

This paper has been prepared by the EFRAG Secretariat for discussion at a public meeting of EFRAG SR Board. The paper forms part of an early stage of the development of a potential EFRAG position. Consequently, the paper does not represent the official views of EFRAG or any individual member of the EFRAG SRB or EFRAG SR TEG. The paper is made available to enable the public to follow the discussions in the meeting. Tentative decisions are made in public and reported in the 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.

Input Paper SRB drafting session LSME ESRS

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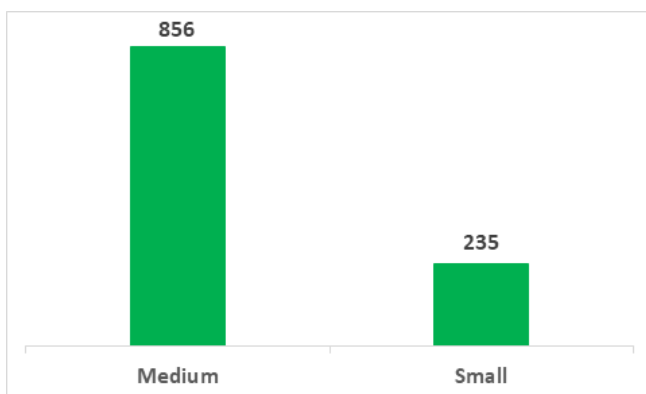
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Objective of the document

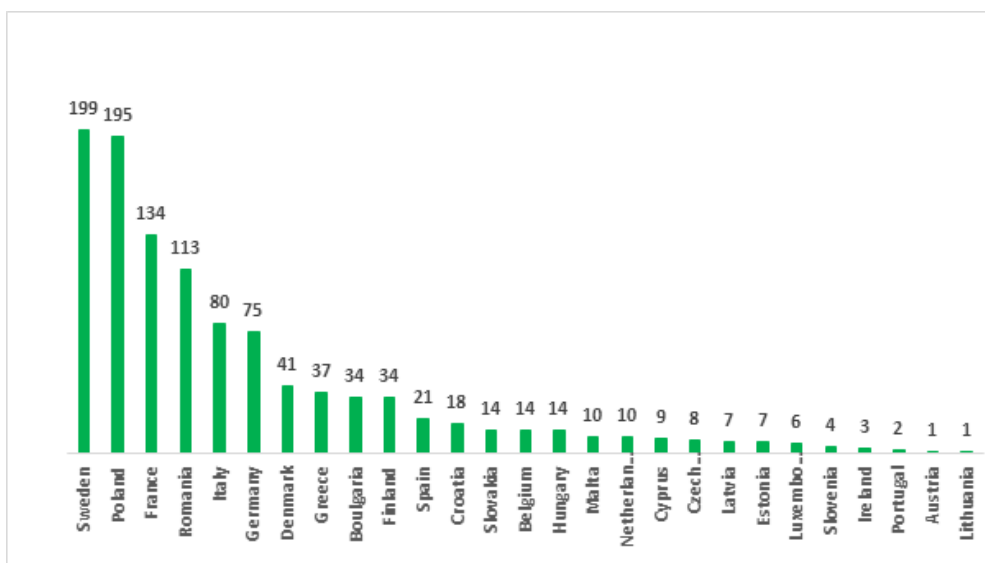
- 1 The purpose of this document is to provide the SR Board members with input for discussion to the forthcoming drafting session on 17 March 2023. The document includes:
 - ✓ The figures on the scope of the LSME ESRS (SMEs, Small and Non-Complex Institutions and captive insurances and reinsurances)
 - ✓ The answers to selected questions of the methodological questionnaire circulated to the LSME Community in January 2023
 - ✓ The answers to selected questions of the methodological questionnaire circulated to the SMEs EWG members in January 2023.
 - ✓ The answers received from financial market participants regarding the approach to materiality for SFDR and EU datapoints.

Figures on the scope of the LSME ESRS

- 2 Article 19a (6) of the CSRD establishes that the following undertakings **may use simplified reporting standards (art 29c)**:
 - **small and medium-sized undertakings (SMEs)**, except micro undertakings, which are public-interest entities as defined in point (a) of point (1) of Article 2 of the Accounting Directive N. 2013/34,
 - **small and non-complex institutions** defined in point (145) of Article 4(1) of Regulation (EU) No 575/2013,
 - **captive insurance and reinsurance** undertakings defined in point (2) of Article 13 of Directive 2009/138/EC of the European Parliament and of the Council***
- 3 Small and medium-sized undertakings (SMEs) Breakdown by size – Source Orbis database. Total 1.091 companies.



