider the development of sector standards (approach b) as soon as additional resources are available without deprioritising the already planned sectors.

Questions to SR Board members and observers

21 Do you agree with the approach described in paragraph 20 above?

22 Do you have specific suggestions for the scope of the project and its organization?

Appendix 1 – Ten sectors assessed by SR TEG and SRB in Summer 2022 as high priority (high risk)

Set 2		GRI standard?
1	Agriculture and Farming	YES
2	Coal mining	YES
3	Mining	IN PROGRESS
4	Oil and Gas – mid to downstream	YES
5	Oil and Gas – upstream	YES
6	Food and beverages	
7	Textiles, Accessories, Footwear and Jewelleries	
8	Transport (road)	
9	Motor vehicles	
10	Energy production and utilities	