4 Breakdown by Country

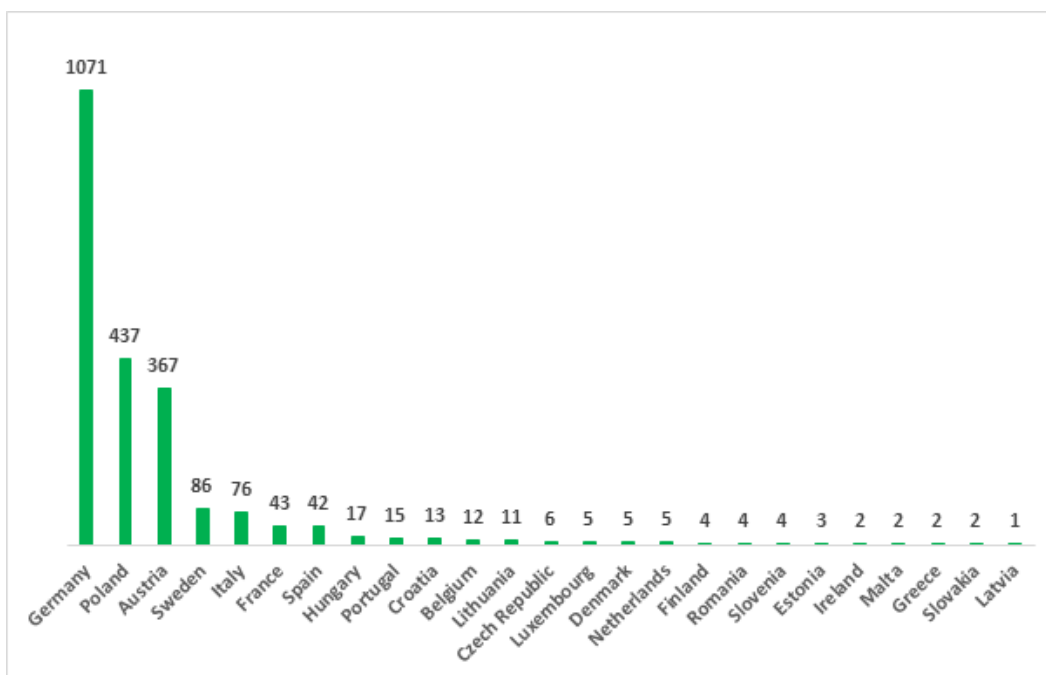


5 Breakdown of listed SMEs by NACE

The breakdown detailed by NACE code is provided in the Appendix of this document. The majority of the listed SMEs operate in the manufacturing sector (403 companies), the second most populated sector is information and communication (193 companies) and the third is wholesale and retail trade (125 companies), followed by professional, scientific and technical activities (76 companies) and financial services (74).

6 Small and Non-Complex Institutions

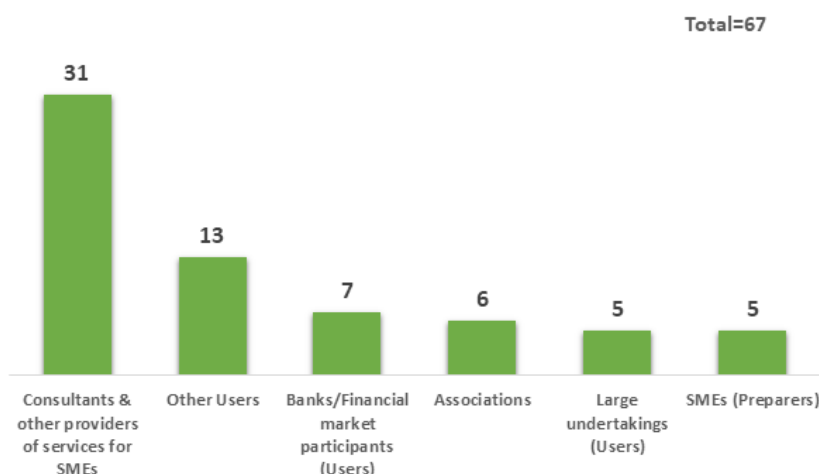
Based on EBA data, the EFRAG Secretariat has identified¹ 2361 Small and Non-Complex Institutions in the EU, with almost 50% representation in Germany, 20% in Poland and 16% in Austria.



- 7 Captive Insurances and Reinsurances : no data available (estimation by EIOPA about 300 companies).

Answers to selected questions of the methodological questionnaire - LSME Community

- 8 The EFRAG secretariat has launched an open call for LSME community in December 2022. In mid-January 2023 the composition of the LSME Community was as follows:



- 9 The LSME community received a methodological questionnaire to prepare for the workshop held on 27 January 2023. The following group responded in writing to the questionnaire. 52 members of the LSME Community participated in that workshop and a general support for the formulated questionnaire was expressed during the meeting.

Total number of respondents to the questionnaire:	32
Out of which respondents:	• 4 banks/investors (as users)

	<ul style="list-style-type: none"> • 6 listed SMEs (as preparers) • 2 NGOs • 12 (who identified themselves as consultants of listed SMEs preparers, associations and law practice) • 4 Academic or research institutions • 1 large company as SMEs' value chain partners • 1 Accountant • 1 Civil society organisation
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10 The answers to selected questions in the methodological questionnaire sent to LSME Community members are presented in the table below:

Selected Question	YES or NO	Further answers
Q8) Approach to materiality. Do you think that a simplified approach to impact materiality should be introduced in the LSME ESRS? If yes, could you report below which aspects could be modified to make the materiality assessment process easier to implement by the SMEs?	Yes: 45,8% No: 33,3%	Of which: <ul style="list-style-type: none"> • Yes : 3 financial market participants (as users), 4 listed SMEs (as preparers) and 4 consultants of listed SMEs • Several respondents highlighted the opportunity/need to have guidelines, in particular industry-based, or examples and user-cases. • The respondents that did not support simplified approach indicated that the same materiality principle shall apply for large undertakings and LSME
Q10) Approach to materiality: Do you agree to include in the LSME ESRS the SFDR PAI, Benchmark and Pillar 3 related disclosures as "subject to materiality" on the assumption that this would not conflict with the possibility of large undertakings of requiring the same data to SMEs in their value chain?	Yes: 52% No: 48%	Of which: <ul style="list-style-type: none"> • 3 listed SMEs (as preparers) replied Yes and 2 replied No (pressure from investors/clients/ratings will only increase) • 4 consultants of listed SMEs preparers replied Yes (disclosures are either material for entities or not / guidelines to provide help) and 6 replied No (information needs to be standardized / ensure no unequal treatment in funding of the SMEs) • 2 financial market participants replied Yes (SFDR PAIs are essential / applicable to LSMES) and one replied No (no for the first two year / allow SMEs to build system)
Q12) Opportunity (may disclose"): Do you agree in treating opportunities as a voluntary content with the consequent adaptations in text of draft LSME ESRS compared to main ESRS? (i.e. by including DRs and ARs related to	Yes: 72% No: 28%	Of which: <ul style="list-style-type: none"> • 3 listed SMEs (as preparers) replied Yes (focus on ensuring a minimum level of performance / too soon to ask opportunities, struggling to achieve the basics) and 2 replied No (Opportunities vital part of sustainable information / can inspire more SMEs to follow)

<p>opportunities as “may disclose” in the topical section and by adding a general sentence in Section 1 which clarifies that reporting on opportunities is on voluntary basis only.</p>		<ul style="list-style-type: none"> • Consultants of listed SMEs preparers replied Yes (opportunities are a value judgement call / in line with the proportionality principle / not too relevant for SMEs) • financial market participants replied Yes • risk needs to be taken care of (gaps or continuous improvements), while opportunities are voluntary hence reduce the complexity for LSMEs.
<p>Q13) Targets: For targets, do you agree to include them only to the extent that the undertaking has established targets?</p>	<p>Yes: 61 % No: 39%</p>	<p>Of which:</p> <ul style="list-style-type: none"> • 2 listed SMEs(as preparers) replied Yes (Defining targets requires a solid understanding of business strategy, available resources, and planning. To have real goals, many LSME may need to become more mature); 3 listed SMEs replied No (Targets should be mandatory / reporting on a topic without a target is meaningless / hurt the credibility, should be included for all material issues) • 7 consultants of listed SMEs preparers replied Yes (provided that governance, materiality assessment and due diligence process are well covered / resources are scarce for SMEs) and 5 replied No (targets are relevant for risk reduction / to have some limited amount of measurable targets for SMEs) • 3 financial market participants replied Yes in line with proportionality principle. and 1 replied No.
<p>Q16) Centralised Disclosure Requirements for policies, actions and targets: Do you agree with a fully centralised disclosure requirement on policy action and targets? Do you think that this provision could facilitate the implementation of the standard by SMEs? Or rather makes it more complex? Please insert comments.</p>	<p>Yes: 57% No: 33%</p>	<p>Of which:</p> <ul style="list-style-type: none"> • For those who replied Yes: <ul style="list-style-type: none"> ○ 2 listed SMEs (as preparers) replied (simplification always welcome for SMEs) ○ 6 consultants of listed SMEs preparers replied (easier to submit / will allow to focus on concrete quantitative data in topical sections) ○ 4 financial market participants replied (reporting much easier) ○ Topical sections can be focused on facts and contain quantitative data requirements. Reporting policies, actions and targets more vague and less tangible. ○ Often, companies define joint policies, actions and objectives on social and environmental issues, so they have this information together.

		<ul style="list-style-type: none"> For those who replied No: <ul style="list-style-type: none"> 3 listed SMEs (as preparers) replied No and 6 consultants of listed SMEs (not easy to read as a preparer) Topic-specific offers a predefined framework.
<p>Q17) Do you agree with the proposed decision tree? Do you agree with the list of DRs to be included in the draft LSME ESRS?</p>	<p>Yes: 59% No: 41%</p>	<p>Of which:</p> <ul style="list-style-type: none"> For those who replied Yes: <ul style="list-style-type: none"> 2 listed SMEs (as preparers), 7 consultants of listed SMEs preparers and 4 financial market participants <ul style="list-style-type: none"> The decision tree seems complete, logical and comprehensible. Allow to simplify wherever possible. Reporting burden, as light as possible for SMEs. For those who replied No: <ul style="list-style-type: none"> 1 listed SME (as preparer) and 5 consultants of listed SMEs preparers replied No <ul style="list-style-type: none"> The DRs needed to meet the information needs of financial market participants under SFDR can be included in simplified ESRS only to the extent that they do not conflict with the limited scope defined by Art.19a para.6. Value chain reporting should not apply to LSMEs - it is too much.

- At the LSME community workshop on 27 January 2023, the 53 participants confirmed answers in written questionnaire.
- EFRAG secretariat has held a session with **a small sub-group of preparers and financial market participants members** of the LSME Community on 24 February 2023. The main outcome of the session was: i) general support for SFDR, Benchmark and Pillar 3 being under materiality assessment, ii) general feasibility to report the SFDR, Benchmark, Pillar 3 datapoints (some difficulties were expressed from the small non-complex credit institutions perspective), iv) agreement with proposed simplifications in social DRs, if needed prioritisation for collective bargaining (breakdown employees/non-employees); v) general issues from the small and non-complex credit institutions perspective, related to value chain for banks.

Answers to selected questions of the methodological questionnaire - SMEs EWG

- The SMEs EWG (Expert working group) is composed as follows:

Total number of EWG members	9
Organisations / Countries	<ul style="list-style-type: none"> University of Salento / Italy European Investment Fund / Luxembourg The Norwegian Institute of Public Accountants / Norway Studio Dee / Belgium Sustainable Value Investors / Italy

	<ul style="list-style-type: none"> • RBC International / Netherlands • Crowe / Spain • Svenskt Näringsliv / Sweden • B.A.U.M. e.V. / Germany
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14 EFRAG Secretariat has organized four meetings with the SMEs EWG:

- ✓ 19 December 2022
- ✓ 19 January 2023
- ✓ 9 February 2023
- ✓ 8 March 2023

15 The methodological questionnaire on LSME ESRS was sent to EWG in January 2023, 7 out of 9 members have answered. The replies to selected questions are below:

Question	Summary
Question to EWG SMEs on approach to materiality	
Q6) Do you agree with the suggested approach that in the LSME ESRS the SFDR PAI, Benchmark and Pillar 3 related disclosures shall be introduced as "subject to materiality" on the assumption that this would not conflict with the possibility of large undertakings of requiring the same data to SMEs in their value chain?	<ul style="list-style-type: none"> • 4 out of 7 agree • 2 members did not respond • 1 member doesn't know
Q7.2) Do you agree that requiring to report SFDR indicators mandatorily (outside materiality assessment) in LSME would be disproportionate?	<ul style="list-style-type: none"> • 4 out of 7 agree • 3 out of 7 disagree • 2 members pointed out that there are ways of covering PAIs of the SFDR and this information is important for downstream processes (on a comply or explain principle)
Q10) Do you think that in LSME there should be more space for materiality assessment (as this provides flexibility and so reduces the burden) or less space for materiality assessment (as the exercise of judgement results in the need to have more dedicated resources and more mature processes than the average situation in an SME)?	<ul style="list-style-type: none"> • All 7 members suggested that is essential to have materiality assessment • 1 member pointed two key factors: a sectorial approach and importance of external assurance (external vs internal assessment) • 1 member suggested that LSME should offer easy pathways for SMEs with less resources, but for others it should be more specifying and engaging with external requests
Question to EWG SMEs on reporting on opportunities and targets	
Q13.1) Do you agree in treating opportunities as a voluntary content with the consequent adaptations in text of draft LSME ESRS compared to main ESRS? (i.e. by including DRs and ARs related to	<ul style="list-style-type: none"> • 4 out of 7 agree • 1 member agrees on the second option • 1 member disagrees

<p>opportunities as “may disclose” in the topical section or, alternatively by adding a general sentence in Section 1 which clarifies that reporting on opportunities is on voluntary basis only.</p>	
<p>Q13.2) For targets, do you agree to include them only to the extent that the undertaking has established targets?</p>	<ul style="list-style-type: none"> • 6 out of 7 agree • 1 member suggests that it is unnecessary. • 2 members suggested to have it on a comply or explain basis (e.g., a line where the LSME explains why it does not have a target and when it plans to include one)
<p>Q19.1) Do you agree or disagree in defining implementation examples for the mentioned topics?</p>	<ul style="list-style-type: none"> • 4 out of 7 agree • 2 out of 7 disagree
<p>Q19.2) Could you please prioritize the above topics, reporting below the related list?</p>	<ul style="list-style-type: none"> • 4 out of 7 put impact materiality assessment on top • 3 out of 7 put financial materiality assessment as second • Variety of answers

Answers received from financial market participants regarding the approach to materiality for SFDR and EU datapoints.

- 16 The Secretariat has investigated the approach to SFDR and the other EU datapoints with the EFRAG experts in the working groups on insurance and financial institutions of EFRAG financial pillar.
- 17 To strike a balance between simplification/ proportionality and user needs the respondents suggested as possible solution (supported by ESMA) in the LSME ESRS, the introduction of mandatory requirements only for the SFDR Table 1 SFDR Principal Adverse Impacts (PAI) Indicators (Annex I of the European Commission Delegated Act supplementing Regulation (EU) 2019/2088). This would allow to preserve the materiality assessment, while providing a focused set of PAI disclosures that are defined as mandatory for financial market participants to provide in their statement on principal adverse impacts of investment decisions on sustainability factors. The other indicators related to Table 2 (Additional climate and other environment-related indicators) and Table 3 (Additional indicators for social and employee, respect for human rights, anti-corruption and anti-bribery matters) of the same Annex, would remain subject to materiality assessment.
- 18 EFRAG secretariat notes that Table 1 contains 14 SFDR PAIs of which 9 are environmental and quantitative (metrics).
- 19 The SFDR Table 1 SFDR Principal Adverse Impacts (PAI) Indicators is as follows:

Working paper on [draft] LSME ESRS – Cover Note

Table 1 – Indicators applicable to investments in investee companies		
Adverse sustainability impact	Metric	[draft] ESRS reference
Climate and other environment-related indicators		
1. GHG emissions	Scope 1 GHG emissions Scope 2 GHG emissions Scope 3 GHG emissions Total GHG emissions	ESRS E1-6 Gross Scopes 1, 2, 3 and Total GHG emissions, §41
2. Carbon footprint	Carbon footprint	ESRS E1-6 Gross Scope 1, 2, 3 and Total GHG emissions, §41
3. GHG intensity of investee companies	GHG intensity of investee companies	ESRS E1-6 Gross Scope 1, 2, 3 and Total GHG emissions, §50 to §52
4. Exposure to companies active in the fossil fuel sector	Share of investments in companies active in the fossil fuel sector	ESRS 2 SBM-1 Market position, strategy, business model(s) and value chain, §38(d)i
5. Share of non-renewable energy consumption and production	Share of non-renewable energy consumption and non-renewable energy production of investee companies from non-renewable energy sources compared to renewable energy sources, expressed as a percentage of total energy sources	ESRS E1-5 Energy consumption and mix, §35(a) and §36
6. Energy consumption intensity per high impact climate sector	Energy consumption in GWh per million of EUR of revenue of investee companies, per high impact climate sector	ESRS E1-5 Energy consumption & mix, §37 to §40
7. Activities negatively affecting biodiversity-sensitive areas	Share of investments in investee companies with sites /operations located in or near biodiversity-sensitive areas where activities of those investee companies negatively affect those areas	ESRS E4 DR related to IRO-1 Description of processes to identify and assess material biodiversity and ecosystem-related impacts, risks and opportunities, §22(d)i
Adverse sustainability impact		
Metric		
[draft] ESRS reference		
8. Emissions to water	Tonnes of emissions to water generated by investee companies in million EUR invested, expressed as a weighted average	ESRS E2-4 Pollution of air, water and soil, §27(b)
9. Hazardous waste and radioactive waste ratio	Tonnes of hazardous waste and radioactive waste generated by investee companies per million EUR	ESRS E5-5 Resource outflows, §41
Indicators for social and employee, respect for human rights, anti-corruption and anti-bribery matters		
10. Violations of UNGC principles and OECD Guidelines for Multinational Enterprises	Share of investments in investee companies that have been involved in violations of the UNGC principles and OECD Guidelines for Multinational Enterprises	ESRS S1-17 Incidents and complaints and severe human rights impacts and incidents, §99(a) ESRS S2-1 Policies related to value chain workers, §19 ESRS S3-1 Policies related to affected communities, §17 ESRS S4-1 Policies related to consumers and end-users, §16

Adverse sustainability impact	Metric	[draft] ESRS reference
Climate and other environment-related indicators		
11. Lack of processes and compliance mechanisms to monitor compliance with UNGC principles and OECD guidelines for Multinational Enterprises	Share of investments in investee companies without policies to monitor compliance with UNGC principles and OECD guidelines or grievance/complaints handling mechanisms to address violations of UNGC principles and OECD Guidelines for Multinational Enterprises	ESRS S1-1, Policies related to own workforce, §22 ESRS S2-1 Policies related to value chain workers, §17 ESRS S3-1 Policies related to affected communities, §16 ESRS S4-1 Policies related to consumers and end-users, §15
12. Unadjusted gender pay gap	Average unadjusted gender pay gap of investee companies	ESRS S1-16 Compensation indicators (pay gap and total compensation), §92(a)
13. Board gender diversity	Average ratio of female to male board members in investee companies, expressed as a percentage of all board members	ESRS 2 GOV-1 The role of the administrative, management and supervisory bodies, §19(d)
14. Exposure to controversial weapons (anti-personal mines, cluster munitions, chemical weapons and biological weapons)	Share of investments in investee companies involved in the manufacture or selling of controversial weapons	ESRS 2 SBM-1 Market position, strategy, business model(s) and value chains, §38(d)iii

20 This approach may offer a good compromise to cater for the need of ESG data from investee companies for financial market participants to solidly build their art.8 and art.9 products under SFDR (avoid bilateral engagements and reputational or legal risk) while not overburdening LSMEs. Indeed, the scope of LSME includes 1.091 small and medium listed companies (especially concentrated in certain EU countries) and 2.300 small non-complex institutions, that if not listed (about 1.000) would be outside investment portfolios of financial market participants. Hence the benefit of promoting the financial market participants needs and the development of SFDR products is being balanced against the costs of LSME investee companies.

Appendix

